Endeavour Group Limited, H1 2024, Earnings Call 2024-02-25

Presentation

Operator

Thank you for standing by, and welcome to Endeavour Group's half-year 2024 results briefing.— ***Operator Instructions*** —

I'd now like to hand the conference over to Mr. Steve Donohue, CEO. Thank you. Please go ahead.

Steve Donohue

Thank you. Good morning, everyone. Thanks for joining us for Endeavour Group's results announcement for the first half of F '24. I'm Steve Donohue, Managing Director and CEO of Endeavour Group and I'm joined today by our Chief Financial Officer, Kate Beattie.

I'd like to start today by acknowledging the Gadigal people as the traditional custodians of the land on which we're gathered and pay my respects to their elders; past, present and emerging.

I'll start on Slide 5 and before I step through the details of our results, I wanted to refer you to our vision to be the leading platform enabling social occasions and remind everyone of our 5 strategic pillars. These 5 areas represent the key input elements of our new shareholder value scorecard, which we presented to the market at our Investor Day 2.5 months ago.

We remain committed to delivering on the aspirations we outlined back in December. And we'll provide a more detailed unpack of our progress at the full year. Today's update centers on how we combined our unique assets and capabilities to meet the changing needs of customers while delivering for shareholders in the first half.

So on to Slide 6, which covers our performance highlights for the group. In H1, we delivered what we view was a resilient performance, particularly given the changing nature of pressure on customers and the impacts of inflation on our operations. In a half where demand became more variable, the team delivered sales growth across both the retail and hotel segments.

Our focus on delivering value to customers across all of our businesses drove outsized performance in key events such as Cyber Week, Christmas, and New Year's Eve. We managed to deliver EBIT growth slightly ahead of sales through a dedicated focus on cost optimization and continued investments to improve gross margin.

As previously indicated, higher finance costs have impacted net profit. Importantly, we continue to generate strong underlying cash flows with a cash realization ratio of 140% for the half, enabling us to continue to invest for growth while also delivering a half year dividend of $0.143 per share, which is in line with the prior corresponding period.

So now looking at our retail performance. Total retail sales were up 2.5%. Sales for Dan Murphy's and BWS were up 2.9% for the half, with their sales accelerating in the second quarter to a growth rate of 3.2%. Pleasingly, we also saw online sales and profitability increase, supported by a pickup order mix of about 50%.

Through the half, we maintained our focus on price leadership and delivering value for customers. We continue to closely monitor customer sentiment through Voice of the Customer, which remains strong overall, including on the topic of value for money.

During the half, transaction levels remained stable with overall basket values growing through mix and pricing more than offsetting a reduction in items per basket. Cost of living pressures and changing customer tastes resulted in a more pronounced mix movement in some categories.

Australian sparkling wine benefited from reduced demand for French champagne. — ***Indiscernible*** — also saw more refreshing styles of beer, such as Largo, which is growing at the expense of craft beer. The explosion in demand for lemon-flavored beverages also played out in the half as customers continued to embrace new and trending products that were generally lighter and/or fruitier. We arranged over 1,000 new products in H1, of which over 60% were sourced from smaller suppliers.

Now, looking at Dan Murphy's first half highlights in a little more detail. With customers focused more than ever on value, we invested to increase our price leadership. Dan Murphy's sales performance benefiting from it's; lowest price guarantee with the average discount to competitors growing during the half. Dan Murphy's also strengthened its position as Australia's preferred drinks destination for events through the festive season with targeted promotional planning and outstanding execution by the team delivering our best Christmas ever.

Across all Dan Murphy's sales strategies are underpinned by our focused customer engagement and the My Dan's membership program which grew to 5.4 million members at the end of 2023. We also continue to grow the Dan Murphy store network, opening 4 new large-format stores in the half.

Over to BWS on Slide 9. In the half, BWS reinforced value for customers through the new A Win's a Win' brand campaign, highlighting everyday saving opportunities. This, combined with a highly successful brand relaunch, which included activations such as the BWS CoolRoom Concert Series, saw BWS achieved double-digit sales growth with GenZ customers.

We continued to invest in expanding our portfolio of stores, and there were 12 net new stores opened in the half. With 1,447 BWS stores serving communities around the country, BWS remains Australia's most convenient liquor store network. As with Dan Murphy's, BWS also saw profitability in online channels increased in the half, driven by efficiency initiatives and enhanced customer convenience through expanded delivery options.

Now on to some highlights from the Pinnacle business. In the half, the quality and value delivered by our range of exclusively sourced and manufactured products was appreciated by 7 out of 10 of our retail customers. Towards the end of F '23, we added Margaret River's Cape Mentelle to the Paragon Wine Estates' portfolio of luxury brands, so the team focused on that integration in half 1.

In the meantime, Pinnacle wines continued to be recognized with industry accolades in the half, including 15 trophies and 96 gold metals. For wines like the 2021 Riddoch The Author Coonawarra Cabernet, which won gold and a trophy for best cabernet; of show at the Australian Cool Climate Wine Show.

We continue to invest behind our support of the Australian wine industry, both via Pinnacle and through our retail and hotel networks. Pinnacle's portfolio of quality wines of provenance are made by 22 winemakers and 14 viticulturists managing 550 hectares of owned and leased vineyards across Australia and New Zealand.

We also continue to source large volumes of fruit and finished wine from third-parties and to innovate with new product development to meet the needs of Australian consumers and for export to international markets.

I'm also pleased with the construction of our upgraded Dorrien Winery is now substantially complete. And the team are well progressed with the 2024 vintage crush. The upgrade will drive capacity and efficiency benefits and is being built to minimize its carbon footprint with an ammonia refrigeration plant, a solar energy system, an electric on-site vehicles as well as an expanded wastewater treatment and reuse program.

