PLC Preliminary results

Wednesday, 2nd December 2020

Operator: Good morning everyone and welcome to the Stock Spirits Group PLC Preliminary Results Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press star one on your telephone.

I must advise you that this conference is being recorded today. I would now like to hand the conference over to your speaker today, Mr Mirek Stachowicz. Please go ahead, sir.

Introduction

Mirek Stachowicz

CEO, Stock Spirits Group

Thank you. Good morning, everyone, and thank you for joining us for our 2020 Full Year Results. We have this morning published our reported numbers for the 12 months to 30th September 2020, and all comparative figures for the 12 months to September 2019 have been restated to align with the new IFRS 16 requirements. As usual, I'm joined today by Paul Bal, our CFO.

Agenda

Moving to slide two and the agenda for today. I will slide by – excuse me, I will start by providing a brief summary of the year, then give you an update on what COVID-19 has meant for Stock Spirits whilst also reminding you of our differentiated and unique business model.

I'll then take you 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 finances in detail. I'll then come back to give you some closing remarks after which you will have the opportunity to ask questions.

Performance

Turning to slide four, I'd like to start by summarising our performance during the 2020 financial year. In terms of our financial performance, we delivered underlying revenue growth of 6.9% and underlying adjusted EBITDA growth of 4.6% as well as adjusted basic earnings per share growth of 8.5%. Given the backdrop against which we were trading, I believe this is a very decent set of numbers.

During the first half, we successfully managed the impact of the excise tax increase in our two largest markets of Poland and the Czech Republic. For the year as a whole, Poland delivered its highest value market share in five years and the Czech Republic exceeded our expectations. Other regions such as Italy and our International division have been more challenged due to the pandemic.

Acquisitions

Despite the impact of COVID-19, both the acquisitions that we made in 2019 have performed well. Bartida in the Czech Republic traded well ahead of our expectations despite its reliance on on-trade distribution. Distillerie Franciacorta in Italy delivered a small positive contribution for the year. We fully expect it to be earnings enhancing in 2021 as was originally planned.

In both cases, the integrations are now completed. Cash conversion remains strong due to careful working capital management through the pandemic. Lastly, we are proposing a final dividend of 6.78 €cents per share which is 7.4% up on last year's final dividend. We are also proposing a special dividend of 11 €cents per share.

This is because we were no – excuse me, this is because there were no acquisitions during this year. And as you know, we have consistently said that we would consider making additional distributions to shareholders in the absence of meaningful M&A. So that leaves a total dividend for the year of 20.55 €cents per share which is an increase of 130% on last year.

Priority

Turning now to slide five, and an update on the areas we have been prioritising as a result of COVID-19 and the impact that the pandemic has had on our markets. Our number one priority has been to protect our employees. We have also sought to assist the communities in which we operate including mass producing hand sanitisers, and donating it to governments, local communities, hospitals, and frontline staff of our retail customers.

Secondly, all of our production plants and logistic centres have continued to operate as normal with no interruptions even when working across national borders. We maintained our NPD programme in order to keep premiumising. A prime example was our new premium Żołądkowa Gorzka Rześka product in Poland which sold over 1 million litres in its first six months.

We have seen robust levels of demand for our products in Poland and the Czech Republic. In both of these markets any impact from the closure of the on-trade was mitigated by this shift to off-trade channels. Finally, we managed to redeploy our on-trade resources to focus on digital marketing, particularly as consumers are focusing more of their attention on the online world.

First half results

Turning now to slide six, we covered this in detail at our first half results in May, so I won't dwell on this. But I wanted to remind you again of how differentiated Stock Spirits is from its international peers, particularly as this differentiation has been the key to our resilient performance over the course of the financial year. The key word here is local across our operations, supply chain, employees, customers, brands, and consumers.

We will now go through the performance on a market-by-market basis starting with our core markets of Poland on slide eight. The overall Polish spirits market is now worth €3.9 billion, up 10.7% at September 2020 versus September 2019.

Consumption levels remained strong despite the 10% duty increase from January which represented circa 7% retail price increase. Spirits volume overall was up 3.7%, and the clear vodka category was up 8.2%. However, this was outperformed by the higher margin flavoured vodka category, which was up 8.8% year-on-year.

Premium clear vodka again grew strongly, up 22%. And whiskey continued to be a fast-growing category, up 19.7%. Overall, this data confirms that the Polish spirits market has continued to premiumise despite the ongoing impact of the COVID-19 pandemic.

Mainstream pricing

Turning now to mainstream pricing on slide 9. As you can see from this chart which covers the last 18 months, we successfully managed to pass the duty increase on with Żołądkowa Gorzka Czysta de Luxe maintaining a consistent price premium over Zubrowka.

It is worth noting that all major competitors chose to pass the excise tax increase fully on to the consumers, with Stock and Roust taking an additional margin during the course of the year. Furthermore, the segment's dynamics have significantly changed following Marie Brizard's announcement of sale of their Polish business with Krupnik now clearly following a different pricing strategy.

This resulted in Roust gaining share in clear vodka at their expense. At the same time, Stock focused on the more profitable flavoured vodka segment whilst continuing to participate in the clear mainstream vodka segment growth. I will cover our progress in the flavoured vodka category on the next slide, number 10.

