Strategic review

Chief Executive Officer's statement

Having been appointed to the role of CEO for the Group during 2016, I am pleased to be presenting my first CEO statement.

We have, I believe, successfully navigated a challenging year for the Group. The key priorities during the year have been the turnaround of the Polish business and putting the Group back on track to deliver the strategy agreed at the time of the IPO. We have made tangible progress on both of these key priorities.

Since my appointment as Interim CEO in April, I have committed the majority of my attention to the turnaround of our Polish business. Additionally, I implemented a number of initiatives, in order to accelerate change across the entire Group. These included development of people capability, organisation structure review and strengthening of management processes; review of the UK Head Office; detailed review of the Group cost base; revision of the new product development (NPD) processes; product range reduction across all the markets (SKU rationalisation); reduction of waste through operations efficiency; and revenue growth in key profit pools through distribution agreements. All of these projects have yielded positive results during 2016, with further benefits to accrue in 2017.

Group financial performance

We have recorded full year volume of 12.3 million cases. We have recorded growth in both volume and net sales revenue. Full year volume of 12.3 million cases is 0.5 million cases, 4.2%, ahead of 2015, whilst net sales revenue has recorded a 1.2% increase to €261.0m (on a constant currency basis).

Adjusted Group EBITDA is €51.5m in 2016. Whilst this is below the result of last year, removing the net impact of one-off items (CEO pay in lieu of notice, CEO recruitment, NED recruitment, additional AGM costs, closure of Swiss office and PSP adjustments) would result in a reported adjusted EBITDA of €53.0m.

The profit for the year is €28.4m, a significant increase versus 2015 of €19.4m.

Our cash flow generation is a key focus area for the business and remains strong. Against our commitment to return 100% of net free cash flow to shareholders for 2016, this will result in dividends totalling €39.2m being paid to shareholders in respect of 2016.

Taking into consideration our small acquisition in the Czech Republic of €5m, as described on page 12, our year end net debt was €59.7m, versus €57.2m at the end of 2015.

The Group retains very strong liquidity, significant headroom in our borrowings and a robust balance sheet, providing us with the financial strength to take the business forwards.

Polish 'root and branch' review

To reiterate elements I presented at the half year and the progress we have made in the second half of the year, here is a summary of the actions taken in 2016 against the outputs of the root and branch review. Further detail is given later in the regional review covering Poland:

- We have reallocated internal marketing funds (previously allocated to new product development) across the Group to fully support pricing of our core brands, principally Żołądkowa de Luxe, particularly in the important Traditional Trade channel to make them more competitive
- We replaced the entire senior Polish management team with external hires in the course of 2016. The one exception is the Marketing Manager role, where an internal candidate is currently undertaking the role

Chief Executive Officer's statement continued

- We changed the way in which we build capability in the salesforce. We recruited externally experienced sales personnel to increase our capability in the second half of the year. We also recruited externally the Senior National Key Account Manager and brought in-house the Category Management specialist role, rather than rely on third parties
- We have refocused the sales force to concentrate on the customer relationships with the wholesalers, who supply the Traditional Trade channel, by using more effective promotional tools and implementing new pricing architecture that is expected to reduce channel conflicts between the Traditional and Modern Trade channels
- We adapted our route to market by aligning the sales force with the smaller purchasing groups for the Traditional Trade, which are growing in importance in this market. We have also managed to increase the number of sales calls made by sales people by changing the sales force priorities and redesigning sales routes
- We altered sales force incentives to better align the sales force activity with the financial performance of the Group
- We have created a sales analysis team and initiated the implementation of a new Salesforce Automation System, to be fully functional by the end of H1 2017
- We signed a new distribution agreement with Synergy Company for the ultra-premium Beluga vodka collection and extended the agreement with Beam Suntory (for more detail, see 'Targeting growing profit pools with distribution brands' section on page 13) increasing our presence in the important premium segments. Leveraging this, we have significantly strengthened the position of our own brands, Amundsen Expedition and Stock Prestige, in these fast growing segments. Consequently, we were the fastest growing major player in these segments and I am very pleased to report that Stock Prestige again became a millionaire brand.

Work continues to fully implement all of the initiatives from the root and branch review. The actions taken so far have only been in place for part of a year, and I am confident that with the changes in place for a full 12 month period the benefits will be considerable in 2017.

