Preliminary Results

Wednesday, 5th December 2018

Introduction

David Maloney

Chairman, Stock Spirits Group

2018: 9 Month Period Results Summary

Change in year-end to 30th September

Right. Good morning, everyone. Thanks for being here at our nine months' results for the period ended 30th September 2018, which is our new accounting year-end. We've also published today our pro forma and unaudited 12-month numbers to September 2018, with comparative pro forma unaudited results for the 12 months to 30th September 2017. As usual, with me today is Mirek Stachowitz, our CEO, and Paul Bal, our CFO.

The agenda for this morning is on slide 3. I will give you a brief introduction before handing over to Mirek to review the company's performance in 2018, and he will tell you how we've delivered against commitments that we made at the last full-year results back in March. Paul will then talk us through the financial results, before handing back to Mirek for his closing remarks, after which you will have the opportunity to ask some questions.

Positive financial performance

Turning now to slide 4, I'm very pleased to say we've delivered another period of positive financial performance. We've made good progress in Poland, and also had some success in tackling some of the headwinds in the Czech Republic that we were experiencing in early spring of this year. As a result, we've delivered growth in revenue, EBITDA, EBITDA margin and EPS.

Strategy delivering across all 4 pillars

This performance reflects the early positive impact of our four-pillar strategy, which Mirek will focus on shortly in more detail.

Cash generation continues to be strong

Another financial highlight has been our free cash flow conversion, which was 134% for the nine-month period.

Enhanced final proposed dividend

This has allowed us to announce an enhanced final dividend. We're effectively paying a 12-month dividend for a nine-month period, and paying it three months earlier. The final dividend proposed of 6.01 Euro cents per share represents growth of 5.1% from the prior year final dividend.

With regards to M&A, we're continuing to assess a range of acquisition opportunities that would deliver enhanced growth and shareholder value for the future. But in the end that we do not complete any meaningful M&A in a reasonable period of time, it would be our intention to pay an enhanced dividend.

Board strengthened

Lastly, as we announced in September, we're delighted to have appointed Kate Allum to the board as a non-executive director. Kate started with us on 1st November, and brings a wide variety of experiences from both human resources and supply chain management, and from within Central and Eastern Europe, which will be hugely beneficial to us as we continue to grow. Kate has been appointed to the audit and remuneration committees, and we are thrilled to have her on board. I'll now hand over to Mirek, who will take you through a review of the year.

Business Review

Mirek Stachowitz

CEO, Stock Spirits Group

Summary results

Performance during the period

Thank you, David, and good morning, everyone. Firstly – sorry, going the wrong way. Firstly, a brief summary of our performance during the period. In Poland, we continued to grow from the foundations that have been re-laid in recent years, delivering steady progress despite the ongoing competitiveness of the market. In the Czech Republic, our second-largest market, in which we have held spirits market leadership for over 20 years, we achieved good top-line growth, driven in part by our increasing programme of investment in our brands. The turnaround in Italy is progressing, although the macroeconomic environment remains very tough. And in Slovakia we have achieved strong revenue and EBITDA growth, reinforcing our position as the second-biggest spirits company in the off-trade. This resulted in pro forma revenue growth of 8.7% to €282.4 million, an increase in gross profit margin to 48.9%, adjusted EBITDA growth of 11.5% to €59.4 million, and earnings per share growth of 13.4% to 16.73 Euro cents per share.

Delivering Against Commitments

What we committed to delivering at the last year-end

I wanted to take a few moments to remind you of what we have committed to delivering when announced our 2017 financial results in March. We have set out here on slide 7 those commitments, as well as the success we've had in delivering against them. Oh, I'm going the wrong way, sorry. Counterintuitive for me. So we're on slide 7.

Firstly, we said we would continue to drive growth in Poland, regardless of whether or not the price wars continued in the Polish mainstream vodka. I am pleased to say that we have been successful in this regard, growing both volume and share in Poland whilst delivering increases in both revenues and EBITDA.

Secondly, we said we would deliver on the four strategic pillars, which entails investing to accelerate organic growth through the premiumisation of our product range, the deployment of digital tools, and by attracting millennials to our brands. We also said that we would continue to seek attractive M&A opportunities that can deliver demonstrable shareholder value and provide synergies with our existing portfolio. We have included more detail on those four pillars in the appendix.

What we have delivered

Again, we have delivered pleasing results against those commitments. In premiumisation, we have increased the percentage of revenue from premium brands from 21% to 26% in the last 12 months. In the deployment of digital, we are measuring levels of digital communication where we achieved a range of results, with up to 82% reach of our target consumers. We have made good progress in targeting the all-important millennial segment, with the success of Saska in Poland being a great example. A creative company recruited millennial drinkers and has led to increasing its absolute volume and value more than many other, longer-established, rival flavoured brands.

M&A

As David has already said, we have not carried out any M&A during the period, but continue to assess a range of potentially interesting and attractive opportunities. With regards to Italy, we said that we would invest strongly and consistently in our brands there in order to fix that business and set it firmly on the path of recovery. We have made good progress in this area. I will cover this in more detail later.

Bigger whisky player

And finally, we said that we would focus on becoming a bigger whisky player in our markets. We have grown our volume share in this important segment, which I will describe in more detail later.

The Polish Spirits Market

The core market

Moving now to slide number 9, we will now go through the performance on a market-by-market basis, starting with the core market of Poland on slide 9. The overall Polish spirits market is now worth €3.4 billion, up 2.7% year on year, despite the unfavourably hot summer, which always favours the beer market. Whisky and flavoured vodka have performed particularly well, up 12.6% and 7% respectively. While the overall clear vodka market has grown 1.2%, there has been good growth in the premium, top premium and ultra premium segments. This reflects growing consumer affluence, and there is a general backdrop of robust and strongly growing Polish economy.