Flavoured vodka

Turning now to slide 10. It is worth emphasising that Stock has outperformed both the clear and flavoured vodka markets. But the key focus for us during the excise increase was on taking share in the attractive flavoured vodka category. This segment offers greater margins than the clear category as a result of the brand retail price premiums that it commands as well as the cost of goods benefit that comes from the typically lower ABV.

Our growth in the flavoured is attributed to the very successful NPD programme in the Żołądkowa Gorzka brand, a price leader in this segment. This is covered in more detail in slide 46 of the appendix.

Turning now to slide 11 where all the elements I talked about come together. There are three key points to make here. Firstly, the number three mainstream brand in the Polish market Krupnik is becoming less and less of a factor in the competitive landscape. And its market share has halved in the last 12 months. Secondly, the decline of Krupnik has primarily benefited Roust as their core brand is significantly focused on the mainstream clear segment. And thirdly Stock finished the year with the highest value market share in five years, 31.6% despite our continued focus on profit pools outside of the mainstream clear vodka segment.

Latest developments

Turning now to slide 12, and a snapshot of the latest developments in Poland for Stock Spirits. Firstly, Poland is currently subject to more or less exactly the same lockdown measures as it was during the first lockdown.

And we have seen no noticeable change in the market dynamics this time around. As a reminder, the on-trade represents only around 10% of market sales and only around 2% of ours. Furthermore, the decline in the on-trade is largely compensated by the increase in the off-trade. Secondly, our new Lublin distillery is on track to be completed in our financial year 2023 with a planned five-year payback.

We are making it as sustainable as possible with innovative technology aimed at producing maximum energy efficiency. As we have said previously, legislation was passed in the summer to implement additional taxes on small format pack sizes, i.e., 300 millilitre or smaller of alcoholic products from 1st January, 2021. Our initial assessment is that there will be no material impact to our results, but it remains a risk that we will monitor closely. We have in hand a range of commercial and operational actions to mitigate any impact. And our successful navigation of the recent excise changes gives us confidence in our ability to respond to this new development.

Czech market

Turning now to the Czech market on slide 14. The total spirits market grew by 11% to €0.5 billion with particularly strong performances from rum and vodka, up 12.1% and 14.7% respectively. There was a duty increase in January of 13.2% as you know. But the total spirit market has delivered volume growth of 5.6% still.

Poland

As in Poland, we have seen premiumisation trend continue despite the impact of the pandemic.

Value

Turning now to slide 15. The absolute value of our Czech business has grown by 8.8%, albeit there was a small decline in our market share from 34.2% to 33.6%. We were seeing an increased level of competition in the vodka and rum categories after the excise increase.

Against this backdrop, we have prioritised profit growth ahead of marginal share movements. We were helped by positive results of repositioning of our Fernet brand in 2019 with the premium variant of Fernet Stock Barrel commanding a price premium to our Fernet core range. We also benefited from Bartida where synergies were accelerated. And we expanded the acquired brands into off-trade and Slovakia making the business earnings enhancing in the first year after acquisition, in line with our plans.

Current developments - Czech market

Turning now to slide 16, and a snapshot of the current developments in the Czech market for us. By comparison to Poland, the second wave measures in the Czech Republic are much stricter compared to those in the first wave.

As a reminder, the on-trade represents significantly more than it does in Poland i.e., 32% of market sales and 21% of ours. However, the decline in on-trade has been at least partly compensated by the increase in off-trade. As I already mentioned, overall, we have seen the Czech market become more competitive following the excise increases. So just as the competitive market eases in Poland, it is tightening in the Czech Republic. However, it is clear that – however, as clear market leaders in spirits and with our trusted local brands and strong route to market, we are watching developments very closely and are well placed to deal with these pressures appropriately.

Italy

Turning now to Italy on slide 18. Italy as a reminder accounts for around 9% of our total group revenue. As you all know, the COVID-19 outbreak has had a profound impact on this country. During the period, the total value of the spirits market declined by 2.3% to €1.6 billion. Within that, the on-trade declined by 13.8% and the off-trade grew by 7.8%.

Italy is the market in which we have the highest proportion of our sales in the on-trade by comparison to other markets. Additionally, the categories that we are, shaded in colour on the chart, declined by 2.9% whilst the rest of the market declined only by 1.8%.

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. One of the main highlights in Italy during the period was a positive performance in Brandy where Stock 84 continued to grow market share.

Elsewhere following our increased investment in Keglevich, we grew overall share in clear and flavoured vodka despite the impact that COVID had on these high-energy social drinking occasions.

Stock Italia

Turning now to slide 20, and the current market developments for Stock Italia. The second wave lockdown has seen both lockdown of on-trade as well as restrictions on alcohol purchase timing in the off-trade.

Around 42% of the market sales come from the on-trade with about 29% of our sales coming from that channel. The decline in the on-trade has partially been compensated for by the off-trade. However, the wider impact on our historical brands in Italy has led to the brand impairment as an exceptional item.