Other markets

In the Czech Republic, we completed the recruitment of the Senior Management Team (MD, FD and Sales Director) and the team have been in place since the early part of the year. Our Božkov brand is the single largest spirits brand in the Czech Republic commanding 54%[1] market share in its category. As a major brand leader, it was facing increased price competition and the entire category risked commoditisation. We took the decision to launch a new variant called Božkov Tradicini, and reposition the old product under the name Božkov Original. This has increased our consumer offering and, in turn, has supported the premiumisation of Božkov Original. Although this has resulted in a decline in overall market share, this has been more than offset by an increase in overall value and profitability of the brand. Also, to capture further share of the rum category, we launched a new white rum variant under the Božkov brand.

The expansion of our Božkov portfolio places the business on a firm footing going into 2017 and we were delighted to receive the accolade of "most trusted alcohol brand" for Božkov in a massive independent consumer survey.

Our financial results for Czech support the actions we have taken with a growth in EBITDA of 6.0% to €19.6m.

Our Italian business has made progress and grown share in both limoncello and brandy[2] categories through targeted promotional activity. Although we have also grown our share in the important flavoured vodka, category this is against the backdrop of significant decline in this category[2]. A review is underway to consider all the opportunities to arrest this decline. We re-tendered our logistics services in Italy and

implemented a successful change of provider at the year end, which will deliver cost savings in 2017. The decline in flavoured vodka has impacted the results of this market and we have recorded a reduction in EBITDA during 2016.

The team in Slovakia continue to make good progress and record growth in profit and market share. The business has overseen another successful year for the Golden brand, supported by the new products launched in the last two years. Furthermore, new variants added to the Fernet range during 2015, have continued to grow the brand equity of this leading bitters brand.

Our international markets and export operation has also recorded good profit growth during the year, and continues to benefit from the Beam distribution contracts in Croatia and Bosnia, which have facilitated the launch of Amundsen Expedition vodka in these markets during 2016.

Progress towards strategic goals and M&A

As set out in the Chairman's statement on pages 5 to 7, we continue our focus on the tenets of the strategic review undertaken in 2015 (see box).

It is worth emphasising that expansion within Central and Eastern Europe outside our existing geographies remains part of our strategy, but is not a priority at this stage.

In line with this strategy, in October we announced the acquisition of the spirits business comprising Nordic Ice vodka, Pražská vodka and Dynybyl gin from Bohemia Sekt s.r.o. This was our first acquisition since we listed on the London Stock Exchange and is a positive step forward for Stock Spirits. The brands and production are being integrated into our existing portfolio in the Czech Republic, and strengthen our positions in the vodka and gin categories. The rationale for the acquisition was to gain further access to the growing vodka category in Czech with established brands. All the synergies, generated primarily from production and procurement efficiencies, will be reinvested behind the brands, and therefore the contribution from these brands is not expected to be material in the short term.

The strategy for growth that we are pursuing has six key, interlocking aspects:

1. Further develop the Group's strong brand portfolio in current markets
2. Continue to invest in attractive markets with strong growth potential
3. Utilise purchasing and production capabilities to deliver quality products with a competitive cost advantage
4. Expand distribution capability in current and new markets
5. Continue to invest in people and develop management talent
6. Pursue the significant opportunities for acquisitions across Central and Eastern Europe.

People, organisation and team engagement

Whilst David has mentioned the changes at Board level in his statement, during 2016 we have completed the appointment of the full Senior Management Team in Poland. We now have on board, Marek Sypek as Managing Director, who has a great track record in FMCG and Private Equity and Piotr Dziarski as Sales Director, who has specific alcoholic beverage industry experience in Poland. Both were appointed in June 2016. Earlier in the year saw Bradley Holder appointed as Finance Director, with experience in Poland at both Coke and Pepsi, and later in the year we appointed Jagoda Palider as HR Director, who joined us from TJX Europe in the UK.

1. Nielsen, total Czech Republic, total off-trade, total spirits, MAT volume December 2016
2. IRI retail sales data, total Italy, total modern trade and discounters, total spirits, MAT volume December 2016

Chief Executive Officer's statement continued

With the appointment of new Managing Directors in Czech (Jan Havlis), in early 2016, Italy and International (Michael Kennedy in 2015) we have completed the task to appoint very capable Managing Directors to all markets.