Poland vodka category share gains in the last six months

Slide 10 demonstrates that we are now outpacing Roust in both volume and value share gains and, more importantly, shows that we have consistently grown our value and volume every month of this financial year when compared to the corresponding month of 2017. In fact, to the end September 2018, we have achieved 17 consecutive months of year-on-year volume growth.

Poland market share trends

Similarly, slide 11 shows that we have consistently delivered quarterly share growth throughout the year. It also illustrates the fact that our recent share gains have been greater than Roust’s, and that Marie Brizard continues to decline. While some of our share gain has been sourced directly from Marie Brizard, the main engines of growth have been our own initiatives in the premium and flavoured categories. I should point out that these are spot rates and refer to the year from September to September.

Mainstream clear vodka pricing

Moving now to page 12, over the past year there have been some significant pricing changes from our competitors in the mainstream clear vodka market, most notably by Roust. Their Zubrowka brand is now more expensive than its competitive brands, for the first time in almost a year. But it is too early to tell if this signifies a more fundamental change in their long-term pricing strategy. For our part, we are committed to behaving in a rational way and keeping our pricing stable, a strategy we believe is paying off for us. And this is a clear indication that we are not driving a price war. We continue to monitor the pricing environment very closely and, as always, much will depend on the future actions and performance by both Roust and Marie Brizard.

Poland – strategy in action

Moving to slide 13, lastly on Poland there have been clear signs of our strategy working well across numerous parts of our operations.

In the area of premiumisation, Stock Prestige has achieved growth of 17.8% versus a growth of the wider premium clear vodka category of 6.5%, helped by the launch of a limited edition for the football World Cup over the summer. In the top premium segment, Amundsen trial and distribution building delivered value growth of 53.3%.

As I already said, a good example of our work in the millennials pillar was the positioning of Saska to appeal to young adults with innovative flavours, supported by compelling social media campaigns linking the brand to leading fashion, food and drink influencers and to top restaurants. Despite the fact this is the eighth-largest brand in its segment, this resulted in it contributing the second-highest absolute volume and value growth to the category.

In the wider area of digital, our continuous impact through social media activity on all our core brands, including our first ever Polish virtual bartender league, which some of you may recall from our teach and hear in August, has delivered pleasing results. Stock Prestige achieved Stock Polska's highest ever unique user reach of 7.7 million via its World Cup limited edition digital campaign.

In the area of foundation, we have improved execution at the point of the purchase in 2,400 selected high-value traditional trade outlets, using our Perfect Store programme to optimise shelf space and secure up-weighted display. This made significant contribution to the 2% value growth achieved by the Lubelska flavoured brand and 2.6% value growth achieved by the relaunched Żołądkowa de Luxe clear vodka brand.

The Czech market

Growth in Value

Moving on now to slide 15, turning now to the Czech market, growth has been delivered by the same factors as in the Polish market, i.e. strong economic performance and the growing affluence of the population. The total value of the spirits market grew by 7.3% to €0.5 billion, despite reduced levels of retailer promotional activity, with particularly strong performances in the whisky and rum segments, which were up 13.9% and 9.6% respectively. Volume growth was driven by private label, which in turn has been driven by price-sensitive consumers looking for alternatives in the absence of promotions. The growth in value was driven by the premium segment, which clearly plays to our strategy.

Czech – operational highlights

Moving to slide 16, while our overall value share in Czech is very slightly down, we actually grew the absolute value by 5.3% over the year. We grew value share in rum, the biggest spirits category in the Czech Republic, by 1.4%, from 60.02 to 61.6, which was driven by the outstanding success of the launch, in the early spring, of Božkov Republica. Captain Morgan, which we distribute on behalf of Diageo, remains the number one international rum, and also achieved solid value growth. Our success in rum, vodka and whisky categories outweighed a decline in herbal bitters value share, which was driven primarily by the changed retailer promotional strategy, coupled with aggressive price discounting by Jägermeister. Our new premium herbal bitter, Black Fox, which launched late last year, increased its value share of the premium segment to 3.5%, counteracting in part the decline of Fernet Stock in the mainstream. And, as we have said previously, the EU Commission deliberations on the use of rum ether concluded that it will not be banned in domestic rum for five years. Our team managed this challenge without significant business implications.

Czech Republic – strategy in action

Turning now to look at the evidence of our strategy in action in the Czech Republic on slide 17. As I already said, Božkov Republica was a great case study of our work in premiumisation, and consumers continue to trade up to a more premium variant of the trusted brand. It now has a 26% value share of the premium rum category, only eight months from its launch.

In terms of the millennials pillar, as we have said before, the taste and packaging of Black Fox has been developed specifically to meet their preferences. Black Fox is outselling its competitors in the on-trade outlets in which it has established distribution, giving us good reason to be optimistic about its future.

In digital, we executed a programme of activity across all core brands, designed to move consumers from awareness to advocacy. We used this channel heavily in support of our NPD launches, achieving an average of 68% reach of our core target millennial audience.

And in Foundation, we achieved a step change in category management with two major customers, Ahold and Billa. This allowed us to mitigate some of the headwinds that we experienced in the early spring, when retailers changed their promotional strategies, which led to the growth of private label.

The Italian market

The market is fragmented

Moving to slide 19, looking now at Italy. The market is fragmented, and consolidation is a real opportunity. While trading continues – excuse me. While trading conditions remain tough, due to the ongoing challenging economic environment, there has been overall market growth. However, this has been concentrated in categories where we don’t play currently. The exception is clear vodka, where our Keglevich brand remains the brand leader. In 2018, we entered rum with a third-party brand in order to access this growing category.