Now turning to hotels on Slide 11. Hotel sales were up 2.7% in the period, with comparable sales up 1.2%. Growth was driven by food and bars where we improved and localized our offers. Accommodation and entertainment revenue also grew, while gaming was flat overall, which was a relatively positive outcome given our decision to commence reduced trading hours in Victoria ahead of the rest of the market.

Hotel gross profit margins benefited from sourcing savings and menu optimization. And this more than offset the impact of the lower gaming mix. As detailed at our recent Investor Day, we're driving a focus on optimization of our current portfolio with no new hotels acquired in the half. We renewed 15 hotels and continue to progress our plan for value realization across the portfolio through renewal, development, and sale opportunities.

In the second half of the year, we expect to finalize the acquisition of the Rye Hotel in the Mornington Peninsula and the Bernie Central Townhouse in Tasmania. The Rye Hotel, the destination for holidaymakers and a social hub for the area, while the Bernie Central Townhouse is an accommodation-focused venue.

We also discontinued 1 lease during the half, the Captain Sterling in Western Australia and another in January, the Archer in Adelaide as part of our portfolio optimization strategy.

Since the Investor Day, we've completed a review of our freehold property portfolio, which has a book value of around $650 million. This work assessed the market value of these assets to be in excess of $1 billion.

And as Kate explained at the Investor Day, we'll continue to consider options to unlock the value of these assets, including exploring potential development partnerships.

Now, on to Slide 11 and a few more hotels operational highlights in the half. As with our leading retail brands, our hotels enjoy strong customer engagement given their positioning as family-friendly, affordable hospitality venues, ideally suited for customers in a higher cost of living environment. The best examples of this in the recent quarter were our strong performance through the festive season and record patronage on Christmas Day.

The team put a lot of effort into ensuring we continue to offer the best value in town on pub classics that customers love. That ongoing price competitiveness supported demand as customers continue to embrace their local pub as a great value for money social destination.

Overall, food covers were up 2.8%. We also began to deliver benefits from our Endeavour Go optimization program in hotels in this half, predominantly through venue rostering and process optimization. And this substantially offset the impact of high inflation, notably wage inflation.

Lastly, our new pub+ customer app has progressed to testing with our team and we remain on track to launch it in H2. Pub+ will be a positive step forward for our customers, allowing us to improve the personalization of our offer to each individual's unique preferences.

Now turning to our Endeavour Go cost optimization program, which I've mentioned a couple of times already. Like everyone, we faced a range of cost inflation pressures, particularly in labor, which is our largest — ***Technical Difficulty*** — doing business. Our Endeavour Go program is addressing cost efficiency and productivity across both gross margin and CODB in all parts of our business and is materially offsetting the impacts of inflation.

In the half, Endeavour Go delivered $53 million of savings and remains on track to deliver over $200 million of savings from F ’24 to F ’26. This is supporting our capacity to continue to invest in areas such as analytics and technology to drive future performance and to improve our offer for customers.

Now briefly on our sustainability achievements in the half. Our primary sustainability commitment centers on responsible service of alcohol and the responsible service of gambling. We have a unique leading in responsibility training module, which we aim to have completed by 100% of our team members. And in the half, we progressed to a completion rate of 95%. In a further commitment to responsibility, our moderation campaigns also reached 10 million customers in the half.

On to Slide 15. And as I said in my opening comments, our new scorecard outlines the pillars by which we’ll achieve our target of delivering long-term shareholder value of 10% per year from F ’26. At the full year, we’ll provide a detailed update on our progress against these objectives.

I’ll now hand over to Kate to provide some more detail on our financial results.

Kate Beattie

Thanks, Steve, and good morning, everyone.

So starting on Slide 17, I will briefly cover our results at the group level before unpacking some of the details. As Steve has outlined, sales in total grew by 2.5% to $6.7 billion and earnings before interest and tax grew 2.6% to $661 million.

As previously flagged, we have incurred higher finance costs this half, which resulted in the group net profit after tax declining by 3.6% to $351 million. Cash realization ratio of 140% was reflective of seasonally normal cash flows without the one-off cash outflows that we saw in half 1 of F ’23. This delivered $914 million of operating cash inflow for the half.

We have maintained our dividend at $0.143 per share, as Steve has noted, in line with the first half of F ’23, representing a 73% dividend payout ratio.

Turning to Slide 18. Both the retail and hotel segments delivered growth in sales and in EBIT in the half. Other EBIT, which includes unallocated corporate overhead, increased due to investment in sustainability and compliance as well as one-off advisory costs in the half.

Finance costs of $153 million include lease and debt interest expense. These have increased due to the increase in interest rates as well as an increase in our average net debt in the prior financial year.

The effective tax rate for the half was 30.9%. We expect the full year effective rate to be in the range of 31% to 32%.

Turning to Slide 19, covering our Retail segment. As Steve outlined, both Dan Murphy’s and BWS performed well in the half, underpinning the total retail sales growth of 2.5%. Dan Murphy’s and BWS combined sales growth was 2.9% or 2.1% on a comparable sales basis.

For total retail, which includes specialty businesses such as LANGTONS and Jimmy Brings, comparable sales growth was 1.8%. Retail continued to deliver a solid gross profit margin of 24.6% in the half. This was driven by cost savings in media and advertising and in our supply chain, including last mile delivery to customers as well as trading margin benefits from new products and pricing and promotion optimization, utilizing our growing advanced analytics capabilities.

The cost of doing business rate to sales, increased by 68 basis points, reflecting CODB growth of around 7%. This was well contained in the context of high inflation, including the impact of a 6.25% wage increase, which was materially mitigated by sustainable cost reduction initiatives delivered as part of the group optimization program that Steve has outlined.

The CODB increase also included the impact of the step-up in advanced analytics investment, which is delivering benefits in sales and gross profit, as I just mentioned, as well as costs associated with the One Endeavour technology transformation program, which will deliver longer term benefits.

In addition, as we transition off a number of services provided under transitional services arrangements with Woolworths, we are incurring periods of cost duplication, including to a small degree in this half.