Shortly after taking the role of Interim CEO, I undertook a review of the organisation structure and concluded that the current size of the Group, and immediate priorities, did not warrant the role of COO. The role was therefore made redundant, and Ian Croxford, who had undertaken the role for the past nine years, left the Group. I would like to thank Ian Croxford for his service and wish him well for the future.

We have made further changes to the organisation in 2017, to simplify the business, transfer activities from our Head Office to the markets and deliver savings. Logistics and Customer Service are now integrated within local market teams (previously part of Group operations), and we have restructured the commercial operations in Italy and the UK.

Restructuring opportunities to simplify, de-layer the business and empower the key employees will remain my ongoing focus as I see this as a key competitive advantage in the future.

I have made a number of changes that have allowed executives to make more, and faster, decisions in their specific areas of responsibility. In a break from past practices, I ensured that the personal bonus objectives became transparent to all senior team members, shared among them and aligned towards the strategic goals. I radically increased the amount of interaction between the senior team members by changing the way we work. I believe these changes have improved the level of motivation and sense of ownership among the senior team.

One of the key reasons for unsatisfactory performance of the Group since the IPO was the senior management turnover. To ensure that senior management are motivated to deliver against the many challenges we face at a time of significant internal change, the Board has implemented new retention plans and reward mechanisms. These are based on restricted stock awards, in addition to the normal long term remuneration mechanisms, and aim to retain the key senior management and align their interests with shareholders.

Communications with shareholders

Following my appointment, I had conversations with all our major investors in excess of 30 meetings. I would like to take this opportunity to thank our shareholders for committing their valuable time to these sessions. Whilst I took careful note of all the feedback received during these meetings, it is my responsibility to strike the right balance among the diverse views and recommendations, putting them to the best use for the benefit of all the shareholders.

Review of the location and size of the Head Office

I instigated a thorough review of our Group Head Office, covering all aspects of its size, role, functions, location and tax implications associated with any relocation. The conclusion was that whilst the complete move of the Head Office to Warsaw would result in annual operating cost savings the return was not compelling, as only half of the savings would produce an attractive return within the next three years. This is due to the existing contractual arrangements, the regulatory environment in the UK and Poland, and the considerable tax risk, further exacerbated by uncertainty around Brexit.

Furthermore, the resulting business disruption and diversion of management focus that would arise from a relocation, given the loss of expertise with the need to recruit the entire Head Office and a large part of the Senior Management Team in Poland, would seriously compromise our ability to deliver our strategy, including the turnaround of the Polish business.

The outcome of the review was presented to the full Board in November and it was unanimously resolved to retain the existing Head Office in the UK, and continue to seek opportunities to deliver cost savings with attractive returns, but without compromising the ability of the Group to deliver its strategy.

Cost savings review

I initiated a number of initiatives to review the cost base across the Group.

In August, we announced the closure of our Swiss operation. At the time, we expected the savings from this closure to be €1.5m in a full year and we fully expect this saving to be delivered.

Across all markets there has been a focus on reducing our underlying cost base, with every opportunity taken to action cost savings. From a logistics re-tender in Italy, termination of consultants in Poland and a commercial reorganisation in Czech during the year, the cost base has been placed under intense scrutiny.

We have re-tendered all Group professional services, seeking opportunities to retain access to high quality professional advisors at a lower cost. For corporate tax, employment tax and internal audit we have retained the services of internationally renowned professional advisors with engagement now delivered via their offices in Warsaw, thereby reducing the blended hourly rates on these services going forwards. We have changed our providers for public relations, corporate website and professional advisors to the Remuneration Committee. We have renegotiated our service agreements for corporate law and company secretarial requirements. We also changed the provider for travel services and, coupled with a change to the travel policy for the Board and senior executive management, have already realised savings from this activity. As mentioned earlier, we have implemented further cost saving initiatives in early 2017, as this remains a key focus area.

Targeting growing profit pools with distribution brands

Working towards our commitment to strengthen our premium portfolio, in July we announced two new distribution partnerships, with the Synergy Group in Poland for the ultra-premium Beluga vodka collection and with Distell International in Italy and Slovakia for a number of their premium brands, including Amarula, Black Bottle and Scottish Leader. This objective was further endorsed later in the year with the extension of the Beam Suntory agreement in Poland, which sees an expanded portfolio of premium spirits including some of the world's most sought after Japanese whiskies.