Italy – operational highlights

Moving to slide 20, the main highlights of the year in Italy, which accounts for 9% of group revenue, were the value and volume share growth of our iconic brandy, Stock 84, which we relaunched last year. Our premium Stock 84 XO variant contributed the greatest absolute volume and value growth to the brandy category, demonstrating our ability to turn around our core brand portfolio in Italy. In the growing clear vodka category, Keglevich share has been growing over the last six months, and consequently has strengthened its position as the market leader, despite pressure from private label. The relaunch of our Keglevich fruit flavoured range in the summer, which is a multi-year investment for us, held its share of value in the category that was down over 10%. We continue our focus brand building in selected premium on-trade outlets for Syramusa, the premium sub-brand of Limoncello which was launched in late 2017, and the brand is now listed also in travel retail. And finally, our distribution brand range expanded further, with three new distribution agreements with Dubliner, Dictador rum and Vicenzi liqueur.

Italy – Strategy in action

Moving to slide 21, in terms of our strategy in action in Italy, I think we have covered the premiumisation and millennial pillars already, but I would like to draw your attention to the digital pillar, where our campaign landed at Keglevich reached over 82% of millennials, i.e. 18 to 34-year-olds. This was achieved by a combination of content on demand, Facebook and Instagram activity. The relaunch campaign also included an innovative Spotify collaboration.

And lastly, in the Foundation area, we reorganised our marketing team to include two new millennial brand managers. In addition, the further development of our direct on-trade organisation in northern Italy is delivering positive results on all key brands, with the region achieving higher growth than Stock's national average post the restructure.

Other markets – operational highlights

Slovakia

Looking now at our Other Market division on slide 23, our Slovakian team delivered another strong performance, growing both volume and value by 4.9% and 3.9% respectively ahead of the market. We maintained our leadership in the herbal bitters category, with growth supported by Fernet Stock grapefruit-flavoured extensions. We continued the launch and rollout of brands from other markets. Amundsen vodka has achieved double-digit volume and value growth. Republica rum achieved 35% weighted distribution in the second months after its launch – a strong start when compared to the far-longer-established brand leader in premium rum, which has 42% weighted distribution. The Black Fox rollout is continuing and has added a premium dimension to our bitters portfolio. We were also pleased to enter the borovicka category recently, which was supported by NPD.

Finally in Slovakia, having begun distribution of Beam Suntory's range in May 2017, we doubled Jim Beam's value share from 3.6% to 7.5% with a strong growth in sales. The distribution brands portfolio was also expanded to other growth categories with the addition of The Dubliner and Barcelo premium rum, among others.

Croatia

In Croatia we grew volume and value, primarily through the increas on trade focus, supported by the relaunch of Stock 84, which is now the number-one imported brandy.

Germany

In our export markets, the reorganisation of our route to market in Germany was completed.

Whisky strategy highlights

Third-party distribution

Turning now to slide 24, the highlights of our whisky strategy. In terms of our third-party arrangements, we expanded our relationship with Beam Suntory into the Czech Republic, where we also manage Diageo's core brands. More broadly, our third-party distribution – sorry. We believe that this now gives us the strongest whisky portfolio in Czech. More broadly, our third-party distribution agreements for whisky achieved strong growth, increasing the total share of whisky in our core markets from 10% to 11.3%. In addition, we are starting to build inventory to help mitigate the impact of the imposition of EU tariffs on US bourbon imports. Whilst this does not constitute a material part of our portfolio, it is a valuable growth contributor.

Quintessential Brands investment

With regards to our Quintessential Brands investment, we are looking forward very much to the opening next month of the distillery and visitor centre in Dublin, and we have now agreed distribution agreements for the brand in all our markets.

Own brand development

In the area of our own brand development, we have relaunched Printers blended S3cotch whisky in the Czech Republic, having leveraged the considerable expertise of Quintessential Brands' master distiller. We also have a new distribution arrangement into Taiwan for our 28-year-old Hammerhead single malt Czech whisky, which is generating high-margin incremental sales with a recommended retail price of €180 a bottle.

So, all in all, we are pleased with the progress that we have made over the period, and with that I hand you over to Paul Bal for the financial review.

Financial Results

Paul Bal

CFO, Stock Spirits Group

Financial highlights

Continued improvement

Thank you, Mirek. Good morning, ladies and gentlemen, and it's my great pleasure to present the financial results for the nine months ended 30th September 2018. I start with slide number 26. The audited financial trading results for the nine-months period to 30th September 2017 are required to be reported against a comparative, which is the audited reported results for the full year ended 31 December 2017. Therefore, in order to provide a more meaningful and comparable picture of our performance, we are also reporting pro forma results. These comprise the results for the 12 months ended 30th September 2018, compared with the results for the 12 months ended 30th September 2017.

Because the comparison is more meaningful, my section of today's presentation is based on that pro forma basis of reporting and presenting our results. Our results announcement released this morning and our annual report and accounts, which will be available in due course, set out the details of the basis on which the pro forma results are prepared, as well as the reconciliations between them and our audited reported results. A summary of that information is also included in an appendix to this presentation.

On this pro forma basis, our results reveal continued improvement in our overall financial performance, from the top-line of volume and sales growth to the bottom line, as well as in our margin. Revenues were up 8.7% to €282.4 million. Gross profit margin rose 160 basis points to 48.9%. Adjusted EBITDA grew a strong 11.5% to €59.4 million. Adjusted EBITDA margin rose 50 basis points to 21%, and the basic earnings per share grew 13.4% to 16.72 Euro cents a share.

Beyond the profit-and-loss account, our cash flow delivery remains robust, and as a consequence our balance sheet has got stronger. After I present more detail on these headlines, I will also touch upon some changes in the accounting and reporting requirements. Finally, I will cover the announced dividend that we have declared, which is more than in line with our progressive policy.

