



Financial Review

MANAGEMENT KEY PERFORMANCE INDICATORS	2018	2017	% movement
Volume (case equivalents)	8.4m	8.2m	2%
Presented in constant currency rates:			
Core revenue	£706.7m	£663.1m	7%
Brand investment expenditure	£125.7m	£120.2m	5%
Core contribution	£210.5m	£197.5m	7%
Presented in actual currency rates:			
EBITDA	£232.9m	£227.9m	2%
Profit before tax (pre-exceptional)	£196.5m	£189.6m	4%
Profit for the year (pre-exceptional)	£87.9m	£91.5m	-4%
Free cash flow	£91.0m	£98.3m	-8%
Net debt/EBITDA	2.3	2.1	
Return on capital employed	21.4%	23.2%	

STATUTORY KEY PERFORMANCE INDICATORS	2018	2017	% movement
Earnings before interest and tax	£210.5m	£207.1m	2%
Profit before tax	£194.7m	£189.0m	3%
Profit for the financial year	£86.6m	£91.0m	-5%
Total equity including non-controlling interests	£780.6m	£685.0m	14%

Volume

The total quantity of cases sold, where a case equivalent is measured as 12 70cl bottles at 40% abv.

Core revenue

Total revenue from sales of our branded products adjusted for the impact of foreign currency.

Brand investment expenditure

Advertising and promotional expenditure on our core brands, excluding discounts and restated to constant currency.

Core contribution

Profits from our branded sales and distribution adjusted for the impact of foreign currency and after the deduction of overheads.

EBITDA

Earnings before the deduction of interest, tax, depreciation and amortisation.

Profit before tax (pre-exceptional)

Profit before exceptional items and the deduction of taxation.

Profit for the year (pre-exceptional)

Profit after tax and minority interests excluding exceptional items.

Free cash flow

Net cash flow excluding the movements in borrowings, shares, dividend payments, expansionary capital expenditure and non-cash exceptional items.

Net debt/EBITDA

The ratio of Bank & Private Placement Debt at hedged rates where applicable after deduction of cash balances to reported Earnings before interest, taxation, depreciation and amortisation.

Return on capital employed

Earnings before interest and tax before exceptional items as a percentage of invested capital. Invested capital is defined as being total equity adjusted to remove balances relating to financial instruments, post-retirement benefit obligations, intangible brand values and net debt, along with any associated deferred tax asset or liability.

Constant Currency

For constant currency reporting the comparative information is stated at the average rates used in the current year income statement. This allows direct comparability of the underlying performance across financial years.



Financial Review (continued)

Group Financial Performance (stated on a constant currency basis)

This has been another strong year of growth and increased investment for the Group. Core contribution grew across all of our business units and all of our regions, we further increased the investment in our brands and the premiumisation of our business continued with 76% of core contribution for the year generated by our Premium products.

Core revenue

Core revenue grew by 7% to £706.7m as a result of growth in each of our three business units and the impact of a full year of trading of The Glenrothes, following the acquisition of the brand in April 2017. The growth in core revenue was faster than the 2% volume growth, reflecting an increase in the sales mix towards higher value products.

Brand investment

We increased our investment in brand-building marketing activities this year by a further 5% to £125.7m whilst also increasing the focus on Premium products, which increased by 18%. The investment behind The Macallan grew by 8% following the 28% increase last year, resulting in a 38% increase in the last two years.

Core contribution

Core contribution grew by 7% to £210.5m. The Macallan grew by 7%, Super Premium grew by 18% on a like-for-like basis, increasing to 36% with the inclusion of trading from The Glenrothes, and Regional Power Brands grew by 4% with another strong year of growth from Brugal. Performance of our Premium products was consistently strong across all our markets, while the Standard Blended Scotch category continued to be more challenging.

Statutory results (stated in actual currency rates)

Revenue

Statutory group revenue grew by 5% to £739.3m, at a lower rate than our core revenue as a result of an adverse impact of currency primarily driven by a weaker US dollar relative to the prior year.