EBIT of $436 million was up 4.3%, maintaining our industry-leading EBIT margin of 7.8%, slightly higher than half 1 of F ’23.

Moving on to hotels on Slide 20. Hotel sales of $1.084 billion for the half represented growth of 2.7% or 1.2% on a comparable basis, excluding newly acquired hotels. As noted, food and bar sales drove the growth with gaming sales stable in the half. Accommodation though a relatively minor contributor was also in growth.

GP margin was supported by improved food and bar margins, which more than offset the negative mix impact from flat gaming sales.

Costs were well managed with the Endeavor Go cost optimization program focused on hotels for the first time this half. This delivered in-venue savings that offset the impact of wage inflation.

Depreciation and amortization increased primarily due to CPI adjustments to lease depreciation, growth from new venues and the amortization cost of Victorian gaming entitlements, which we annualized this year.

EBIT of $260 million was up 1.6% on prior year with EBIT margin of 24%, 26 basis points lower than half 1 of F ’23 due to the higher depreciation and amortization expense.

Hotel segment return on funds employed was below prior year, primarily due to the annualization of the renewal of Victorian gaming entitlements in the 13-month rolling average funds employed value. The gaming entitlements increased funds employed and reduced EBIT due to increased amortization expense from August 2023. We are also cycling a higher annualized EBIT in half 1 of F ’22, an impact of post-COVID normalization of trade. As we look forward, we expect ROCE to improve as we move through cycling impacts and continue to optimize the portfolio as we outlined at our Hotels Investor Day.

On Slide 21, you can see that the inventory balance at the end of the half was $1.96 billion, $87 million above the prior comparative period. As of the end of December, comparable inventory volumes were actually lower than the prior year. However, this was more than offset by unit cost inflation, primarily driven by excise increases and a product mix shift to higher unit value items.

In addition, 22 net new stores have been added during this time. In previous updates, we noted that in F ’23, international supply chain disruption had resulted in us buying buffer stocks of international products with longer lead times for delivery. We continue to make progress in the half on reducing this with relatively low levels now remaining.

At the December seasonal peak trading period of the year, the business juggles the balance between optimizing inventory levels and ensuring availability of products for customers to support sales during Christmas. Post December, we have continued to reduce inventory with more than $100 million of reduction in January, resulting in January closing inventory value be falling below the prior year. Optimization of inventory will continue to remain a focus area for the business.

On Slide 22, we have broken down our capital expenditure. Our full year capital expenditure guidance remains unchanged at $420 million to $480 million. Key investments in the half included the expansion of the Dorrien Winery as highlighted by Steve. This investment will result in a reduction in grape to bottle conversion costs, improving product gross margins.

Within hotels, the focus on the half – of the half has been on renewals, addressing multiple sales drivers. Hotel Capital Spend, for the half was lower when compared to the prior comparative period as a result of having no acquisitions in this half. In addition, this month, we commenced an expression of interest process for the sale of 5 freehold retail sites, the anticipated proceeds from which are not reflected in the capital expenditure guidance.

Moving to debt management on Slide 23. As mentioned earlier, cash realization ratio of 140% was reflective of normal seasonal trading driving working capital efficiency without the one-off cash outflows we saw in half 1 of F ’23. As a result of the high cash realization in the half, net debt reduced by $380 million when compared to the end of F ’23.

The seasonal working capital benefit is expected to unwind in the second half, which, when combined with seasonally higher cash dividend outflow is expected to result in end of year net debt approximately in line with F ’23. We expect half 2 finance costs to be similar to half 1 with full year costs in the range of $300 million to $310 million, inclusive of lease interest costs.

Leverage ratio of 3.4x for the half benefited from the reduction in net debt, moving us within our target range of 3 to 3.5x. Debt facilities were increased by $150 million during half 1. And at the end of the half, we had committed undrawn facilities of $1.25 billion. 42% or $725 million of drawn bank facilities are hedged with weighted average cost of debt, inclusive of hedging of 4.8%, up 2% from half 1 F ’23.

I’ll touch briefly on our One Endeavour transformation program outlined on Slide 24. During the half, we continued the implementation of new people, unified commerce and lease management systems. We are also progressing; the assessment of solution options for ERP, store and venue systems. The operating and capital cost outlay for this program in the half is in line with plan. And we expect the full year to be in line with previous guidance of $40 million to $50 million in operating expenses and up to $50 million in capital. The operating costs of this program are included in our respective segment results.

As a reminder, this program replaces technology solutions being provided as part of our transitional services arrangements with Woolworths Group following our demerger. At the end of the program, we will be operating an independent fit-for-purpose modern technology architecture with associated customer experience and productivity benefits as well as the ability to unlock data-driven opportunities. We’ll provide further guidance on our year expectations at our full year results briefing.

I will now hand back to Steve.

Steve Donohue

Thanks, Kate.

We’ll jump to Slide 26 and the outlook for the business. Through the first 7 weeks of half 2, trading in retail was broadly flat with soft sales in January, followed by an improved start to February, which so far has grown at 1.5%. Current trading feels a lot like Q1 in F ’24, where we experienced patches of softness and responded by delivering unbeatable value to customers.

We'll continue to do this and adjust where necessary to drive performance improvement and disciplined cost management. In hotels, patronage in sales remain steady so far in the third quarter, which is typically the quietest period of the year, with sales up 1% year-on-year through the first 7 weeks.

Across the group, we'll continue to match the pace of change in customer sentiment and behavior with changes in how we're operating. The current cost of living challenges facing customers are reflected in our ongoing focus on delivering market-leading value for money.

This focus on value, along with the convenience of our network, the ranges we offer, quality guest experiences and customer service, underpins the strong customer advocacy for our brands. It's that commitment to customers and our focus on cost management, which we believe will enable us to continue to deliver resilient trading performance through the economic cycle.