Consolidated pro forma P&L

Stronger performance

So, starting with the group's consolidated profit-and-loss account on the pro forma basis, on slide number 27. To keep focus on the comparable underlying results, the pro forma P&L excludes the two exceptional items reported in year ended 31st December 2017. The 8.7% increase in revenue was driven by all levers, including favourable currency effect. Otherwise, revenue was up 6.9% in constant currency terms, with volumes up, overall pricing better and sales mix enriched by our strategic focus on premiumisation. Better leverage of our scale and smart sourcing has meant we kept our per-litre cost of goods increases to general inflation level, so that the gross profit margin improved by 160 basis points to 48.9%.

In March this year, we said that we would be investing more into our brands than in previous years, in line with a strategic aim of premiumising our portfolio. We have done this, as seen in the increase in selling expenses, albeit the full extent of this investment is partly offset by efficiencies and savings in other areas.

We continue to invest in talent, especially at the commercial end of the business. The period's stronger performance has also triggered higher staff variable reward costs. We also experienced local inflation rates in our markets that are generally higher than those in Western Europe. These were the main drivers of the higher other operating expenses. Other drivers were costs related to settling historic tax issues, as well as higher audit fees given the year-end change.

We include a 25% share of our results of our associate, Quintessential Brands Ireland Whiskey Ltd, and this result is in line with our expectation. At the time of making that investment in 2017, we said that the payback would not start until year four, and the Dublin distillery opens next month.

Overall, this performance results in double-digit growth in operating profit and a 120 basis point improvement in the operating profit margin to 17.2%. Stripping out the impact of interest paid on settling historical tax issues, net finance costs were broadly flat as our financing lines remained unchanged. The tax charge is also impacted by the settlement of historic tax issues. On an underlying basis, there's a small improvement in the effective tax rate.

Underlying performance is best reflected in the improved adjusted EBITDA, growing 11.5% year on year or 8.1% in constant currency terms, and in the adjusted EBITDA margin growing 50 basis points to 21%. It is also visible in the adjusted earnings per share growth of 13.4%.

H1 – H2 performance

Upward momentum in revenue

Turning to slide 28, breaking down the results by each half-year show the change in reported cyclicality following the move to the 30th September year-end. The first half of the new financial year, containing the important fourth calendar quarter, now our Q1, is now bigger than the second half of the financial year. As you will see, we continue to see an upward momentum in our revenue. Adjusted EBITDA has positive momentum too, and it is pleasing to see adjusted EBITDA margin strengthening. I should remind you that in the first half of 2018 that reflects the higher brand investment that I had signalled earlier.

Volume and revenue

Overall volume growth is solid

With slide number 29, let's now look into the components of our results in a little more detail, starting with the top line. Our overall volume improved 2.8%, with this growth rate applying pretty equally to both clear vodka volume and volumes of the other spirits categories we sell. The market particularly driving this growth was Poland, with its increasing share. The Czech business also did well, despite the earlier headwinds that are being tackled. Stripping out the volume impact, our underlying average prices were up over 3%, driven by the Czech Republic, mostly. Foreign exchange effects of almost 2% were positive, and mix improved as we premiumised further.

Poland financial performance

Continued growth in Poland

Looking specifically at Poland in the next slide, slide number 30, we see revenues benefited from a healthy positive combination of all three growth levers – volume growth, positive pricing and improving mix. Of these three levers, pricing still lags the others, reflecting the continued strong competition in the market, and it more reflects format size and channel mix, rather than direct pricing itself. EBITDA grew in double digit percent, showing our capability in a very competitive market to grow and also deliver a very decent return. It is also pleasing to generate an improved EBITDA margin which, at 26.5%, is within the 26% to 27% range that we aspire to be within as we regain market share and deliver value growth simultaneously.

Czech financial performance

Revenue growth from good sales mix

Turning in the next slide, slide number 31, to the Czech Republic, our second-biggest contributor after Poland. Healthy growth in the top line was primarily driven by the runaway success of the newly launched Božkov Republica, which, as Mirek has explained, is sold at a significant premium price to the core Božkov family. As we analyse sales drivers on a brand basis – in this case it is Božkov – this effect comes mainly through the pricing line, as does the benefit from now distributing Beam Suntory brands. The mix hit predominantly came from lower sales of Fernet. EBITDA growth was slight, with the margin lower. This reflects the increased initial marketing investment we made in the period, particularly in relation to the two major launches of Black Fox and Republica, and their subsequent rollout across the market.

Italy financial performance

Italian economy still challenging

I move now to slide number 32, and Italy has faced another challenging period, with the economic environment testing for our consumers, and reflected most in the declining disposable income of young adults in particular. This has put pressure on all of the growth levers, and therefore revenues were slightly lower. Adjusted EBITDA and EBITDA margin was down, given the lack of sales growth. However, this is also a consequence of us investing further in strengthening the commercial team, as well as the investment into turning around the fortunes of some of our key brands. As we previously stated, we intend to fix our situation in Italy, and in this period we concentrated on the relaunch of Keglevich, the number-one brand for both vodka and flavoured vodka in the market. This increased investment also has an important digital component to it. I should also add that the investment we made in relaunching Stock 84 brandy in 2017 is clearly paying off, as that brand has performed well in the current period.

Other segments finance performance

Slovakia and International divisions posted strong results

Turning now to slide number 33, I'll now move to the rest of our operations. They have all performed very well in the period, with strong revenue growth, and this was especially true of our Slovakian business. Consequently, EBITDA rose strongly, and the EBITDA margin strengthened by 200 basis points. I should remind you that some of this lift is due to lapping the costs associated with the Baltic distillery repairs following its breakdown in mid 2017.

Pro forma corporate costs

Inflationary increases in the underlying cost base

Moving to slide number 34 and some words on central or corporate costs. These represent the costs not only of our UK corporate office, but also the cost of central functional heads such as for operations, procurement and internal audit, who are located elsewhere in group locations. Increases are pretty much inflationary, given that the cost base was reset after waves of restructurings in recent years. However, our stronger performance has meant that staff reward costs are higher than in past years. For the same reason, the accounting impact of new and open share awards is a higher charge in 2018 than in 2017. Restructuring and certain other non-recurring costs are much lower than in 2017, consistent with my earlier message that we have largely exhausted opportunities of large-scale cost savings at the central level. Nevertheless, we remain vigilant for further opportunities to make our model more efficient and redeploy costs for commercial gain in our markets.