Profit before tax

Group profit before tax has increased by 3% to £194.7m, this is lower than the 7% core contribution growth as a result of adverse currency movements, combined with higher interest costs on our debt which increased to fund the acquisition of Glenrothes and the continued investment in our asset base. Partially offsetting these adverse impacts is £4.6m of other finance income, this is an accounting adjustment required under IFRS for hedging instruments in our distribution network which do not qualify for hedge accounting.

Profit attributable to parent

The Group's effective tax rate for the year was 21% compared with a prior year rate of 17%. The primary driver for this was a £6.1m credit recorded in the prior year relating to future deferred tax rate changes, there was no equivalent in the current period. This, combined with higher levels of profit in higher tax jurisdictions accounts for the variance. Profits attributable to non-controlling interests are marginally up year on year due to the better trading result which results in net profits attributable to the parent of £86.6m, a 5% decline on last year.



Financial Review (continued)

Exceptional items

The Group acquired the remaining 50% shareholding in Edrington Webb Travel Retail during the year in order to take full control of Travel Retail distribution routes to market in the Americas. The acquisition generated goodwill of £1.8m. Consistent with the treatment of previous distribution company acquisitions, the company decided to write off the goodwill in the year and this is, therefore, shown as an exceptional item in the income statement.

Cash flow and financial position

Net debt at the 31st March 2018 was £573.3m, an increase of £39.3m from 2017. This increase is net of a £26.6m positive impact from the retranslation of our US private placement financing.

The increase in net debt reflects the significant investments made in the year. Greater cash inflows from the growth in trading were more than offset by increased investment in maturing whisky stocks, in cask assets and in the new distillery and brand home for The Macallan. Furthermore, we brought The Glenrothes back into our Premium portfolio by acquiring 100% of the share capital of BB&R Spirits.

The group is financed by US private placement notes and bank debt. The net debt to EBITDA ratio at 31st March 2018 was 2.3 times (2017: 2.1 times), comfortably within the limit of the bank debt covenant of 3.25 times.

The investment in the year is evident in the closing financial position of the Group.

Total assets increased by £233.9m to £1,904m. £70.5m of the increase was in property, plant & equipment, primarily reflecting the new Macallan distillery and additional cask purchases. £16.5m was an increase in intangible assets, principally related to the acquisition of The Glenrothes. Inventories, of which maturing whisky stocks account for the majority of the value, increased by £63.7m as we invested for future sales growth.

Total liabilities increased by £138.3m to £1,123.4m, £101.3m of which reflects the increase in borrowings to finance the investments undertaken.

Post-employment benefit obligations

The Group operates two defined benefit pension schemes for employees of its principal UK subsidiaries, which have been closed since 2014. The post-employment benefit obligations related to these schemes, as calculated in accordance with accounting standards, moved from a £6.3m liability at 31st March 2017 to an asset of £19.4m at 31st March 2018. This reflected contributions of £14.0m made by the Group during the year as well as a positive return of £4.4m on the schemes' assets. Changes in the demographic and discount rate assumptions reduced the present value of the schemes' liabilities by £9.2m.

While this surplus position reflects the required accounting treatment for the post-employment benefit obligations, on an actuarial basis, the defined benefit schemes are in deficit. At the 31st March 2018, the deficit was valued at £91.7m. As such, the Group is committed to making annual deficit reduction payments of £14.0m until 2026.



Financial Review (continued)

Derivatives and financial instruments

The Group uses derivative financial instruments to hedge its exposure to fluctuations in foreign exchange and interest rates. The fair value of these instruments at 31st March 2018 is included in the Statement of Financial Position.

Assets of £26.8m (2017: £44.9m) related primarily to cross currency swaps. These are used to hedge the value of our private placement debt which is denominated in US dollars. At the prevailing year end rate, the value of the asset reduced relative to the prior year, in line with the reduction in the value of the debt included in our borrowings position.

Liabilities of £4.6m (2017: £26.9m) principally reflect the fair value of forward foreign exchange contracts held at the 31st March 2018. The liability reduced from the prior year in line with the movement in the year end exchange rates on our key trading currencies which we hedge on a rolling 24-month basis.

Share capital and dividends

Dividends for the year amounted to 40.2p compared with 38.1p in respect of last year.

A first interim dividend of 12.0p (2017: 11.8p) per share was paid on 10 November 2017. The directors proposed a further interim dividend of 28.9p (2017: 28.2p) per share which will be paid on 13 July 2018.