Paul will cover more about this later. Thanks to the Distillerie Franciacorta acquisition, Stock Italia is now the number one player in the grappa category in the off-trade. But it has also brought wider benefits to our business. It has tripled the on-trade sales force thereby allowing us to secure Beam Suntory's brand distribution in April for this year – of this year.

It also provides a strong provenance to our Italian brands and has increased our premium portfolio. This will be further enhanced by the recent repatriation of manufacture of our Limoncè brand back to Italy. Financially, it has made a small contribution to EBITDA despite COVID-19, thanks to accelerated synergies in both the off-trade and export markets.

Other markets

Turning now to slide 22, and the highlights from our other markets. It was a challenging year in Slovakia. And our total spirits share declined from 12.1% last year to 11.5% this year due to the impact of COVID on some of our premium categories.

However, our expansion in rum led by Božkov Republica coupled with a strong performance in Amundsen and Fernet bitters enabled us to maintain our position as the second biggest player in the off-trade. This was offset by COVID-19 driven declines in the Beam Suntory range and in Golden Fruit distillates whose categories are more dependent on higher energy social drinking occasions that were inevitably curtailed by the pandemic.

In our international division, Croatia was heavily impacted by COVID given its reliance on tourism. However, we still grew our brand leader Stock 84 share of imported brandy in this country in absolute volume and value. In our export markets, there were also severe lockdowns locally across many locations.

Despite this, the successful reorganisation of our route to market in Germany contributed volume uplift. And the Distillerie Franciacorta brands were successfully introduced into several of the international distribution partners, including Germany, Netherlands, and the UK. And with that, I will now hand over to Paul to talk you through the financials in detail. Paul, over to you.

Financials

Paul Bal

CFO, Stock Spirits Group

Thank you, Mirek. Good morning, ladies and gentlemen. It's my pleasure to present the financial results for the year ended 30th September, 2020.

Acquisitions

I start with slide number 24. As a consequence of the two acquisitions completed in June 2019, our reported results are not comparable year-on-year. Therefore, in places, we refer to underlying results. These exclude the impact from those two acquisitions for both years and are at constant currency. On this underlying basis, our results for this most challenging of years show continued improvement in financial performance from the toplines of volume and sales growth to the bottom line.

Revenue

Revenues were up 6.9%. Gross profit margin was 47%, in line with our expectations. Adjusted EBITDA grew 4.6%. Adjusted EBITDA margin was 21.2%. And basic adjusted earnings per share grew 8.5%. Beyond the profit and loss account, our cash flow delivery remains robust notwithstanding having to manage challenging conditions in both halves of the year. We converted EBITDA to cash at 112.1%. As a consequence, our balance sheet is even stronger with a debt leverage of 0.32 times.

Dividend

The resilience that this financial performance demonstrates has enabled us to markedly raise the rate by which we increase the final dividend for this year. Our final dividend is being proposed at 6.78 €cents per share, a 7.4% increase on last year's final dividend.

This compares with the approximately 5% growth rate the dividends have grown at in recent years under our progressive dividend policy. Furthermore, and in addition, we are today proposing a special dividend of 11 €cents per share.

IFRS 16.

Finally, IFRS 16 on leases became effective for us from the 1st October, 2019. As previously reported, the impact on our results and financial position is not material and is set out on slide 47 and 48 in the appendix section to this presentation. Comparative figures have been restated as if IFRS 16 applied throughout last year as well.

Consolidated profit & loss

So moving to slide number 25, and the group's consolidated profit and loss account with the restated comparatives. The 9.1% increase in reported revenue was impacted by small unfavourable currency effects. Underlying revenue excluding acquisitions and at constant currency was up a strong 6.9%. Clearly, our growth strategy is driving strong topline growth. And our profits are growing too, gross profit being up 7%.

The gross profit margin reflects changing mix across the markets, channels, and the overall portfolio. The increased selling expenses include a full year of costs relating to last year's acquisitions. And we also invested more behind our brands and sales force capabilities than in previous years. Other operating expenses also include a full year of costs of last year's acquisitions and reflect higher people costs in the main[?].

We include our 25% share of the results of our associated investment in the Quintessential Brands Ireland whiskey venture. Whilst a better result was delivered this year, the pandemic has severely impacted the prospects of that startup business, resulting in the impairment we took against this investment at the half year.

Overall, our performance has resulted in a 6% growth in operating profit before exceptional items. We booked five pretax exceptional items this year. First, the three items reported at the half year, the non-cash impairment of €14.2 million against the carrying value of the Irish whiskey investment I just mentioned, a €1.5 million net credit against deferred consideration, and a €1.3 million of M&A costs as the pandemic disrupted progress.

And now, we took a €9.6 million non-cash impairment against the value of our legacy Italian business as it was challenged by the full force of the pandemic in the country. And lastly, there was a €0.6 million of reorganisation costs incurred in streamlining the senior management team. Lower net finance costs reflect lower borrowings.

The higher tax charge is largely explained by last year's payments and settlements in respect of historic tax issues mainly in Italy. As I'll show further on, the underlying effective tax rate is actually lower as a result of the mix of our profits across the different countries. Underlying performance is best reflected in the improved adjusted underlying EBITDA, growing 4.6% year-on-year. It is also visible in the strong adjusted earnings per share growth of 8.5%.