And just before we turn to questions, I'd like to thank the whole team across Endeavour Group for their focus and efforts in delivering this result and for their role in creating a more sociable future for all of us. So thanks for joining us to all of you. And I'll hand back to the call moderator now to open for questions.

Question and Answer

Operator

— ***Operator Instructions*** — Your first question is from Michael Simotas from Jefferies.

Michael Simotas

You've spoken about investments in value for the customer in retail and just looking at what you've done over the last 2 or 3 months, that wasn't hard to see. Notwithstanding that you've delivered a very strong gross margin in retail. Can you just talk about the customer reaction to the value that you've offered and how you funded that value? And just as a follow-up, just interested to know what happened in January with sales down a little bit?

Steve Donohue

Yes. Thanks, Michael. So I appreciate the question on gross profit margins. I think there's, a few things to note. First of all, obviously, the biggest catalyst for price changes in the retail category is excise. So that's what precipitates the change in pricing. And actually, our gross margin story in the half is a lot more about cost control than anything else.

We didn't actually realize price increases in line with the cost increases that flowed through from suppliers as a result of that excise. So we have to work very hard to manage our costs in our COGS. So things like supply chain and marketing, which Kate mentioned, were key areas of focus that supported that positive outcome for gross margin.

The ongoing efforts that we make around mix and NPD, they continue to be a factor. But we also had to really optimize price and promo throughout the half as well. So those were the – those were sort of the key elements of what went into gross margin. But in a strange way, our gross margin was more about cost control than it was about anything else in many respects.

In terms of your question as to the customer reaction, as I said, we saw some variable trade through the half. And where you might recall, recall me talking about Father's Day, some softness in gifting it Father's Day. That was real cause for us to stand back from what the rest of the half was going to look like and make sure that we really maximize every opportunity.

Cyber Week was probably the thing that actually surprised us the most. It was really an exceptionally high level of demand that flowed through. During Cyber Week, we saw some pull forward of demand from what would normally go into December sales actually. And then, through the rest of the half or through December, I should say, really, we saw Dan Murphy's excel at Christmas time, much of which was down to the price offers that were out there for customers and the fact that Dan's obviously beats everybody else's price.

And in an environment like the one we're in people, when they're going to spend more, obviously, choose Dan's because of the outstanding value it offers. So Dan's had at a record break in Christmas. And then in BWS, we had an outstanding new year. So it was really those key events that delivered the second quarter and certainly the half, much of which was driven by the value that we were able to offer through that management of gross margin that I've touched on.

Now, your follow-up on Jan and I'm sure there are a number of folks with interest in the outlook and the January performance. I'll just make a few comments there. So – well, first of all, worth noting that we had a similar sort of situation a year ago. So, at the same time last year when we were sharing our H2 results our first 5 weeks came in at about 0.2% of 1% up.

So it's not uncommon to have a soft January in our categories. We're really accustomed to it. It was positive to see the change in trajectory through February. And there were a few things that changed in January that resulted in softer January performance.

First of all, the weather, we're obviously a weather-affected category and weather versus a year ago was less favorable. Then you had the perhaps as material impacts of the fall of Australia Day. So Australia Day fell on a Friday versus a Thursday last year. We think that has a slight negative impact this year and importantly, the movement of Lunar New Year.

So Lunar New Year moved into February from January the prior year and that's a pretty important trading event, particularly for Dan. So there's, a few puts and takes. We gave you the 1.5% for February. But over the same period, Dan's and BWS were about 2%.

So we've seen a real shift in that trajectory of a softer January. And as we did the year prior, we think we've got every opportunity through the cost management and pricing value we offer our customers to get the trajectory on the track that we expect to.

Operator

Your next question is from Ross Curran from Macquarie.

Ross Curran

Actually, I might ask Simo's question, but on the hotel side, for me, your gross profit margin improvement in hotels was remarkable, particularly given the softness of gaming, which tends to be a pretty high-margin product. Are you able to help us unpick that gross margin movement in hotels, much as it just done in retail?

Steve Donohue

Yes. Thanks, Ross, happy too. I think the first thing that's really important to point out about our hotels is that we pride ourselves on having the best deal in town. So every 6 months, our venue managers get out around 3 or 4 of the local pubs near them. So we check about 800 different locations every 6 months.

And we make sure that we sit under our competitors on pub classics like Schnitzels and Purines and Palmers depending on which side of the board you live on. And that's continued through this half.

In terms of how we manage the profitability on the other side, the team, as I said in my remarks, did a really good job of reengineering some menus, wanted to make them very locally focused and relevant. And we've also adjusted some of the sourcing strategies that we've had previously.

So we've got a relatively new team there in the commercial team in hotels. And they've really started to apply some of the principles we've been using in other parts of the group to augment the way we generate that gross margin. But the key is maintaining our competitiveness. And that's what drove those covers that I said were up 2.8% in the half, which is great.

Operator

Your next question is from Bryan Raymond from JPMorgan.

Bryan Raymond

Just to follow-up on Ross' question. Actually, just wanted to understand where we are in that cycle around gross margins. I feel like you guys probably are a bit lower than your major competitor on gross margins in Food and Bev and just wanting to sort of understand in that sort of sourcing and menu evolution.

Can you continue to realize better gross margins in Food and Bev, because on my numbers, it looks like about 150 basis point step-up in Food and Bev gross margins in first half '24 year-on-year, which is quite substantial. Is there more to come? And is this a sustainable move, I guess, is where I'm heading with my question.

Steve Donohue

Yes. Thanks, Bryan. I think the short answer is, yes. We're very focused on the sustainability of it. There's obviously a lot of moving parts when you think of the breadth of food offer, in a hotel, there's sources of protein and the other elements of the plate.

So as per my answer to Ross, it's still quite early days for this team. They've done some really good work in adjusting our sourcing settings to make sure that we're buying the best possible product at the best possible price, which is important. But that also links to our ability to maintain that really sharp price competitiveness and have the best deals on pub classics in town, which is what we've been able to generate. So I think early days, but positive signs and more work to do.