Summary

The Group has enjoyed another year of strong growth and has further strengthened its financial position in an increasingly competitive marketplace and in the face of on-going economic and geopolitical uncertainty.

We have confidence in our premium brand portfolio to deliver further growth over the long term and continue to increase investment in our brand building capability and infrastructure to support that ambition.



Financial Review (continued)

Principal Risk and Uncertainties

The responsibility for risk management and internal control systems resides with the board, with a framework to support the process for identifying, evaluating and managing financial and non-financial risks. The Audit Committee is responsible for the direct oversight of the Group Risk Management Committee and the internal control function.

Edrington's risk management processes minimise its exposure to unforeseen events and identified risks, allowing the business to focus on delivering its strategic objectives.

The board carried out a triennial strategic risk review in March 2018 to help update the principal risks facing the Company including those that would impact its business model, future performance and solvency. These reviews allow the board to assess the Company's risk appetite and ensure that the nature and extent of the significant risks facing the business are identified and adequately managed. In line with best practice, the assessment includes a review of the impact and likelihood of each risk, together with the controls in place to mitigate the risk.

Risk categories are predominantly macroeconomic or operational in nature. Macroeconomic risks relate to the external environment and the international markets in which Edrington operates, over which the Company has less control. Operational risks include issues such as product quality, supply chain, or failure in business technology. The environment in which Edrington operates is becoming increasingly volatile and constantly evolving, so the Company will remain vigilant to be sure that new risks are identified and assessed timeously, and that appropriate actions are taken to mitigate the impact of these risks on the business.

During the year the Audit Committee reviewed reports received from the internal audit teams. These have allowed the committee to assess the general control environment, identify control weaknesses and quantify associated risks. Moving forward greater emphasis will be placed on reviewing status of actions taken to mitigate these risks.

The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only therefore provide reasonable assurance against material misstatement or loss.

The following represent what the board believes to be the most important risks and uncertainties that may impact the Company's ability to deliver its strategy effectively.



Financial Review (continued)

Identified Risk	Impact	Mitigating Actions
Adverse political and social attitudes to alcohol	<p>Damage to the reputation of Edrington or its brands.</p> <p>Impact on market access or the ability to promote its brands.</p>	<p>Edrington supports a responsible approach to alcohol and considers this a core element of its strategy to grow a sustainable, long-term business. The Company operates a CSR strategy that includes a Code of Conduct and a global Marketing Code reinforced by a global online training programme.</p> <p>Edrington's policies and campaigns are reviewed annually by the Marketing Code Committee.</p> <p>Edrington is a member of national and international organisations that work to encourage the responsible promotion and consumption of alcohol and reduce alcohol-related harms.</p>
Geopolitical and Economic Conditions	<p>Economic or political instability restrict market activity, affecting market access, demand or increased costs.</p>	<p>Brexit and geopolitical instability in a number of regions and markets continues to present a risk to trade and profitability. We are monitoring all developments closely but future trading relationships with the EU etc. are ultimately matters that are outwith our control.</p> <p>Edrington's diverse geographic spread reduces the exposure to specific market risks. Direct ownership of the Company's route to market in its major markets provides local insight combined with a robust central overview. This enables the Company to react quickly and flexibly to such changes.</p>
Consumer Preferences	<p>A change in consumer preferences for one or more of Edrington's brands in one or more key markets where a decline in brand popularity and/or market contraction would result in a reduced share of market.</p>	<p>The board closely monitors financial and operational key performance indicators which include a review of brand performance and equity strength across market segments and geographies.</p> <p>Edrington conducts an annual market and brands strategic planning process building on local market and brand strategy reviews. The board has also recognised the differing contribution and strengths of each of its principal brands globally and regionally and has strategically focused management across its luxury, Super Premium and Regional Power Brands, which have different needs and focuses.</p>
Brand Protection	<p>Ineffective or inadequate protection of intellectual property rights, resulting in reputational damage, an increase in counterfeit goods and a drop in sales volumes and/or market share.</p>	<p>The Company invests considerable effort in proactively protecting its intellectual property rights. Edrington has a clear brand protection strategy and processes aimed at addressing the principal exposures and risks likely to affect alcoholic beverage brands. A specialist Brand Protection Committee reviews the principal components of brand protection: intellectual property management; authentication and security technologies for products and packaging; digital media, channel and communications monitoring; products and packaging compliance; commercial behaviours, alongside brand security education, surveillance and enforcement.</p>