Pricing

Turning to slide number 26. To use a soccer analogy, this slide shows that this has been a year of two very distinct halves given the backdrop against which we have delivered. As we reported back in May, our first half strong volume performance was boosted by better pricing.

First coming from the January excise increases in Poland and the Czech Republic, and then towards the end of the first six months the start of the COVID pandemic's first wave resulting in little promotional pricing as well as strong consumer shopping. This also pushed up margins. The second half began with all of our key markets locked down and the on-trade channel closed.

Restrictions began easing in early summer. From shift in consumption to off-trade provided compensation as did an increase in staycations over the summer. This meant the underlying revenue decline was below 2% compared to the second half of last year, and well short of the 15% that the on-trade and duty-free channels traditionally represented of our sales. Margins were impacted by these lower revenues, and the return to promotional pricing as well as some phasing of costs.

Drivers

With slide number 27, let's now look into the drivers of our full-year results in a little more detail starting with the topline. Overall reported volume grew 3%, and with over half of that coming from the underlying business, and the rest from last year's two acquisitions.

The unit driving the underlying growth was Poland with its increasing share in vodka hitting a five-year high in a growing market. With the Polish and Czech excise-driven price increases and then less promotional pricing for several months, underlying average prices rose strongly. Despite concerns that the pandemic or the higher pricing may trigger consumer down trading, our mix remained positive through the year with our premiumisation efforts rewarded. Foreign exchange effects were negative this year, and I'll cover that further on.

Revenue

Looking then specifically at Poland in the next slide, slide number 28. We see revenue grew a very robust 15.1% at constant currency as it benefited from a healthy positive combination of all three growth levers. Strong volume growth, positive, almost double-digit better pricing, and improving mix.

Of the three levers, pricing made the biggest contribution after some years lagging the others. Post-excise price increases have largely stuck, though the market remains pretty competitive as market – as Mirek showed. Remember that Poland is largely an off-trade market, and we are underrepresented in on-trade.

EBITDA

EBITDA grew a significant 18.3% in constant currency terms showing once again our capability in a very competitive market to grow and yet also deliver a very decent return. The EBITDA margin was just short of our 26-27% range that we aspire to. Simply because we decided to invest more behind our Polish portfolio in order to sustain the strong momentum.

Czech Republic

Turning in the next slide, slide number 29 to the Czech Republic, our second biggest market after Poland. Here we also delivered very healthy growth in the topline at 8.7% in constant currency terms. However, stripping out the contribution to revenue from the Bartida business, underlying growth was slight[?].

Whilst, we experienced for a few months the same benefit from less promotional pricing as we did in Poland, in the Czech market post-excise increased pricing did not stick as much due to increased competition. I recall also that the Czech market has a larger on-trade channel that traditionally represented some 30% of our revenues.

And whilst there was a marked switch to off-trade as the lockdown came about, it wasn't enough to maintain our previous growth momentum. This is reflected through the key growth drivers with the small benefit from pricing and mix largely offset by the lower volume in on-trade in the second half of the year.

EBITDA growth was a strong 8.4%. Even without the solid contribution from Bartida, it was up 2.3%. Underlying EBITDA margin excluding Bartida advanced to 31.5% reflecting lower marketing investment this year and good cost management. Bartida's performance has been remarkable in the circumstances.

Given that this is an on-trade business, it faced considerable threat as the channel closed for several months. But it remobilised quickly and was well placed to exploit the summer of staycations that we experienced in the Czech Republic.

Italy

I move now to slide number 30. The year's double-digit revenue growth in Italy reflects the full-year participation of Distillerie Franciacorta offsetting a small decline in the underlying business.

However, it is encouraging to report stronger underlying revenue performance in the second half of the year coupled with continued progress with pricing. Italy is a big on-trade market with some 40% of our revenues traditionally earned in that channel. It is also a market very dependent on tourism.

Sadly, it was also the most impacted of our market when it came to the opening wave of the pandemic. This has triggered a further impairment in the carrying value of our legacy Italian brands as I mentioned earlier. Nevertheless, we did see strong switching to the off-trade channel tempering our volume decline considerably, and enabling underlying revenues to remain flat in the second half versus last year.

EBITDA

Understandably, adjusted EBITDA, and the adjusted EBITDA margin was down in these circumstances. But nevertheless, despite the difficult circumstances, it was pleasing to see Distillerie Franciacorta still make a positive contribution to EBITDA. Likewise, the Beam Suntory distribution business initiated in April in the midst of the on-trade lockdown.

Revenue

Turning now to slide number 31, and the rest of our operations. The decline in revenue was mainly driven by three factors. Continued negative impact from regulations in Slovakia that favour local and smaller businesses, a turndown in export orders when the pandemic struck, and then Croatia experiencing both the pandemic and has in Italy also a dramatic fall in tourism.

EBITDA

A full-year contribution from Distillerie Franciacorta's export sales provided some offset, even though these were also impacted by the pandemic in the second half of the year. Adjusted EBITDA and the adjusted EBITDA margin declined as a result. The positive EBITDA contribution from Distillerie Franciacorta exports was not enough to offset this.