Impact of FX movements

Tailwind to our top line

If we now move to slide number 35, I have already mentioned that foreign exchange movements provide a tailwind to our top line. This was also the case for the bottom line.

This benefit came predominantly from the strengthening of the Czech crown and the Polish zloty against the Euro, reflecting the continued strength in those economies.

Given the macroeconomic uncertainties of the period ahead of us in Europe, in the appendix to this presentation we have set out the key exchange rates over recent periods, as well as where they stand at present, and I can reconfirm that we don't believe the proposed Brexit will have a material impact on our business and there are no formal hedging instruments in place as at 30th September 2018.

Net finance costs

Higher financing costs

The next slide, slide number 36, sets our net finance costs. As our financing arrangements have not changed over 2018, I would not expect much underlying movement if interest rates remain stable. The Czech Republic's interest rate, known as PRIBOR, has risen over the period, so raising our interest cost a little. Otherwise, we have seen higher financing costs, due to paying interest in respect of the settlement of some historic tax issues in the Czech Republic and Germany. Our financing facilities, extended last year to run to late 2022, remain unchanged. Combined with a strong balance sheet, these financing facilities provide us with a good base from which to pursue our strategic aspirations.

Tax

Effective tax rate stable year-on-year

I now move to slide number 37, turning now to the subject of taxation, and where required we have used the effective tax rate to arrive at the pro forma tax number. The slight improvement in the current tax expense came largely from the overall corporate tax rate in Italy reducing to just under 28% in early 2017. However, this benefit was more than offset by prior year tax charges relating to Italy, the Czech Republic and Germany. The slightly higher deferred tax charge largely reflects movements in accruals for sales rebates and the utilisation of tax losses. The tax environment is becoming more challenging, with authorities taking a more aggressive approach, and we see this especially in Poland. The group holds provisions totalling €8 million 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 as due by authorities and then seek their recovery as appeals processes run their course.

Free cash flow

Continuing strong levels of cashflow generation and conversion

Moving to the next slide, slide number 38, and we come to cash flow. Strong cash generation has been a hallmark of this group, and free cash flow rose. The implied conversion rate has moved back from 99.1% to a still very robust 91.5%. The main reason for this lower conversion rate is the increase in inventories covering our third-party distribution agreements, as these tend to represent a higher value than our own product inventories.

Net debt

Strong net cashflow from operating activities

I've clicked now to slide number 39, and staying with this theme on the next slide, our strong cash flow generation has enabled us to reduce net debt to $31.6 million, a reduction of $21.5

million during the year. Of course, this reflects the absence of any completed M&A in the year. Our already low balance sheet leverage has reduced further, to 0.53 times. The group has significant liquidity available to it and is well funded for the future to pursue our strategic aspirations and reward our shareholders with progressive dividends. And, should there be opportunity, we are also well placed to consider further distributions.

Accounting standards

IFRS 15

With slide 40, I now turn to the impacts of changing accounting and reporting rules on our accounting policies. From 1st January 2018, we have applied IFRS 15, revenue from contracts with customers, which altered the way promotional spend with customers is accounted for. It gives a small hit to revenues, and therefore a small profit margin hit, but a small adjusted EBITDA margin gain, as certain promotional costs are now taken against revenues. The absolute adjusted EBITDA itself is unchanged. This change has been applied to the statutory comparatives too, and also to the pro formas, including the segmental information for both years, so that they are comparable. The impact of the restatement of costs and revenues is set out in today's results announcement and in the annual report and accounts.

IFRS 9

IFRS 9, financial instruments, applied from 1st January 2018 also. It essentially requires trade receivables to be discounted to amortise costs, less any impairments losses. But given our various mechanisms to protect our trade receivables, this did not have a material impact on us. And again, this change has been reflected across all of the periods and the pro formas to allow comparability.

IFRS 16

IFRS 16, leases, will apply from 1st October 2019. We do not expect this to have a significant impact on our P&L, given the level of our leasing. We will report on this impact in our next annual report and accounts.

Dividends

Proposing an enhanced final dividend

I now turn, with my final slide, slide number 41, to the subject of dividends. The Board today has proposed a final dividend of 6.01 Euro cents per share for the nine months ended 30th September 2018. This is more than progressive, as it is a 5.1% increase on the 5.72 cents per share final dividend for the year ended 31st December 2017. In effect, the Board has proposed the equivalent of a progressive 12-month dividend for the nine-month period. Besides this enhancement, which is some 3.41 Euro cents per share, there are two further benefits for our shareholders. Due to the change in year-end, this dividend will be received some three months earlier than under the old cycle, and this proposed dividend sets the base for the future. The final dividend will be paid on 1st March 2019, based on the record date of 8th February 2019.

In terms of the full distribution for the nine-month period to 30th September 2018, this means a total dividend, including the interim dividend of 2.5 Euro cents per share, of 8.51 Euro cents per share, and this is a 5.1% increase over 2017's total dividends.

Going forward, we will continue to focus on providing our shareholders with progressive dividends, where cash generation allows. The capital reduction early in the period provides us with ample distributable reserves for this purpose. And if, through the combination of our continued strong cash generation and little executed M&A, the group finds itself with an inefficient capital structure, the Board will consider making additional shareholder distributions.

And with that, I thank you and I hand back to Mirek.

Concluding Remarks

Mirek Stachowitz

CEO, Stock Spirits Group

Conclusion

Delivering on our promised statements

Thank you, Paul. So, to conclude, or to provide a quick summary of our achievements. Most importantly, we are delivering on our promises. Poland is now growing, we have managed the headwinds in the Czech Republic that we have experienced in the early spring, and we are taking further steps to fix our Italian business.

