



# Diageo plc (DEO)

Updated January 30<sup>th</sup>, 2022 by Nathan Parsh

## Key Metrics

<b>Current Price:</b>	\$202	<b>5 Year CAGR Estimate:</b>	4.3%	<b>Market Cap:</b>	\$115 billion
<b>Fair Value Price:</b>	\$154	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	2/25/2022
<b>% Fair Value:</b>	131%	<b>5 Year Valuation Multiple Estimate:</b>	-5.3%	<b>Dividend Payment Date:</b>	4/7/2022
<b>Dividend Yield:</b>	2.0%	<b>5 Year Price Target</b>	\$226	<b>Years Of Dividend Growth:</b>	9
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	5% <sup>1</sup>

## Overview & Current Events

Diageo is a large alcoholic beverages company. The company dates all the way back to the 17<sup>th</sup> century and the Haig family, the oldest family of Scotch whisky distillers. Today, Diageo manufactures popular spirits and beer brands, such as Johnnie Walker, Smirnoff, Captain Morgan, Baileys, Tanqueray, Guinness, Crown Royal, Ketel One, and many more. Diageo has 20 of the world's top 100 spirits brands. Diageo is based in the U.K., but U.S. investors have access to the company through an America Depositary Receipt, or ADR. One ADR share equals four shares of the underlying company.

Diageo released earnings results for the first half of fiscal year 2022 on 1/27/2022. Net sales increased 15.9% with organic growth surging 20%. Organic volumes were up 9.3% as the company lapped a challenging period as a result of the COVID-19 pandemic. Each region had at least 13% organic sales growth, led by a 45% improvement in Latin America and a 27% gain in Europe. More than 80% of the portfolio maintained or gained market share. Super Premium and Premium brands had organic growth of 31% and 27%, respectively. Tanqueray, Crown Royal, Johnnie Walker, Guinness, and Don Julio had organic sales growth of 4%, 5%, 7%, 10%, and 41% respectively. Smirnoff fell 4% while Baileys was down 10%.

Analysts expect Diageo to earn \$7.69 in 2022, up from \$6.15 previously. We have updated our forecast accordingly.

## Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
<b>EPS</b>	\$4.88	\$6.00	\$6.33	\$5.95	\$4.78	\$5.60	\$6.20	\$6.70	\$5.60	\$6.50	<b>\$7.69</b>	<b>\$11.30</b>
<b>DPS</b>	\$2.77	\$3.00	\$3.37	\$3.36	\$3.12	\$3.20	\$3.44	\$3.46	\$3.55	\$4.02	<b>\$4.00</b>	<b>\$5.11</b>
<b>Shares<sup>2</sup></b>	689	689	689	689	689	689	674	670	645	645	<b>585</b>	<b>575</b>

Diageo's primary catalyst for earnings growth is the emerging markets. Emerging markets such as Latin America, China, and India have huge growth potential for Diageo, as these regions have large populations and rapidly-expanding middle classes. Share repurchases will also fuel earnings growth, though the company has paused its share repurchase program recently. We do believe that Diageo will eventually restart its share repurchases. We estimate 8% annual earnings growth over the following five years given the company's strong organic growth results under normalized conditions. Diageo's interim dividend for fiscal year 2022 was increased by 5% in local currency.

## Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
<b>Avg. P/E</b>	15.4	18.1	19.3	19.9	19.6	22.9	20.1	24.6	24.0	29.5	<b>26.3</b>	<b>20.0</b>
<b>Avg. Yld.</b>	3.5%	3.1%	2.6%	2.7%	2.9%	3.1%	2.7%	2.2%	2.6%	2.1%	<b>2.0%</b>	<b>2.3%</b>

Diageo's stock is unchanged since our 8/14/2021 report. Diageo currently trades for a price-to-earnings ratio of 26.3 based on update estimates for the fiscal year. We reaffirm our five-year P/E target of 20 to better reflect the average

<sup>1</sup> In local currency

<sup>2</sup> In millions of shares

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valuation over the last decade. As a result, we continue to view the stock as overvalued. If shares were to revert to this new target multiple by fiscal year 2027, then valuation would reduce annual returns by 5.3% over this period of time.