Currency

Now to slide number 32. I've already mentioned that foreign exchange movements provided headwind to our topline. This was also true for the bottomline. This came from the weakening of our two main currencies, the Czech koruna and the Polish złoty versus the euro. In appendix one to this presentation on slide 43, we have set out the key exchange rates over the periods.

Notwithstanding recent headwinds, these currencies have been relatively stable against the euro over time. And we can reconfirm that we don't believe that the impending Brexit will have a material impact on our business.

Finance costs

The next slide, slide number 33 sets out the net finance costs. Overall, lower drawings have resulted in lower interest charges. Reduction in the Czech Republic's interest rate also helped. As a result of implementing IFRS 16 this year, operating lease interest charges are now included as finance costs and the comparatives have been restated accordingly. Our financing arrangements run to the end of November 2022, and have not changed over the year.

Tax

I now move to slide number 34 turning now to the subject of taxation. The rise in the current tax expense comes from both higher taxable profits and also having exhausted brought-forward tax losses in Poland. However, there is a corresponding offset from a deferred tax credit. The picture is also distorted by movements related to prior-year taxes.

Last year saw a benefit from settling historic issues under an Italian tax amnesty, ignoring exceptional items, and prior-year issues, a declining effective tax rate from the mid-20s to the low-20s results. The tax environment remains challenging with authorities taking an aggressive approach.

As previously reported, we feel this especially in Poland. Here in May, we lodged an appeal with the Supreme Administrative Court, the highest authority against the assessment on our 2013 corporate tax return, mainly relating to pre-IPO corporate restructurings between 2009 and 2013. A hearing is not expected for a year or two at least.

Based on updated professional advice received, we remain confident that our position will ultimately prevail on the main issue. Meanwhile, investigations have taken place in respect to various aspects of our 2014-2015 Polish corporate tax returns, but no assessments have been received to date.

The group has provisions totalling €3.5 million, down from €4.3 million last year where based on professional advice future settlements are likely or expected in respect of historic positions. Nevertheless, in some other circumstances, the group may have to pay over sums assessed by authorities, and then seek their recovery through appeals.

Cash flow

Moving to the next slide, slide number 35 when we come to cash flow. Strong cash generation has been a hallmark of the group and free cash flow rose a very strong 29.9%. The implied conversion rate was a robust 112.1%. Like many businesses as the pandemic unfolded, we tightened our focus on cash generation and management.

Whilst an obvious area to watch was trade receivables, our strong working capital control did allow us to support some customers and suppliers who were more challenged. Through this, we expect our relationships to emerge stronger. We also invested more in our manufacturing facilities than in previous years.

The Lublin distillery project is now underway with completion expected in the fiscal year 2023. I click now to slide number 36. The adoption of IFRS 16 has also meant the restatement of our opening net debt position. Our strong cash flow generation over the year has enabled us to reduce net debt by €32.7 million to €22.7 million.

Our balance sheet leverage has fallen to 0.32 times. This is below our desired range of 0.5 to 1.5 times leverage. The group has significant liquidity available to it and is well funded for the future to pursue our strategic growth aspirations and to pay increasing dividends under our progressive policy.

Dividend

I then turn with my final slide, slide number 37, to the subject of dividends. The board today has proposed a final dividend of 6.78 €cents per share for the year. This reinterprets our progressive dividend policy, being a step up of 7.4% increase on the 6.31 €cents per share final dividend paid last year. The annual increases in dividends over recent years have been consistently around 5%.

In recent years, the board has said that it would consider making additional distributions to our shareholders should there be no meaningful M&A completed or expected shortly. Our M&A activity has been disrupted by the pandemic with the practicalities of conducting cross-border transactions very difficult for now.

Therefore, in addition to the final dividend, the board is today also proposing an additional special dividend of 11 €cents per share. This will be paid alongside the final dividend. This means that the dividends paid for this year will total 20.55 €cents per share and represent an increase of a 130% on last year's total payout.

The resilience of this business through this most challenging year has indicated that we can continue paying progressive dividends at a higher rate of growth than before. And with that, I hand back to Mirek.

Concluding remarks

Mirek Stachowicz

CEO, Stock Spirits Group

Mirek Stachowicz: Thank you, Paul. Moving to slide 39. And before concluding today's presentation, I want to give you an update on our M&A plans. At the start of the year, we were making good progress against our objectives in this area. However, our efforts were subsequently interrupted by COVID-19 and our cross-border M&A work has been postponed.

However, our ambition in this area has not changed. We are continuing to examine acquisition opportunities which we hope to execute when a pathway out of the global pandemic is more certain.

Turning now out to slide 40. Those of you who dialled in on our first half results may remember this slide. But I thought I would – it would be worth reiterating here that we fully expect to emerge from the COVID-19 pandemic with stronger stakeholder relationships than ever before.

Summary

So moving to our final slide, slide 41. Just to summarise what we have just heard. This has been a year of overall growth delivery, which has resulted in the increased final dividend that we are proposing today, plus the special dividend as we have not been able to execute any meaningful M&A.