We continue working on other distribution opportunities in the market segments and geographies that are of high interest to us strategically.

New product development (NPD)

Given the very high number of new product launches in 2015, and the need to focus upon implementation of the root and branch initiatives in Poland, we slowed down the pipeline of new products being launched in 2016. This allowed us to embed the successful brand launches from 2015, and focus the 2016 new product activity around core brands and premiumisation opportunities. Marketing funds specifically planned for other new product launches were reallocated to provide support for the core brand pricing initiatives in Poland.

NPD was an area where we suffered a setback in the last year, when we had a dispute over the Saska brand's intellectual property rights, due to mistakes made in the product launch in 2015. This prevented us from utilising the full portfolio of our flavoured vodka and vodka-based liqueur brands including Lubelska, Żołądkowa Gorzka and Saska to deliver their full potential in Q4. Nevertheless, we managed to keep the leadership of the flavoured vodka category and, by February 2017 the situation with Saska was resolved. With Saska now firmly back on the market, we can now focus upon the development of our flavoured vodka portfolio.

Chief Executive Officer's statement continued

Partly to prevent such mistakes from happening again, we carried out a complete review of the NPD process. The primary objective was to ensure there is a good balance between satisfying changing consumer needs, sales force priorities, as well as internal supply chain and inventory efficiencies. Historically, this balance hasn't always been delivered. I believe that the process going forwards will produce more targeted innovations and reduce our obsolete inventory provisions, which in the past three years significantly impacted our financial results.

Operations efficiency

I have implemented a review of the processes for demand planning and inventory management in order to focus on eliminating waste. This included the roll-out of an improved sales and operations planning (S&OP) process across the Group and a comprehensive stock keeping unit (SKU) rationalisation project. As a result of the latter, we have ceased production of a significant number of under-performing SKUs. This initiative is expected to have a negligible effect on our future contribution margin but, importantly will improve supply chain planning and inventory efficiency. Positive results have already been generated, with a reduction in year-end inventory compared to the prior year of €6m, despite growing sales volumes. I expect this review to deliver more benefit in 2017.

2016 saw more focus on IT projects, including the implementation of a Group-wide single network and a strengthening in our cyber security environment, achieving the UK Government Cyber Essentials Scheme certification.

Other IT investments included the automation of our Customs registers and a new warehouse management system in Poland and in Italy, a new integrated electronic data interface (EDI) to our new logistics provider and a sales force customer relationship management (CRM) solution.

For the future, I see IT as an important element within our businesses and we will invest more in this area than historically.

During the year, we completed our investment in production flexibility capability at our plant in Lublin as well as investment in our infrastructure specifically targeting health and safety initiatives. Our manufacturing base is well invested, and I expect that we will only continue to invest in maintenance and health and safety initiatives.

Outlook

Since taking over as CEO I have pursued an intensive agenda of change. My focus on Poland continues unabated, and will remain so until I am happy that the business is able to deliver sustainable top line and profit growth. The focus in 2017 will continue to be on the turnaround of the Polish business and making sure that the Group delivers on its strategic objectives. To facilitate this, we will remain focused on delivering cost savings, driving profit and cash and developing our people to build a highly motivated team.

I believe the business is in a much stronger position than it was 12 months ago. Whilst I don't underestimate the size of the task we face, we have already implemented some very difficult decisions and delivered positive results from the actions we have taken, so I am confident in the future of the Group.

My confidence is further reinforced by the fact that the bulk of the work we have completed so far was put in place during the second half of the year, with some of the key initiatives only coming on stream in Q4 2016 and Q1 2017. More importantly, the new management teams in Czech, and especially Poland, are only now emerging from their inevitable team-building processes and will show their full potential in 2017. I look forward to working with them, and the entire team, to meet expectations of the stakeholders of the Stock Spirits Group.

Mirek Stachowicz
Chief Executive Officer
8 March 2017

1. Nielsen, total Czech Republic, total off-trade, total spirits, MAT volume December 2016
2. IRI retail sales data, total Italy, total modern trade and discounters, total spirits, MAT volume December 2016