Diageo pays a semi-annual dividend. Diageo's current annualized dividend totals \$4.00 per ADR. We expect the company to continue to raise the dividend at around 5% annually for the foreseeable future. We note Diageo's dividend is variable and difficult to predict.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

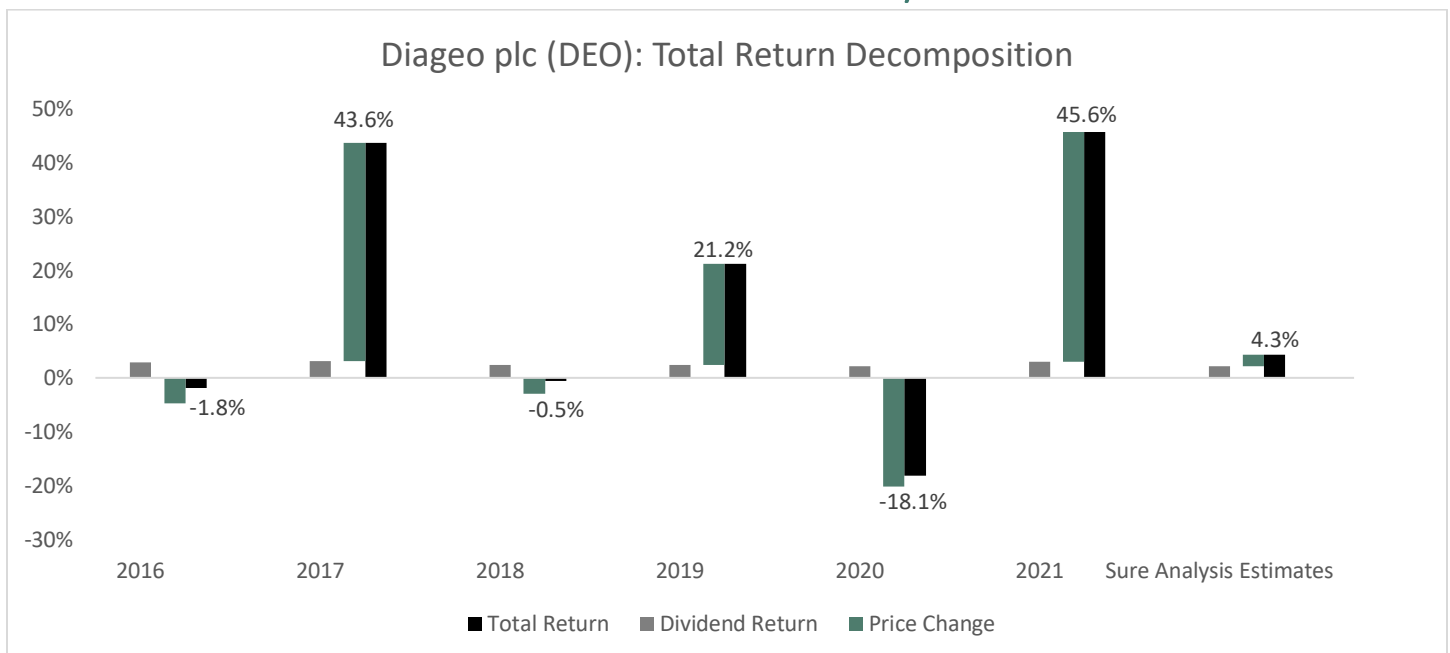
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	57%	50%	53%	57%	65%	57%	56%	54%	63%	62%	52%	45%

Diageo scores highly in terms of safety and quality. The company has a long-term credit rating of A- from Standard & Poor's, and A3 from Moody's, which indicates a healthy balance sheet. Diageo's numerous competitive advantages support its high-quality business model. Its top brands command pricing power, and its massive distribution network will allow the company to expand in new geographic markets. Plus, Diageo is highly resistant to recessions. Spirits and beer demand remains steady during economic downturns—and perhaps even rises during recessions. Diageo remained highly profitable during the Great Recession. Earnings declined slightly in 2010, but more than recovered in 2011. The dividend is highly secure, with a recession-resilient business model and a dividend payout ratio above 50%, which we don't expect a material change through 2027.