We have delivered a resilient performance in our key markets which in turn have led to strong underlying financial returns. In terms of the outlook, the toughening approach of the Polish government and tax authorities continues. This has manifested itself through more aggressive interpretation and execution of the existing laws and regulations as well as new legislation such as the small format tax.

As far as the latter is concerned, as was this year's excise increase, we see opportunity as well as risk in this change. And our successful management of excise increase gives us confidence in our ability to respond to these new developments. As we near the end of the Brexit transition period, our message remains that we see no material impact on our business.

Strategy

More broadly, our strategy remains highly relevant. And in the appendices, there are a couple of slides showing our progress against our strategic pillars of premiumisation, millennials, and digital. We will continue our drive for further value creation through both organic growth as well as restarting M&A activity after COVID-19. And we remain confident in the future prospects of our business.

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

Q&A

Operator: Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. As a reminder, if you wish to ask a question, please press star one on your telephone keypad and wait for your name to be announced. Please stand by while we compile the Q&A queue. This will only take a few moments. If you wish to cancel your request, please press the hash key. Once again, it's star one if you wish to ask a question. Thank you. And your first question comes from the line of Ryan Fintan from JPMorgan. Please ask your question. Your line is now open.

Ryan Fintan (JPMorgan): Good morning, Mirek. Good morning, Paul. Fintan Ryan here from JPMorgan. Two questions from me please. Firstly, with regards to the Poland small format tax implementation, could you give us a bit more colour in terms of like some examples of what you're going to do in practice in order to try and mitigate the impact of this tax?

And just a sense of where in terms of your current assumptions around like what could be the potential volume elasticity of the tax being put through? And if anything, particularly given COVID has made the consumer environment may be less susceptible for putting through the tax increase now versus the pre-COVID environment?

And secondly, just with regards to your Italian business, maybe the underlying margins have come under pressure this year even though the Franciacorta acquisition has done better than expected. What do you expect for the Italian business going forward and particularly the financial equation once we have the full impact of the Beam Suntory portfolio rollout? Thank you.

Mirek Stachowicz: Ryan, I'll take the first question. And then I'll ask Paul to respond to the Italian question. Now regarding the small format tax businesses, you would not be surprised that I'm not going to share any specifics with you here because of the commercial sensitivity of the market. However, as we said, we see both a risk and an opportunity in this.

And the reason why we are taking this view of the small format tax is because fundamentally small format address a different occasion for our consumers. And that has wide-ranging consequences including the volume elasticity that you referred to. And suffice to say that because of the fact that it is a different drinking occasion for our consumers, the pricing per litre in this segment has been much higher already. So, we believe this increased tax will not have a profound impact on the volume in this area, profound enough to make a significant impact on our business.

I have to qualify this. Of course, there's a lot of uncertainty around a new kind of tax that has never been introduced in the country. So we have raised this as a potential risk. But as I said, we feel relatively confident that we will be able to address this through a combination of a number of activities that we have in hand. So we have been working on this for quite considerable amount of time since this tax was already mentioned over a year ago. Over this period of time, we believe we have come up with a number of commercial activities which we'll be able to deploy once the tax is effectively placed in trade.

And that will be probably in the second quarter of 2021 since the first quarter will be a period when the stocks will be still clearing the trade. So the pricing will not be established until probably around next[?] year. I know it doesn't fully respond to answer your question, but I'm not really able to go beyond that because of the specific commercial sensitivity. Paul, over to you about Italy.

Paul Bal: Hi, Ryan. So on Italy and margins, again, I'm not really going to make any forward-looking statement. But let me share with you what our aspirations are for the margin dynamics of the business. So this year, the business has reported an EBITDA margin of 6.5% which is down from the 13.5%.

Now given the evolution of the Distillerie Franciacorta acquisition and the picking up of the Beam distribution business, both of those have had a slight dilutive effect on the underlying or the overall reported margins. So the underlying margins in the business were closer to 8%. Now that’s still not a satisfactory position for us. Obviously, it reflects the reduction that we have seen in the business in recent years. The aspiration remains to at first stage to be getting back to around 20% EBITDA. And the longer-term aspiration for a market like Italy with pricing has got to be around the mid-20s, and that's where we would want to get back to.

So it's going to be a multi-stage journey to get there. But certainly, we think that once we are beyond the dilutive effect of this year of both Distillerie Franciacorta and the Beam acquisitions, we should be able to see positive evolution of the EBITDA margin in the coming years. Now what gives us comfort here is if we look at the operating expenses of the business, there was very little movement this year in the underlying operating expenses. The only increase was really driven by the additional investments we had to make in headcount to now incorporate the Beam Suntory business.

So again, unable to make a forward-looking statement, but I hope that gives some comfort as to our aspirations for the Italian margins.

Ryan Fintan: Yeah, it's very clear. Thank you, Paul. Thanks, Mirek.

Mirek Stachowicz: Thanks, Ryan.

Operator: Thank you. Your next question comes from the line of Sahill Shan from N+1 Singer. Please ask your question. Your line is now open.