Strategy is embedded through three strategic pillars

Our strategy is now firmly embedded in our operations through three out of four strategic pillars and, as we have illustrated today, we have made tangible progress in each of our regions as a result.

Fourth Pillar: M&A

In terms of the fourth pillar, the M&A, we are currently assessing a range of opportunities with a clear criteria of only focusing on businesses and assets that would generate significant synergies with our existing business and add complementary brands in our existing markets and categories. However, if other opportunities outside of these criteria present themselves, we would also consider them if they are compelling enough.

That concludes the presentation, and I would like to now open the floor for questions. Please can I ask you to give your name and the organisation you represent before asking your question, thank you.

Q&A

Matthew Webb (Panmure Gordon): Good morning. It's Matthew Webb from Panmure Gordon. I wonder if you could just talk a little bit about calendar Q3 specifically. It looked to me to be quite a strong quarter in terms of revenue growth and EBITDA margin, and I just wonder whether there was anything particularly driving that in term of, you know, by geography or by brand? And also, connected to that, if that's the case, whether we should take that as an encouraging sign as we move into the key trading period?

Mirek Stachowicz: Do you want to take this?

Paul Bal: Yeah, sure. Thanks, Matthew. We don't comment in detail on a quarter-by-quarter basis, as you'll appreciate. However, as we had signalled, actually, back in August at the time of reporting our half-year, we were already beginning to pick up encouraging signals in respect of the Czech market. The Czech market, if you recall, had had a challenging first half because of various shifts in the trade environment. So that positivity that we were sensing back in August did play through in the third quarter, and then the second driver, of course, was the continued progress that was clear from the slide that Mirek set out in terms of the share gains that we continue to make in the Polish market. So, if you take those two main drivers together, we did see a positive third quarter.

Mirek Stachowicz: If I can add, you were asking about what we expect. Well, in our RMS, there was a quote from me saying that I see this as a positive outlook for the future. There are some fundamentals that are working to our advantage, and we're trying to point out to these. So we have growing economies, we have growing affluence of consumers. Our strategy of premiumisation is tapping into this, and we clearly are doing what we promised to do in terms of premiumisation, with the percentage of our products growing from 21 to 25 in a matter of 12 months. I think that that helps us, and I do believe we will continue to see good performance coming from this business.

Matthew Webb: Thank you very much.

Ted Nyhan (JP Morgan): Hello. Ted Nyhan, JP Morgan. Overall, can you give a sense of the contribution of product launches over the course of the year to constant currency growth? And a second one, if I may, can you quantify the margin drag from the investments you made in Italy and in the Czech Republic? Thank you.

Paul Bal: I'll take that. So the clearest way, Ted – thanks for that. The clearest way to look at the contribution coming through from the innovations and the developments of the year is to look at the volume pricing mix analyses that we provide for the various markets. So there, as I sort of mentioned when I was presenting them, you'll see the impact coming through in terms of mix and the mix improvement, which is supporting, for example in Poland, the growth of Stock Prestige and work that we did with Stock Prestige. In Czech you'll see, as I said, coming through the pricing line, the significant impact of the benefits we've seen from not only Republica but also Black Fox. So that's where you will see the bulk of the benefits coming through for the innovations of the last 12 months.

In terms of the second part of your question, which was to the extent of the investments and the impact that that's made on the margin, we don't – we provide some detail in the annual report and accounts as to how the advertising costs have moved, but we don't go into a lot of detail in terms of by brand or anything like that, as you would suspect. But I can tell you that there was a significant year-on-year investment made. Now, the full impact of that investment was masked by the fact that we had savings in other areas as we resource allocated. So, while selling costs are up around 5% on the headline, the underlying increase in investment was more than 5%.

Chris Wickham (Equity Development): Yeah, hi, it's Chris Wickham from Equity Development. First of all, congratulations on having your star striker scoring the goals. I mean, it's clearly very good performance in Poland, which I think is what we wanted you to do. I mean, you've clearly got this very healthy, you know, relationship between net debt and EBITDA, you've got the great momentum in terms of the organic performance, and you allude to the fourth pillar, M&A. You know, those are objectives which most people, you know, with an acquisitive strategy in distilled spirits will be chasing, and we do know that good opportunities in spirits M&A can be few and far between. What is the organic strategy, and how sustainable is that organic strategy, if you don't go down the fourth pillar route?

Mirek Stachowicz: I'll take this. Thanks for your question, and thank you for referring back to the analogy from the last announcement. Yes, we did score, I think, this one. The strategy consists of the two pillars: organic growth through premiumisation, millennials and digital; and M&A. So, Chris, let me just say we announced the strategy in March, and I would not be announcing the strategy if I believed that the M&A opportunities were few and far in between, as you said. I think that the opportunities are there. We are examining them. We are working hard on this. I think that shareholders should take comfort from the fact we haven't announced anything in the last 12 months, because we want to get really good deals that are meeting our criteria, and these criteria are about synergies and enhancing brand portfolio.

We are a company about brands, and we believe in strength of brands, local brands. We think, based on the performance to date of our organic growth, we know how to make local, traditional brands relevant to young consumers. The digital outreach is phenomenal in some markets, yeah? These are not 60-year-olds who are watching the YouTube channel with Boruc, who is the football player, well-known Polish football player, drinking our drinks, made with our vodka, and talking about his life as a footballer, yeah? These are millennials. Makes the brands really relevant to the younger generation.

So we know how to do this. Now, how sustainable this is, I believe it is sustainable, because in the end we've analysed where the market is shifting and how is it moving, yeah? You can see that we have disproportionately grown our sales in the segments that are growing faster and that are delivering higher margins, so that's a clear focus from us.