## Final Thoughts & Recommendation

Following interim results for fiscal year 2022, Diageo is now expected to offer a total annual return of 4.3% through fiscal 2027, up from our previous estimate of 0.2%. Our projected return stems from an 8% earnings growth rate and 2.0% starting dividend yield that are offset by a mid-single-digit headwind from valuation reversion. Diageo's strong portfolio of brands continues to perform well. Organic growth was up in all regions and in most key products. The valuation, however, continues to be high. We have raised our five-year price target \$45 to \$226 to reflect revised earnings estimates, but now rate shares as a hold due to projected returns.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Revenue</b>	16850	17730	16679	17042	15553	15284	16425	16655	14817	17139
<b>Gross Profit</b>	10186	10803	10128	9776	9247	9348	10167	10357	8949	10358
<b>Gross Margin</b>	60.4%	60.9%	60.7%	57.4%	59.5%	61.2%	61.9%	62.2%	60.4%	60.4%
<b>SG&amp;A Exp.</b>	2647	2775	2634	2567	2317	2280	2541	2643	2321	2911
<b>D&amp;A Exp.</b>	645	624	1023	693	702	458	666	484	2319	602
<b>Operating Profit</b>	4923	5302	4402	4408	4078	4514	4984	5232	2694	5022
<b>Op. Margin</b>	29.2%	29.9%	26.4%	25.9%	26.2%	29.5%	30.3%	31.4%	18.2%	29.3%
<b>Net Profit</b>	3028	3846	3790	3753	3329	3376	4081	4090	1776	3580
<b>Net Margin</b>	18.0%	21.7%	22.7%	22.0%	21.4%	22.1%	24.8%	24.6%	12.0%	20.9%
<b>Free Cash Flow</b>	2564	2191	1867	3015	3029	3315	3376	3336	2042	4076
<b>Income Tax</b>	1601	795	727	734	736	928	805	1162	743	1221

## Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Total Assets</b>	34678	38121	39112	40577	38354	37532	38849	39661	40998	44223
<b>Cash &amp; Equivalents</b>	1670	2669	1059	742	1466	1550	1143	1181	4090	3805
<b>Acc. Receivable</b>	2714	3083	3413	3040	2900	2771	2814	2754	2598	2515
<b>Inventories</b>	6136	6417	7191	7193	6164	6229	6557	6935	7105	8366
<b>Goodwill &amp; Int.</b>	13686	13748	13440	17661	16652	16349	16437	15913	13909	14897
<b>Total Liabilities</b>	24110	25784	26185	26022	24650	21883	23536	26790	30610	32554
<b>Accounts Payable</b>	1673	1658	1538	1389	1465	1776	1979	2147	4533	2787
<b>Long-Term Debt</b>	13389	15359	15693	15470	13635	11764	12946	15911	20660	20382
<b>Total Equity</b>	8670	10733	11621	12220	11483	13417	13006	10596	8336	9545
<b>LTD/E Ratio</b>	1.54	1.43	1.35	1.27	1.19	0.88	1.00	1.50	2.48	2.14

## Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Return on Assets</b>	9.1%	10.6%	9.8%	9.4%	8.4%	8.9%	10.7%	10.4%	4.4%	8.4%
<b>Return on Equity</b>	35.4%	39.6%	33.9%	31.5%	28.1%	27.1%	30.9%	34.7%	18.8%	40.0%
<b>ROIC</b>	13.0%	14.9%	13.5%	12.8%	11.6%	12.3%	14.7%	14.3%	5.9%	11.3%
<b>Shares Out.</b>	689	689	689	689	689	689	674	670	645	645
<b>Revenue/Share</b>	26.86	28.18	26.51	27.08	24.71	24.23	26.33	27.44	25.18	29.24
<b>FCF/Share</b>	4.09	3.48	2.97	4.79	4.81	5.26	5.41	5.50	3.47	6.95

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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