Bryan Raymond

Just to follow-up on that. Is it predominantly in the food side as opposed to beer? I imagined you already buy pretty well in beer. But just wanting to sort of understand is this sort of food oriented? And is there much of a mix effect in there. I know that can move around gross margins period-to-period as well.

Steve Donohue

Yes, definitely a little bit of mix as you see some red proteins giving space to white proteins and that's definitely a factor. But to your good question on bars, what we're seeing is a bit of mix shift there as well. So the continued demand for bottled product or cocktails and the like has given us a nice layer on top of what is already a very strong performance in draft beer.

So there's, definitely changes taking place out there from a consumer standpoint that are helping with the mix in bars as well.

Operator

Our next question is from David Errington from Bank of America.

David Errington

Steve, this is probably more a question to Kate. I'm trying to, Kate, understand the Endeavour Go cost savings of $53 million and where they actually – where they actually turned up. I mean, it looks like there's a fair chunk that goes into gross margin probably in the retail business. But you also called out some one-off costs that you're wearing in your retail cost of doing business.

I suppose I'm just trying to put together the bridge, if you like, of what's happening in your cost line because it looks like there are some one-offs that you're wearing. But then I'm trying to understand where the efficiencies are coming through in Endeavor Go across the retail and the hotels business.

I know it's a bit in that question. But if you could help us out understand what's happening on your cost line that would be really appreciated.

Steve Donohue

David, thanks for the question. It's a big focus for the group, as we've highlighted. And we'll be happy to give you a bit more color on it. I'll just start before I pass to Kate by highlighting what we talked about in terms of the material focus on the largest line in the cost of doing business, which is wages. So there's been a huge amount of effort delivered by support teams, but through store teams and hotel teams to adjust processes and rostering and all of the other things that we do with our teams in those locations.

But importantly and I track this personally very closely. We've actually improved our customer scores on the way through. So the fact that we've been able to reengineer processes, increased productivity and at the same time, up the ante on what customers are saying about their experience is a testament to the work the teams have done.

I think Kate will give you a bit more color. But obviously, on Slide 13, we talked a bit about Endeavour Go and the various elements that it touches, but I'll pass it to you, Kate.

Kate Beattie

Thanks, Steve. Yes, I think the starting point is Slide 13, where it talks to all of the places in which the Endeavour Go program is providing optimization opportunities across retail and hotels and Endeavour Group services, which are, of course, allocated back to the 2 segments.

I think the reason for highlighting some of the one-offs or the cost increases in retail was to make it clear why proportionately the cost increases in retail are slightly higher than what you're seeing in hotels.

So in hotels, all of the benefits from Endeavour Go are currently flowing through the cost of doing business, where, as Steve highlighted, in retail, we're getting about 40% of that sitting up in GP with the rest sitting in cost of doing business.

So that combined with the fact that we're incurring an increased cost year-on-year from the One Endeavour transformation program as well as in the short to medium-term a degree of duplication of costs as we transition off or worth transitionary services agreements plus the investments we're making in areas like advanced analytics are driving that difference in cost growth momentum seen in retail versus hotels.

David Errington

So that on Slide 24, what you're pointing out there, the operating costs of retail $13 million and $5 million. Can you define them as being one-offs? Were they going to be embedded in your cost line?

Kate Beattie

They're program costs that we will transition through. What we've said in relation to the One Endeavour technology program cost is that while we run through the program. We're incurring a year-on-year increase in costs that will peak in the next coming year or so. And then start to taper off and then we'll be replaced with the benefits realization that will flow through from those investments.

But as we roll through the program side of the technology information implementation side of the program, we are incurring an increase in cost.

Steve Donohue

Sorry, David, go on.

David Errington

No, you go, Steve. Because I was just going to mention, Kate mentioned duplication costs that should come out. And I just wanted to — I'm sorry.

Steve Donohue

No, no, my apologies. It's a good segue to probably what I was going to talk to. We know we have these sorts of costs that are going to flow through on the technology side of things. As Kate said, it's minor. But there are some duplicative costs, particularly in the technology space, when you consider, we've got Woolworths providing technology services. We're trying to stand up our own technology capability at the same time.

So obviously, you're going to have a little bit of crossover there. And that's why we're so focused on delivering the program of work, which is the One Endeavor transformation. It very much sits in lockstep with Endeavor Go, because as we execute that technology transformation. It increases our opportunity to bring productivity to processes and so on as well as avoid some costs which we currently incur. But I wouldn't know how to state it. It's not so material.

Operator

Your next question is from Shaun Cousins from UBS.

Shaun Cousins

Just a question further on Endeavor Go savings, $53 million, so that was all banked in this half. I'm just curious in that you're sort of banked over around 1/4 of the total cost-out program in the first sort of 6 of the fiscal '24 to '26 Period? I'm just curious around – just to confirm that that actually was all realized. And then also, why so front end? And does that sort of indicate some upside for later in terms of that plus $200 million could be a bigger number, please?

Steve Donohue

Yes. Thanks, Shaun. Well, obviously, yes, it was all realized. So it's all very factual and very closely tracked and monitored. And very important for the reasons that we've talked about in context of the challenging conditions that everybody faces as inflation is concerned.

Look, it's at varying degrees of maturity. So in the retail space, we're at a much later point in the maturity in terms of our rostering programs and our productivity work. So there's less to be had there. You'd have to think though that there would perhaps be more to be had in the case of hotels, where this is really the first half where we instituted activity-based rostering and really dug in with the people who do the work. Importantly, the people who operate the pubs and help them with systems support that delivers better outcomes.

So I'd also point your attention to the fact that we said $200 million plus. So it's not going to be capped. And we'll obviously understand more as time goes by, particularly in relation to the technology transformation that I touched on in my response to David's question. That is absolutely intended to unlock benefits as we have to invest in making those changes.