Sahill Shan (N+1 Singer): Thank you. Mirek, Paul, morning. Well done. Another good year there for you. Three questions from me. Firstly, on the Czech business; has that business gone ex-growth now given all the competitive pressures you've been talking about over the last 12 to 18 months or so, so a bit of colour around the competitive landscape and your view on growth aspirations going forward?

Second question is, again, around tax and more a general view as to, is there anything we need to be aware of further tax risk going forward in your key territories because there's a bit of a pattern emerging now in terms of these tax rises coming through on a regular basis?

And my final question is around margins, but more specifically for the two major territories, i.e., Poland and Czech Republic in terms of again walking us through aspiration and expectations as you just explained for Italy. Thank you.

Mirek Stachowicz: Thanks, Sahill. It will be no surprise, I will hand over the last two questions to my CFO. I'm sure Paul will be much more confident to respond to that. However, on the Czech and the growth aspirations, you have seen that the Czech business we have signalled that we can see that the level of competition in Czech Republic has increased.

And whilst we are seeing some easing of competition after many years in Poland which is good news, we have seen as a result of the excise some of the competitors engaging more into price-based competition in the Czech Republic. Now this is not unexpected. And that is why we said that the Czech business performed in line with our expectations.

If we go into details, there are three categories in which we see this competition. We have already seen price-based competition in the herbal bitters category from Jagermeister. We have now also seen, now we see a more price-based competition in the new category of premium imported rums which was created effectively by Božkov Republica launch two years ago.

And finally, we see more price-based competition in clear vodka. Now responding to each of these in detail, we have been already covering the actions that we've taken in the herbal bitters. We have relaunched our brand. We have created a new pricing architecture that we believe is delivering what we expected to deliver.

We have seen a significant increase in profitability in this area. And we're also seeing a gradual recovery of the reversal of the trend of the decline of our share. So we think we are on the right track there. It takes time to do this, but it is moving as we planned.

When it comes the premium rum territory, we created a new category. And we now see me-too products that are coming into this. And we are now – we've now seen two me-too products from two of our local competitors. It is inevitable that a creator of a new category will not be able to hold 100% of this category. And we are responding in two ways because this is price-based competition, we're clearly focused on protecting profitability of our premium brand. So therefore, we launched a price-based competitor to our me-too competitors. And we also are accelerating innovation, and we have just launched line extensions in Republica Rum, both in the liqueur area which is Republica Espresso which is a very promising product. And we also moved Republica brand into vodka territory. We launched a sugarcane vodka in Czech Republic at super premium positioning. That's the right way to move with premium brands, which is not to respond in price, but to respond in innovation and in leveraging our route to market. So we are able to list these innovations against the me-too competitors.

And then finally in the vodka, we believe that we have – we're on the right track. We play the category game. We are by far the biggest player. And we have by far the strongest ability to play the category game. Now we have a competitor who decided not to pass on the excise to consumers hoping to make a lot of volume gains.

The way to respond to this competitor is to demonstrate to them that their volume gains are not offsetting their margin shrinkage. And that's what we're doing. So in the end in our statement, we have spelled out that we are planning to leverage our brands, our strong route to market, and our ability to work with customers to respond to these challenges.

We're not taking the easy route which is to respond in kind to price competition in rum and in vodka because that would bring down our profitability. We believe we have ability to respond in different ways and continue to grow profitability because for us, and responding to your question about how much growth do we see there, we're looking at profitable growth, yeah. So we think we can deliver that. Our results this year demonstrate that we were able to do that. Handing over to Paul.

Paul Bal: Yeah. Thanks, Sahill. So tackling your first question about taxation and fiscal. I think you've got to really break this down into two things, the specifics and then a general environmental question. So first of all, in terms of specifics, yes, as we said, we have seen over the years a more aggressive approach being taken by the tax authorities in Poland.

And I think we do single out Poland there because we haven't really detected a real difference in the environment elsewhere so far. Now in Poland, again, it can take two forms, a specific legislation that we have for example forthcoming with the small format tax. The motivation for that legislation I think we have discussed before are not necessarily fiscal. It may be something to do with the dynamics of the various categories within alcohol, given that it seems as though spirits in line were more singled out by the ambit of this tax. But if you look at the wider corporate tax environment, well, as you know, we have the big issue outstanding. And really what we've seen here is skirmishes around that.

So we've seen a challenge on our 2014-2015 tax years. Remember, we have said that the issue that we have in litigation right now in respect of 2013 potentially runs all the way to 2017. So really these are skirmishes around that main case as it were. I think what's probably worth stating is a more environmental point, that perhaps looking ahead as government get their head around to how to rebuild the financials post-COVID, we will see I think more fiscal tightening. We've yet to see what form that will take. But I think that's something that will be a lookout in general terms.

Moving to your second question to me about margins. Well, traditionally we've given guidance on our Polish aspiration to be 26% to 27% EBITDA margin. We don't see any reason for that to differ. We'd like to be in a place where we're comfortably delivering to that. And certainly, the pricing that we have seen this year helps us. Over in Czech, we've had a number of periods where we've gone beyond 30%. And traditionally if you look at the business, the business has generated in the high 20s, but we now find ourselves into the 30s. I think as we will probably settle and we will probably settle for that in the high 20s into the low 20s, I think we will stabilise around here. We do need to get the balance right between profitability and maintaining our leadership position. And that's something that we are monitoring closely. And we'll need to get the balance right through some of the actions that Mirek mentioned, through additional NPD to differentiate ourselves from some of these me-too players that are creating more competition for us. But I don't see guidance on the margins for Czech drifting from the high 20s maybe into 31% that we see today.