When you look at what we are doing in Italy, we are deliberately entering growth segments with third-party brands, because we want to tap into growth there. And maybe a comment on, you know, on Italy, if you allow me, because a lot of attention is turned to Italy. And I have already said in the presentation it's 9% of our top line. To be completely honest, I don't see Italy as a problem. I see it as an opportunity. We will fix Italy. Now fixing Italy in itself doesn't create a further opportunity. Fixing Italy gives us a basis to explore Italy, where we are only playing in half of the market, where the margins are the best in all the markets we play, where the market is fragmented with multinational companies not doing terribly well, because they don't know how to play in this country. So, if we can do more in Italy, it will be a source of growth for us. So, in some roundabout way, I would want to add, in addition to growing in Eastern Europe, I think Italy will be an engine of growth for us in the future.

Paul Hickman (Edison): Thank you. Paul Hickman from Edison. Actually, three from me, if that's all right. As ever, I think one of the most fascinating slides here was slide 12, where you look at the market performance compared with competitors in Poland, and I wonder if you would like to comment on the price actions at Roust in August and September? And also your comment that you intend to follow a rational policy – did that imply that you think their policy is irrational?

Second point was on the slight loss of value market share in Czecho. Could you define that a bit further? I wonder to what extent is that mainstream vodka, to what extent is it herbal bitters, and also directionally, to what extent was it linked with the earlier promotional issues?

And the third point is, how would you define an inefficient capital structure?

Mirek Stachowicz: I'll take the first two, and I'll ask Paul to answer the second. So, speaking of the pricing, I commented on us being rational because we believe, within our strategy, it makes sense. You can see the trending here. I think we have a very stable pricing policy, and the price position we find ourselves in at the end of this period is pretty much the same as at the beginning of this period.

I also commented on Roust pricing being first time ever above all others. Well, I think we need to report to you on this. I'm not holding out great hope that things will change rapidly. Don't forget, this is the chart to the end of September, and it is the fourth quarter, usually, when things begin to happen and go out of sync with the previous months as pressure increases on suppliers like us to make deals at the end of the year with big customers. I believe we will continue to be rational in this respect because of the fact that change of the year makes us less resistant to this pressure. So we will be following our pricing policy even more than before. I think that the overall message on pricing is, it is very relevant. It represents an upside rather than a threat, because, as we try to emphasise, we have set our strategy with an overriding objective of not being sensitive to pricing in mainstream. And I think the performance to date shows that we have found a way in which, whether pricing in mainstream improves or doesn't improve, we do deliver our strategy.

And the second question was about Czech and the slight decrease in market share. It's exclusively coming the decrease in the herbal bitters, where we have launched Black Fox and it has gained – for a new brand, it rapidly grows market share, because it's a new-to-the-world brand, so it takes a lot of effort to introduce it. We are also doing this deliberately through on-trade channel, because we want the advantage of this brand to come through. The advantage is taste profile. It much better fits the needs of millennials, and we can see that, in the outlets where it's sitting next to the key competitor, which is Jägermeister, it outperforms Jägermeister on the basis of its superior taste. I don't have a problem talking about this, because I know Jägermeister will never vary the taste of their global brand, and that's the advantage of having a local brand. You can better fit it to the needs of consumers.

So I think it exclusively comes from this. We are doing very well in the other product categories. In vodka, we are doing also well – it is helped by the brand that we acquired two years ago, Pražská. It's performing very strongly.

And the capital structure?

Paul Bal: Yeah, thanks. Thanks, Paul. Let me give the short answer first, and then back it up with the basis for the answer. So I would consider an inefficient capital structure for us if our leverage were to go below half, roughly speaking. And that's consistent with what I've said in the past, when asked – that the sort of range at which I would want to sort of keep to is somewhere between half and one and a half. I think that's appropriate for our business. I would definitely be sort of monitoring things if I was above one and a half. Certainly wouldn't feel comfortable going to the sort of peer group levels, which are sort of north of two, right? Now, what sets that sort of framework for me is looking at the markets in which we operate, the models with which we operate, and our strategy and how we, and the funding requirements of our strategy. I also take into account the competitive environment we're in, and remember, Poland remains very competitive. I also take into account the fiscal environment, and also I take into account the macroeconomics as well. So, taking all of those in, that's the framework under which I would look at sort of our capital efficiency.

Damian McNeela (Numis): Damian McNeela from Numis. Just on the charts on page 12, it stops at the end of September. Can you give us an indication of what pricing has done in the last couple of months? And I appreciate your comments around about the end of the calendar year being where the pressure is. Can you sort of provide us with some colour as to how the Polish pricing market looks at the minute, please?

Mirek Stachowicz: Certainly. Should I take this? We've seen the open data for the following month, and we have seen the trend continuing, in both respect to Roust and Marie Brizard. I think Roust, in October, has been behaving in line with this, so they have not done any irrational behaviours. Marie Brizard is going through a significant period of significant change and disruption, and they have responded by, as you can see from this chart, changing the distribution arrangements in Poland, where they are again going to the market through a number of wholesalers instead of just one. And they have also started driving pricing down from August this year, and that, the price, this price level continues. I think it's quite important for them to show change in their position in Poland, hence the radically low pricing in this segment. Don't forget, it is mainstream, yeah? It's the mainstream category where this is all happening. In other categories, we see none of this. So overall I think that I would expect Marie Brizard, under new management, to re-examine its position and to start thinking a bit longer-term on the position in Poland.

Damian McNeela: Thank you. On Italy, I appreciate what you're saying about the sort of multi-year process of fixing Italy, and you don't really regard it as a problem. In terms of EBITDA contribution, though, to the group, do you think we've reached the trough in EBITDA contribution from Italy, or should we expect it to recover, or just stabilise it at current levels?