So we'll keep everybody updated as to what it looks like on the go forward. But it's definitely not capped at $200 million. And I'd certainly like to think we could do better than that over the course of it.

Shaun Cousins

And my follow-up, just around February, how much of the step-up was just excise? And more broadly, the business continues, given excise in beer and spirits suggest that generally, volumes are declining. How long do you think volumes continue to decline? And how do you manage that? Maybe it's just the February step-up because of excise and then how do you handle volume decline?

Steve Donohue

Yes. Good question, Shaun. Thanks. So yes, volumes are definitely in decline and have been for as long as I've been around, generally speaking, relative to excise increasing over time. It's worth though looking back through the excise increases.

So February a year ago, so February '23, the excise increase was 3.7%. Then in August that we've just cycled through it was 2.2%. And the most recent one was 1.8%. So linked to obviously, excise increases are linked to CPI. We're seeing moderation in CPI. So therefore, we're seeing moderation in excise increases.

The amount of inflation, though that sits in our range, in retail in – it's moderated a bit in Q2. So as we came out of the last financial, it was almost sort of reaching up to around the 6% point. But it came back towards 5% and it's much, much closer to about 5% in the last quarter.

So I think with that 1.8% that we saw flow through in February, we're going to continue to see moderation, which you would expect to either reduce the downward pressure on volume or ideally, and that is our aspiration, give us the opportunity to grow our volume through having that distinctive price proposition that we've talked a lot about.

Operator

Your next question is from Tom Kierath from Barrenjoey.

Thomas Kierath

Just want to ask on premiumization. I think during COVID, you obviously had a decent tailwind from that. And then, obviously, people are under a bit more pressure now. Are you seeing that unwind? And then, secondly to that, is there a gross margin headwind as people trade down from more premium products to more kind of entry-level basic products?

Steve Donohue

Thanks, Tom. Yes, you're right about premiumization through COVID. And I mentioned in my opening remarks, some of the examples like champagne switching into Australian sparkling. I guess, every cloud, the margins for retailers in Australia in French champagne are very constrained. And the margins in sparkling wine are more in line with the broader table wine category.

So there's some benefits in profitability there. And we are seeing real volume growth actually in demand for sparkling wine as an example. So, even when consumers are trading down or through categories, we see opportunities to offset those challenges in a variety of ways. And there's, obviously, lots of movements.

There's – as importantly as trade down, there's NPD. And I often talk about the new products being the lifeblood of the category and that in some respects we're more akin to fast fashion than we are many other consumer segments.

We touched on the fact that there was, 1,000 new products added in the half, which is a considerable volume of new products when you think of the nature of our business. And they're very much tracking in line with what consumer demand is doing in terms of change.

In fact, there has been an absolute explosion in demand for lemon-flavored beverages through the half. Now, everybody is familiar with hard solo now hard rated and the significant impact it had on the category. But it extends well beyond that to just about anything with a lemon flavor in it has had exponential growth through the half, particularly over Christmas.

And that links back to my other comments about GenZ being more engaged that generally speaking, that segment and category that they're interested in. So premiumization was a factor during COVID. But NPD has been something that we've been strong supporters of for producers, manufacturers, grape growers right across the country. And we'll continue to be particularly small producers, because it's through them that we're offering our customers market-leading ranges. And we're trying to do it at a pace that well exceeds that our competitors do.

And right now, I think we've got about almost 70 lemon shallows in our range. Lemon shallow went absolutely gangbusters at Christmas. And it's been great to see our team be able to react and be responsive to that change in customer demand. So very fluid environment, no pun intended. But we're very focused on keeping pace with changing customer needs.

Thomas Kierath

And sorry, just a follow-up. And so the gross margin on the NPD is higher than the category average or the existing products? Is that the inference there?

Steve Donohue

Yes, generally speaking, at a very tight level. So at the subcategory, you look at the cohort of products that are there. And we work out how we can augment profitability on the look forward with new products.

Operator

Your next question is from Lisa Deng from Goldman Sachs.

Lisa Deng

First question is on market share. In the second quarter, we accelerated for Dan's and BWS into 3.2%. We debate about this all the time. But what is your read in terms of your market share positioning in that second quarter and then going into the Jan as well.

Steve Donohue

Yes. Thanks, Lisa. Look, I think as you highlighted in your question, there isn't a particular specific reference point that any of us have for market share in the category. Some of the references are understated size of the category and so on. What I think gives us the prospect of growing market share is that continued focus on, what customers want. And customers definitely want lower prices.

They want us to help them with the challenges they have around cost of living. Nobody is doing a better job of that. I don't mind saying and I don't mean to say any modest than Dan Murphy's nor has anybody ever actually. So Dan Murphy's will continue to beat everybody's price proactively and that is what will bring customers to Dan Murphy's.

And we're definitely seeing it. We saw it in the half. We saw it in a record-breaking Christmas when people are stocking up. They go to Dan Murphy's. So how it plays through in terms of market share based on the various REITs that we'll get out of other data points remains to be seen, but our focus will continue to be on delivering for customers.

Lisa Deng

So then the second question is actually on cost. I noticed that we haven't given the FY '25 One Endeavor tech-transfer program. Cost we've given the FY '24. So is the broad thinking that whatever we can actually get out of Endeavour Go will largely mirror sort of the additional costs that we need for One Endeavor. And so net-net, the actual EBIT dollar impact is largely immaterial? Or how should we think a little bit about that?

Steve Donohue

Yes. It's a good question, Lisa. It's sort of coincidental. I suppose that they're similar in terms of scale and – or has been historically. The look forward is yet to be determined. So we're still doing the detailed work around the next couple of programs that we detailed on that slide.

So we've always said we'll keep everybody updated. And it would absolutely be our aspiration to offset the maximum amount of cost as we possibly can. We'll also look at means of smoothing the costs of some of those implementations over time as well. So it's a bit of a stay tuned on those ones. And we'll come back with more information in due course. But the work is underway right now on them.