Sahill Shan: Super. Thank you very much for that, guys.

Mirek Stachowicz: I think we can take one more question. One more question, yes, please.

Operator: Thank you. Your next question comes from the line of Doriana Russo from HSBC. Please ask your question. Your line is now open.

Doriana Russo (HSBC): Yes, good morning guys. Most of my questions have been answered. I just want to come back to the tax issue and the outstanding challenges that you've got in Poland. You mentioned that you set aside about €3.5 million as a provision on a provisional basis. But can you give us an update of what could be the cumulative liabilities that you've got outstanding if the outcome of the challenges is not positive?

And also, on the small format tax, you mentioned the timing is early next year. What activities are you adopting in terms of monitoring competition because it sounds like every time there's a new tax, the competitive environment may shift. So, I just want to understand what actions are you taking to keep on top of what the other people are doing to make sure that there's an equilibrium in terms of prices maintained?

Mirek Stachowicz: Maybe, I'll start with the small format tax, and then I'll hand over to Paul. Doriana, thanks for your questions. Just to reassure you, I already mentioned in response to Ryan that we are monitoring the consumer response. Your question is really about competition. And rest assured, we have a deep understanding of what competition are doing in Poland.

In the area of small format tax, there are only two players that matter and that's Roust and Stock. So it really is about monitoring Roust's response to this. And we believe over the period of time when we had to deal with Roust leaning so heavily on us since all the way from 2014, we have developed a good understanding of their way of operating. And we have good sources of information from the market, we share the same customers. Any move by them would have to be precedented – preceded by a communication with the trade. We have built relationships with the trade to allow us to understand this.

Now that’s just the mechanics. In terms of the direction, we are encouraged by the development of – developments of this year. But because you can see that we have seen a consistent move in pricing in mainstream territory. And that was the territory that was the battleground for between us and Roust and Marie Brizard. We think that Roust has responded differently this year than in the previous years. We have seen Roust increasing pricing in line with excise, and then increasing prices again once they notice that the price increase that we put in at the time of excise which was higher than excise stuck. So, if that's any guidance, we expect them to behave similarly when it comes to small format tax, yeah. And it's really between us and Roust. Handing over to Paul on the tax.

Paul Bal: Yeah, sure. So, on the – Doriana, on the main tax issue that we have in Poland in respect of the intellectual property restructuring 2009 to 2013, the overall position really hasn't changed from where we were 12 months ago. We're further down the appeal process. And we don't expect any outcome for at least a year or two as I said earlier.

In the details in nine on the RNS and then obviously on the financial statements tax note, we set out some indicators of what we think the overall exposure could be relating to this issue. Now it's very hard to be specific because a lot depends on the approach that the authorities will take when it comes to questions of the interest rate that is charged on the outstanding amounts that are levied and any penalties that may be applied.

But we've set out a broad range over the years of what we think the potential exposures and the interest rates that could be levied would be, what enable sort of estimates to be made. Our own working estimate hasn't really changed that the overall exposure is somewhere around €40 million all in which would include interest, would include penalties and so forth. But as I said, it's an imprecise science because a lot of it will depend on the approach that's taken by the tax authorities. But nevertheless, I would emphasise, ultimately, we believe based on all the advice that we have received and refreshed that we believe that ultimately we will prevail on this. And that this is – it's a potential exposure worth noting, but certainly not one that we recognise.

Mirek Stachowicz: I believe there is one more question from Matthew, and we could still take it. So if you could please ask the question.

Operator: Your line is now open.

Speaker: Yeah, thanks very much. I'll conform myself to one question as the clock's ticking. I'm just wondering if you had any comments on recent trading in October and November. Clearly much if not all of your region has been in lockdown for quite a chunk of that. And I was just wondering in particular whether there were any differences in consumer behaviour and the shift from on to off-trade versus what you saw during the last lockdown – sorry, the first lockdown? Thanks.

Mirek Stachowicz: Matthew, I will hand over to Paul. His English is better equipped to dodge this question.

Paul Bal: Thanks, Matthew. Of course, we're not going to make a forward-looking statement. But in terms of the shift as you're asking in terms of the consumer, yes, there has obviously – with the lockdowns that we've seen since the middle of October there has been a shift towards the off-trade. And as you would expect Poland with its relatively small exposure to on-trade maintains momentum. But the rest of it, I wouldn't want to comment more than that.

Speaker: Fair enough. Thanks very much. That's helpful.

Mirek Stachowicz: Thanks for your question. I think that concludes this session. Many thanks for joining us. And I hope to see you once the COVID is over in person. That will be a great pleasure. Thank you.

Paul Bal: Thank you.

Operator: Ladies and gentlemen, that does conclude your conference call for today. Thank you for participating. You may now all disconnect. Thank you.

[END OF TRANSCRIPT]