



Diageo plc (DEO)

Updated February 21st, 2023 by Nathan Parsh

Key Metrics

Current Price:	\$175	5 Year CAGR Estimate:	9.0%	Market Cap:	\$99 B
Fair Value Price:	\$169	5 Year Growth Estimate:	8.0%	Ex-Dividend Date:	03/02/23
% Fair Value:	104%	5 Year Valuation Multiple Estimate:	-0.7%	Dividend Payment Date:	04/18/23
Dividend Yield:	2.1%	5 Year Price Target	\$248	Years Of Dividend Growth:	9
Dividend Risk Score:	B	Retirement Suitability Score:	C	Rating:	Hold

Overview & Current Events

Diageo is a large alcoholic beverages company. The company dates all the way back to the 17th 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.

On January 26th, 2023, Diageo released earnings results for the first half of fiscal year 2023 for the period ending December 31st, 2022. For the first half of the year, net sales improved 18.4% while organic growth totaled 9.4%. Pricing and mix added 7.6%, with volume contributing a gain of 1.8% even as the company lapped another challenging comparable period. Each region had organic sales growth, led by a 20% gain in Latin America and Caribbean, a 17% improvement in Asia Pacific, a 10% increase in Europe, and 3% growth in North America. More than 75% of the portfolio maintained or gained market share. Super Premium brands had organic sales growth of 12%. Guinness, Don Julio, Casamigos, Smirnoff, and Capitan Morgan had organic sales growth of 15%, 20%, 27%, 6%, and 1%, respectively. Crown Royal fell 8%, Johnnie Walker was down 7%, Ketel One declined 14%, and Baileys was lower by 5%.

Analysts expect Diageo to earn \$8.43 in fiscal year 2023, down from \$8.54 previously. This would be a 12.9% increase from the prior year. We have updated our forecast accordingly.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$6.00	\$6.33	\$5.95	\$4.78	\$5.60	\$6.20	\$6.70	\$5.60	\$6.50	\$7.47	\$8.43	\$12.39
DPS	\$3.00	\$3.37	\$3.36	\$3.12	\$3.20	\$3.44	\$3.46	\$3.55	\$4.02	\$3.96	\$3.63	\$4.63
Shares¹	689	689	689	689	689	674	670	645	645	581	570	550

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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	18.1	19.3	19.9	19.6	22.9	20.1	24.6	24.0	29.5	23.3	20.8	20.0
Avg. Yld.	3.1%	2.6%	2.7%	2.9%	3.1%	2.7%	2.2%	2.6%	2.1%	2.3%	2.1%	1.9%

Diageo's stock has declined \$15, or 7.9%, since our August 2nd, 2022 report. Diageo currently trades for a price-to-earnings ratio of 20.8 based on update estimates for the fiscal year. We reaffirm our five-year P/E target of 20 to better

¹ In millions of shares

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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reflect the average 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 2028, then valuation would reduce annual returns by 0.7% over this period of time.

Diageo pays a semi-annual dividend. Diageo's current annualized dividend totals ~\$3.63 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 due to currency fluctuations.

Safety, Quality, Competitive Advantage, & Recession Resiliency

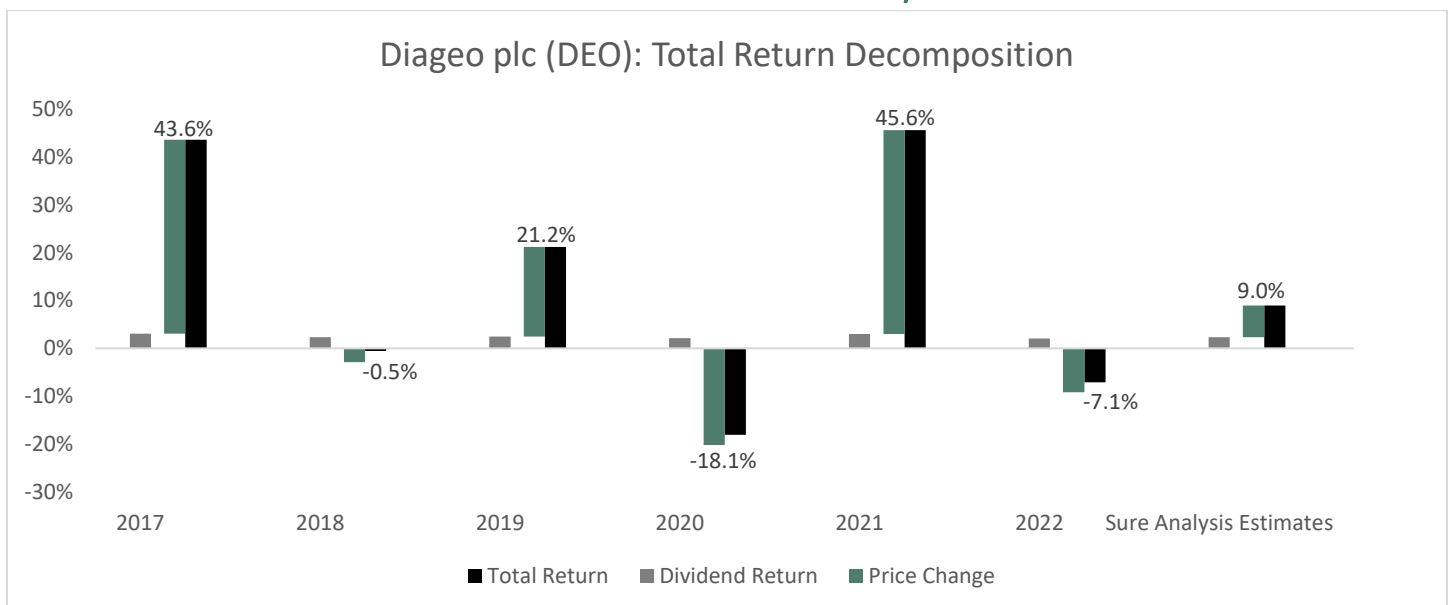
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	50%	53%	57%	65%	57%	56%	54%	63%	62%	53%	43%	37%