Lisa Deng

But can't think of that as I look at mirror just yet?

Steve Donohue

No, I wouldn't suggest you do that just yet. But we will give everybody up-to-date on what it's looking like in due course.

Operator

Your next question is from Craig Woolford from MST Marquee.

Craig Woolford

Just if I can circle back to the gross margin in retail, you called out obviously the product suite and the new products that have been launched as well as promotional optimization and supply chain.

Are these all things that should continue at a similar pace in the second half? Is there anything else that would change the outlook for gross margin trajectory?

Steve Donohue

Yes. Thanks, Craig. Look, I think what we've been doing with gross margins being very consistent actually across all of the calls that I've done. We've always pretty well focused on the same things. And obviously, we've had some questions today about volume, the reductions in volume mean you move fewer boxes, so your supply chain costs should go down. It should also give you the opportunity to drive productivity into your outlets, which we do.

So I think we can continue to a degree, rely on those efficiency opportunities. We'll also continue to seek to be market-leading in terms of bringing new products to market and supporting the trade, be they small producers or large producers with innovative new products that our customers want.

This is a very much a fashion-lead category. And whilst ever we're able to get new products to market fast than anybody else, we should enjoy the benefits of that. So we'll continue to do that. But I'd also point out. We're going to continue to invest. So we're investing behind analytics and capabilities that improve those outcomes as well.

And we have aspirations for Retail Media in due course. It's very, very early days for us. But those sorts of things will come down the line as well. So we see line of sight to continue doing what we're doing and improve what we're doing when it comes to the elements of gross margin.

But we will, be very focused on delivering value for our customers. So that, at the end of the day is what matters the most, that's what sustains our business.

Craig Woolford

Is that the reason you called out a change of marketing spend? You felt there was a better return on investment by some of the promotional campaigns you did later in the half.

Steve Donohue

My reference to marketing is the cost of advertising in marketing that sits up in our cost of doing business. So we drove some productivity and efficiency in that. And in part, that's an exercise and communicating to customers the great value service and range that both Dan's and BWS offer everybody. So that was what I was referring to there.

Operator

Your next question is from Ben Gilbert from Jarden.

Ben Gilbert

Maybe just one for Kate. Just interested around the net interest guidance, it's obviously sorts of tightened up towards the upper end. What was the driver? Was that just funding, because you obviously had a very strong cash flow result for the period.

And then, just secondly, how are you thinking around sort of the whole balance sheet optimization side of things, like you've talked to the $1 billion of property there. It's obviously greater than what it was on the books at. And you've also got a lot of undrawn facilities. And I appreciate you want some tenure in the debt. But I presumed there's some reasonable costs associated with having those undrawn facilities as well.

So just firstly, on the higher net interest and then secondly, just how you're thinking about balance optimization and the fact you talked about $1 billion. Is it something then we should expect to see some divestments or partnerships in the sort of nearer future?

Kate Beattie

Thanks, Ben. So firstly, interest expense, the primary drivers of that are twofold. One is the higher average net interest rate period-on-period. And then the second one is a higher level of drawn debt. And they're broadly in proportion the impact of those 2 things.

In terms of balance sheet optimization, sorry, just one more build on that, I guess. We've mentioned that we expect net debt as at the end of the year to be broadly in line with the prior year. And I guess the inherent implication of that is that we're not expecting net interest expense to grow materially from here in the absence of any further upside movement in interest rates. So we think we're broadly at peak levels of debt and therefore peak levels of interest expense as it stands.

In terms of balance sheet optimization, yes. We have referenced the updated valuation of our freehold property portfolio as being at over $1 billion. I think the intention there is to more clearly articulate the upside we see from the optimization of our portfolio.

And as we highlighted at the Investor Day in December, we're looking at multiple ways of doing that, including opportunities for sale, including sale and leaseback, redevelopment and recycling of assets in the portfolio to accelerate bringing that latent potential through for our shareholders.

In terms of our debt facilities, you'll see in our debt maturity profile that we have 2 quite large syndicated facilities due for renewal, one in the middle of 2024 and one in the middle of 2025. I think you're right about the level of headroom and the need to continue to consider what headroom we actually need.

And those 2 syndicated facility renewal points give us the opportunity to reconsider whether we need to maintain the level of headroom that we currently have.

Operator

Your next question is from Richard Barwick from CLSA.

Richard Barwick

It looks like just with the way your pub numbers are moving, you're unlikely to get the 5% for the full year. I'm just wondering, is a net 5% per annum still a reasonable guide beyond FY '24. And then as a follow on to that, obviously, you're targeting your $150 million uplift in hotel EBIT through to FY '28. How many net new pubs are you assuming as a part of that EBIT growth guidance or EBIT growth target, I should say.

Steve Donohue

Yes. Thanks, Richard. No, look, I wouldn't assume a 5% hotel addition to the network. Post the presentations we made at the December update, what we were conveying was an intention to focus actually much more on our existing network and improve that.

And we've tried to touch on some of the examples today as to how we've done that with food and bars. And there is obviously ongoing work in relation to venue upgrades. And we'll get to the point of unlocking some of those redevelopment opportunities that Kate touched on.

In terms of the $150 million, no, I wouldn't necessarily be baking in a whole wave of hotel acquisitions into that number. That needs to be driven as much through the organic changes to performance that we know we have in our grasp over the course of time that we've outlined.

So yes, we're as much focused on improving our network as we are considering growing it. But we will be very choiceful about the venues that we bring into the network. And I mentioned 2 in Rye, the Bernie Central townhouse, both of which are great. Both of which are very different. Both of which will be accretive and give us the returns on investment that we should be generating. So that's how we're thinking about it.