And then, just a last one on M&A strategy. You indicated that the primary focus is on core markets. Are there any sort of markets that you would highlight as being particularly attractive outside of your core markets that you might consider?

Mirek Stachowicz: Right. So, on Italy, I would prefer not to do any, make any forward-looking statements. But rest assured, if we are optimistic about the future, we will do what's right in Italy, whilst continuing to grow the group overall. I think Italy is, we have various ideas what we can do in Italy, and we know we are going to try them all. We are talking about multi-year investment, because we are going to find a way into Italy in most efficient type of way, but it will require investment.

And geography. Well, the most attractive markets are the ones we are in. I think we are looking also currently, there are opportunities in the Balkans where there is strong brand recognition of our brandy. And the success we have in Croatia after relaunch shows its potential in other parts of the Balkans. And we have already communicated we are changing route to market in Germany. Germany is a very interesting market for us, because strong vodka consumption and large Polish minority, so we want to capitalise on this.

Also, our Italian brands represent very interesting opportunity, and overall I think that the Italian brand portfolio is a very interesting opportunity to penetrate internationally, you know. In the UK alone, if memory serves me well, there's about a million Poles, about 600,000 Italians. 3,424 Italian restaurants in this country, if memory serves me well, which represents an opportunity for us, yeah, because we have true heritage Italian brands. Now, UK is not our primary focus, precisely because the size of opportunity somewhere else is bigger, but we will come to that as well. As we grow stronger, I see opportunity to internationalise our local brands more, but we will not do this in a way that big global multinationals do that, yeah? We are going to tap into the heritage of brands and look for niche positions.

Doriana Russo [?] (HSBC): Doriana for HSBC. I've got a couple of questions, if I may. Firstly, on M&A, you said that your principal criteria is to find something that fits with your existing brands and your existing markets. But what is the underlying financial criteria that you're trying to respect? I mean, in terms of return on invested capital, payback? I mean, just give us an idea of what are the financials criterias that drive your decisions-making.

Secondly, in Poland, we're all pleased to see that there is some stabilisation in pricing. With the premium strategy working quite well, at least given the first signs, isn't the opportunity now to try and be more – I mean, what I'm trying to say is, like, the EBITDA margin target that you have declared of 26 to 27 is still well below what the historical margin was. Is there a sign that perhaps you want to stay aggressive and invest more behind your brands, or is that a target that could potentially go back to historic levels if the condition allow in terms of pricing?

And one more, if I can. I said two, but it's actually three. Italy, which is my own country, you are very well known in a category which is in decline – in sharp decline, and this is inherently what is impacting you. What is your patience in terms of investing behind a declining strategy to try and turn it around? Are you going to look for a multi-year, which means two or three years, or are you tied to the market and therefore – you know? I just want to have a sense of what sort of idea you have in mind in terms of trying to find the fruit of what you're doing.

Mirek Stachowicz: Would you mind –

Paul Bal: Yeah, I'll –

Mirek Stachowicz: – taking the first one?

Paul Bal: Yeah, I'll take the first – happy to take the first two.

Mirek Stachowicz: All right, fine.

Paul Bal: So the first one, in terms of sort of what are we looking for in terms of the financial metrics. Doriana, the metrics and what we're looking for are going to vary deal by deal, right? And great examples, you know, if you look at the two deals that have been done in the past – 2016, we acquired some brands, a very quick payback and a good contribution to the Czech business. We did the deal in 2017, we took a stake in Quintessential. This was going to start paying back from year four. So, very different sort of metrics. But what we have said when we sort of reiterated the strategy at the beginning of this year was that we will be looking for synergies first and foremost, and the ability to realise the synergies, yeah? So that, if there's one thing which is sort of common to it all, you know, classic M&A, we will be looking for sort of synergies and the early realisation of synergies. But in terms of payback, that's going to depend on the size of the deal and the nature of the deal, whether it's a business, whether it's brands, and the size of the deal as well, all right?

In terms of the guidance in terms of the Polish EBITDA, the Polish EBITDA guidance has been there as we started the process of recovering in that business. And I think you actually said it in the question itself, that, you know, it's pricing which will really move us, in a paradigm way, beyond the 26 to 27 that we're currently targeting.

Mirek Stachowicz: And on Italy, how much patience do we have? A lot of patience, I think. but it doesn't mean that we'll be pouring money into Keglevich flavoured forever. Now, don't forget, Keglevich flavoured is just part of Keglevich portfolio, so whatever we do in terms of advertising Keglevich flavoured has a spill-over effect on clear, and our performance in clear this year has improved significantly versus previous years because there was a spill-over effect and increased awareness, consumer awareness of Keglevich brands overall. So this has to be weighted against a declining category.

We believe that, with our massive share in this category, we need to test how much would it cost us to reverse the fortunes of this category. And the answer to this one is in two steps. One step is to increase awareness or rebuild awareness of the Keglevich flavoured vodka among its normal target consumer group, which is millennials. And that's what we have done in the first wave of investment. We are now looking to broaden the consumer base of Keglevich flavoured with reaching out to, with communication to consumers who would not consider using it, and to different consumer usages of this product. We are monitoring this very closely, because of the digital nature of the investment. We get almost instant measures of effectiveness of the campaign, and we will behave accordingly.

Now, the beauty of this situation is that we are not fixed, we are not tied to Keglevich flavoured. If we see that other investment in other brands that we have in Italy – and we have brands that are already experiencing success of Keglevich clear, and brandy, and Limoncello, which has a dominant share in its category. If we see that return from this is better than from Keglevich, then we will change the strategy. We want to fix the business. We don't – we are not married to Keglevich flavoured forever. It is a tool to achieve an overall objective of growing our business. The length? Multi-year means probably two to three years. First year is behind us.

I think that covers the questions, unless there are any more. Thank you very much for coming, and looking forward to seeing you again at the next announcement.

[END OF TRANSCRIPT]