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 around 50%, which we don't expect a material change through 2028.

Final Thoughts & Recommendation

Following first half results, Diageo is now expected to offer a total annual return of 9.0% through fiscal 2028, up from our previous estimate of 7.6%. Our projected return stems from an 8% earnings growth rate and 2.1% starting dividend yield that are offset by a small headwind from valuation reversion. Diageo had a mixed quarter as the company faced a difficult comparable period. Each region continues to see strength in pricing, which hasn't greatly reduced demand. We have lowered our five-year price target \$3 to \$248 to reflect earnings estimates for the fiscal year, but we continue to rate shares of Diageo as a hold due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	17730	16679	17042	15553	15284	16425	16655	14817	17139	20577
Gross Profit	10803	10128	9776	9247	9348	10167	10357	8949	10358	12623
Gross Margin	60.9%	60.7%	57.4%	59.5%	61.2%	61.9%	62.2%	60.4%	60.4%	61.3%
SG&A Exp.	2775	2634	2567	2317	2280	2541	2643	2321	2911	3623
D&A Exp.	624	1023	693	702	458	666	484	2319	602	1103
Operating Profit	5302	4402	4408	4078	4514	4984	5232	2694	5022	5871
Op. Margin	29.9%	26.4%	25.9%	26.2%	29.5%	30.3%	31.4%	18.2%	29.3%	28.5%
Net Profit	3846	3790	3753	3329	3376	4081	4090	1776	3580	4327
Net Margin	21.7%	22.7%	22.0%	21.4%	22.1%	24.8%	24.6%	12.0%	20.9%	21.0%
Free Cash Flow	2191	1867	3015	3029	3315	3376	3336	2042	4076	3779
Income Tax	795	727	734	736	928	805	1162	743	1221	1397

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	38121	39112	40577	38354	37532	38849	39661	40998	44223	44290
Cash & Equivalents	2669	1059	742	1466	1550	1143	1181	4090	3805	2771
Acc. Receivable	3083	3413	3040	2900	2771	2814	2754	2598	2515	3557
Inventories	6417	7191	7193	6164	6229	6557	6935	7105	8366	8604
Goodwill & Int.	13748	13440	17661	16652	16349	16437	15913	13909	14897	14436
Total Liabilities	25784	26185	26022	24650	21883	23536	26790	30610	32554	32750
Accounts Payable	1658	1538	1389	1465	1776	1979	2147	4533	2787	7140
Long-Term Debt	15359	15693	15470	13635	11764	12946	15911	20660	20382	19430
Total Equity	10733	11621	12220	11483	13417	13006	10596	8336	9545	9458
LTD/E Ratio	1.43	1.35	1.27	1.19	0.88	1.00	1.50	2.48	2.14	2.05

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	10.6%	9.8%	9.4%	8.4%	8.9%	10.7%	10.4%	4.4%	8.4%	9.8%
Return on Equity	39.6%	33.9%	31.5%	28.1%	27.1%	30.9%	34.7%	18.8%	40.0%	45.5%
ROIC	14.9%	13.5%	12.8%	11.6%	12.3%	14.7%	14.3%	5.9%	11.3%	13.7%
Shares Out.	689	689	689	689	689	674	670	645	645	581
Revenue/Share	28.18	26.51	27.08	24.71	24.23	26.33	27.44	25.18	29.24	35.40
FCF/Share	3.48	2.97	4.79	4.81	5.26	5.41	5.50	3.47	6.95	6.50

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

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