Richard Barwick

And Steve, can I just clarify. Obviously, the $150 million target was quite a big element of the December Strategy Day. There's actually no explicit reference to it that I can see anyway in today's communication. Can you just confirm that you still are, in fact, targeting the extra $150 million uplift in EBIT for hotels by FY '28?

Steve Donohue

Yes, absolutely. No doubt about it. Teams are progressing with their plans. And again, we touched a little bit on some of the work that's underpinning that in augmenting food, for example. But there's a lot that goes into it and we'll definitely keep everybody up to date. No, not resulting from that one at all very focused on it.

Operator

Your next question is from Phil Kimber from E&P Capital.

Phillip Kimber

A question, I think I heard Kate say something about 5 freehold asset sales in FY '24 that are not included in the CapEx. One, did I hear that right? And then two, are these like sale on leasebacks? Are we actually going to exit the hotel? And should we be assuming what sort of gain should we assume what sort of cash inflow? Anything you could help there would be great.

Kate Beattie

Thanks, Phil. Yes. So I mentioned that we have on the market currently an expression of interest invitation for 5 freehold retail sites. Actually, they're not hotel sites. And they are being sold on a sale and leaseback basis. And we've chosen to divest those because we think that the holding them as freehold is nonstrategic for us and we've got better use for the cash.

Phillip Kimber

And should we expect any – like a material cash inflow from them, like broadly speaking?

Kate Beattie

Not materially in the context of our total debt level.

Phillip Kimber

And if I can ask, the specialty sales, when you – thanks for that appendix at the back where you've given the products or what sort of category split. That still be quite a big track. Could you remind us what's in it? And does it start cycling at some point? Or should we continue to assume relatively strong weakness in that line?

Steve Donohue

Yes. Thanks, Phil. So we're talking to Slide 32 here and it's unpacked in the footnote. So it includes Jimmy Brings, LANGTONS, Shorty's, Vinpac and Pinnacle, that's what you're referring to?

Phillip Kimber

Yes.

Steve Donohue

Yes. Look, there is definitely some cycling opportunities in some of those smaller businesses. Remembering – and we don't talk a lot about them. But what they intended to do is provide us with benefits beyond the sales transaction.

So in the case of Jimmy Brings, the underpinning on-demand delivery platform called Flip actually delivers for Dan Murphy's and BWS. So it's a very important element of that business. LANGTONS gives us access to very premium product. And it is a real touchstone brand for the most premium customers in the country. And Shorty's helps us deliver corporate sales as well as gifting and events activities.

So they're all at various different stages of that cycle that you referred to. Some of them more affected by the COVID impact of some time ago now than others. Important to note though that Vinpac and Pinnacle Drinks are tracking along okay actually.

And that's where some of our export data sits for some of our Pinnacle product that's going overseas, which is on a very small base, growing very, very quickly, particularly, with sales up into the U.S. So we feel pretty positive about the prospects of that one.

But I think what we'll do with those is provide a more fulsome update at the full year and provide a little bit more of an unpacked of the detail that sits behind them.

Operator

Your next question is from Bryan Raymond from JPMorgan.

Bryan Raymond

Probably one for Kate. Just on the commentary around inventory in January, stepping down another $100 million, I think if I heard that right, but then, also your guidance for a flat year-on-year net debt in June this year at $1.9 billion. You've got less CapEx, less hotel acquisitions. And you've got inventory benefits, good free cash flow generation in the first half. Am I missing something in the second half to get you back to flat?

Kate Beattie

No, I don't think you're missing anything. I think the primary driver of the reduction in net debt in the first half was the working capital benefits that we get through Christmas trade. And the primary movement back up in the second half is the unwinding of that combined with the cyclically higher dividend payment that we pay out in the second half.

The movements in the inventory are largely offset by movements in accounts payable. So it all flowed through in the working capital movement.

Bryan Raymond

And then just on the $100 million reduction in inventory. Was that the right number, first of all? And then in January, this is – and then secondary – secondly, is that driven by – I recall something about late delivery of some Pinnacle product in January 2023. Is it driven by like the baseline being elevated? Or is it actual optimization of inventory that you've seen sequentially in January this year? I know the seasonality, but just trying to understand the drivers of that January move.

Steve Donohue

Yes, I might have a go and let I mean Kate, I think talked about it a little bit in her remarks. So we had the buffer stock of international product that Kate referred to, we've moved through that.

What's, happening now is really focused efforts around optimizing the amount of inventory we've got domestically as well as on the international side of things. So the team has been very, very focused on making sure that we're getting that just right.

In context of a category where the biggest impact to our valuations come from the excise changes. So we'll get, hopefully, a bit of a benefit in the moderation of those excise increases and a bit of mix as well. So it's actually – we're not quite where we want to be just yet with that $100 million in the more recent period. But we're very much on the right trajectory.

So do you have anything to that, Kate?

Kate Beattie

No.

Bryan Raymond

If it's possible to sneak one more in, just a clarification, the $53 million of Endeavor Go benefits in the first half. Did you guys call out how much of that $53 million was realized in hotels versus retail?

Kate Beattie

No. We haven't provided the breakdown, I guess, in the context of $53 million on the total cost base is not material enough to warrant drawing out the details of the segment level. What we did explain was that in hotels, it all sits within cost of doing business. Whereas in retail, it's a bit more evenly between cost of doing business and gross profit benefits.

Steve Donohue

Yes. And I'd point you back to my comments about relatively early days for hotels in this space, so opportunities ahead.

Operator

There are no further questions at this time. I'll now hand back to Mr. Donohue for closing remarks.

Steve Donohue

Well, thanks, everybody, for joining the call today. I appreciate your interest in Endeavour Group. As I said in my opening remarks, we're pleased with the efforts that the team brought to delivering a very resilient result in the first half. And we remain acutely focused on delivering value for customers and managing cost of doing business as we proceed through H2. So look forward to seeing you out in the trade and thanks for joining the call today.

Operator

Thanks very much. That does conclude our conference for today. Thank you all for participating. You may now disconnect.