Financial Review (continued)

Identified Risk	Impact	Mitigating Actions
Regulatory Compliance	Failure to comply with local laws and regulations, resulting in regulatory sanction, reputational damage and/or financial loss.	<p>Edrington has a management process to ensure that employees are aware of their responsibilities and all applicable regulatory requirements. Formal training sessions are undertaken throughout the year.</p> <p>Edrington proactively reviews its principal regulatory compliance obligations and controls, including, but not limited to, the new data protection regulations, competition laws, liquor laws, environmental laws, compliance with EU and UN trade and political sanctions, and local statutory laws (e.g. health & safety).</p> <p>These activities are underpinned by a Code of Conduct, a Global Anti Corruption Policy, and a Speaking-Up Policy which apply to all its employees, agents, distributors, contractors and suppliers. Contractual arrangements with key third parties must include provisions to establish required performance standards aligned with the Code.</p> <p>Induction procedures include evidenced completion of a standard on-line training course and assessment which covers the Code and its supporting policies. The course, which is translated into all the main languages spoken across the Company, is also periodically refreshed and retaken at all locations.</p>
Financial Risks	Exposure to market risk (including medium term movements in exchange rates, interest rates risk and commodity price risk), credit risk and liquidity risk, may adversely impact on profits.	<p>Financial risks are reviewed and managed by the Treasury Committee whose remit and authority levels are set by the board. The Treasury Committee's remit is to ensure compliance with the terms of borrowing facilities and to minimise financial risk arising from exposure to fluctuations in interest rates, foreign exchange rates and cash flow. Comprehensive policies are applied covering debt management, interest rate hedging, foreign exchange currency hedging and cash flow reporting. Approved financial instruments and authority levels are articulated through the policies with compliance monitored on a regular basis.</p> <p>The Treasury Committee reviews cash flow forecasts throughout the year and assesses headroom against banking covenants regularly. The Finance team utilises external tools to assess credit limits offered to customers, manages trade receivable balances vigilantly and takes prompt action on overdue accounts. Certain markets operate on a cash-on-delivery basis.</p> <p>Commodity price risk is managed through a combination of medium to long term contracts, covering periods from 2-3 years, and regular tender and review processes with suppliers.</p> <p>Edrington's financial control environment is subject to review by both internal and external audit. The focus of internal audit is to proactively work with and challenge the business to ensure an appropriate control environment is maintained.</p>



Financial Review (continued)

Identified Risk	Impact	Mitigating Actions
Cyber	Theft, failure or corruption of digital assets and/or key systems could have an adverse impact on the business and profits.	<p>Led by our business technology function, the business has carried out a business wide information risk management review, enhanced by its cyber incident response plan, and implemented a user awareness training and education programme.</p> <p>Edrington has also increased system patching, updates and monitoring, carried out penetration testing, performed a SAP System User Role Review to eliminate excessive access and segmented the network to protect mission-critical networks from general access networks.</p>
Major Operational Failure	Major supply chain failure affecting supply of raw materials or equipment, loss of maturing inventory or the customer orders process.	<p>Assets managed by the business include intangible brand assets, plant and equipment, people and business technology. Disaster recovery, incident management plans and contingency measures are in place and tested regularly.</p> <p>Edrington's wood and cask supply is reviewed and long-term agreements and processes established to provide reasonable assurances of a sufficient and sustainable supply of casks that meet Edrington's high quality requirements.</p> <p>Contingency bottling/blending options are refreshed and tested to ensure that Edrington's operations can be maintained in event of loss or impairment of its own facilities.</p> <p>Energy and water supplies are reviewed to ensure continuity, sufficiency and quality of supply. A contract to supply renewable energy to The Macallan distillery over the long-term, contributes to fossil fuel reduction targets.</p>

Approved and signed on behalf of the board

Paul A Hyde
Chief Financial Officer

15 June 2018