



Diageo plc (DEO)

Updated August 19th, 2023 by Nathan Parsh

Key Metrics

| | | | | | |
|-----------------------------|-------|--|-------|----------------------------------|----------|
| Current Price: | \$168 | 5 Year CAGR Estimate: | 10.4% | Market Cap: | \$94 B |
| Fair Value Price: | \$172 | 5 Year Growth Estimate: | 8.0% | Ex-Dividend Date: | 08/24/23 |
| % Fair Value: | 98% | 5 Year Valuation Multiple Estimate: | 0.4% | Dividend Payment Date: | 10/17/23 |
| Dividend Yield: | 2.4% | 5 Year Price Target | \$252 | Years Of Dividend Growth: | 10 |
| Dividend Risk Score: | B | Retirement Suitability Score: | C | Rating: | Buy |

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 August 1st, 2023, Diageo released earnings results for fiscal year 2023 for the period ending June 30th, 2023. For the year, net sales improved 10.7% while organic growth totaled 6.5%. Pricing and mix added 7.3%, which was offset by a 0.8% decline in organic volume. Most regions performed well. Organic growth for Asia Pacific, Europe, Latin American and Caribbean, and Africa totaled 13%, 11%, 9%, and 5%, respectively. North America was flat. More than 70% of the portfolio maintained or gained market share. Premium-plus brands accounts for nearly two-thirds of net sales.

Analysts expect Diageo to earn \$8.58 in fiscal year 2024. This would be a 30.4% increase from the prior year. We have updated our forecast accordingly.

Growth on a Per-Share Basis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2028 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|----------------|
| EPS | \$6.33 | \$5.95 | \$4.78 | \$5.60 | \$6.20 | \$6.70 | \$5.60 | \$6.50 | \$7.47 | \$6.58 | \$8.58 | \$12.61 |
| DPS | \$3.37 | \$3.36 | \$3.12 | \$3.20 | \$3.44 | \$3.46 | \$3.55 | \$4.02 | \$3.96 | \$3.64 | \$4.05 | \$5.17 |
| Shares¹ | 689 | 689 | 689 | 689 | 674 | 670 | 645 | 645 | 581 | 568 | 568 | 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 2024 was increased by 19.6% year-over-year for U.S. investors.

Valuation Analysis

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | Now | 2029 |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 19.3 | 19.9 | 19.6 | 22.9 | 20.1 | 24.6 | 24.0 | 29.5 | 23.3 | 26.4 | 19.6 | 20.0 |
| Avg. Yld. | 2.6% | 2.7% | 2.9% | 3.1% | 2.7% | 2.2% | 2.6% | 2.1% | 2.3% | 2.1% | 2.4% | 2.1% |

Diageo's stock has declined \$7, or 4.0%, since our February 21st, 2023 report. Diageo currently trades for a price-to-earnings ratio of 19.6 based on estimates for the fiscal year, nearly matching our five-year target price-to-earnings ratio of 20.0. If shares were to revert to this new target multiple by fiscal year 2029, then valuation would be a 0.4% tailwind to annual returns over this period.

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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Diageo pays a semi-annual dividend. Diageo's current annualized dividend totals ~\$4.05 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

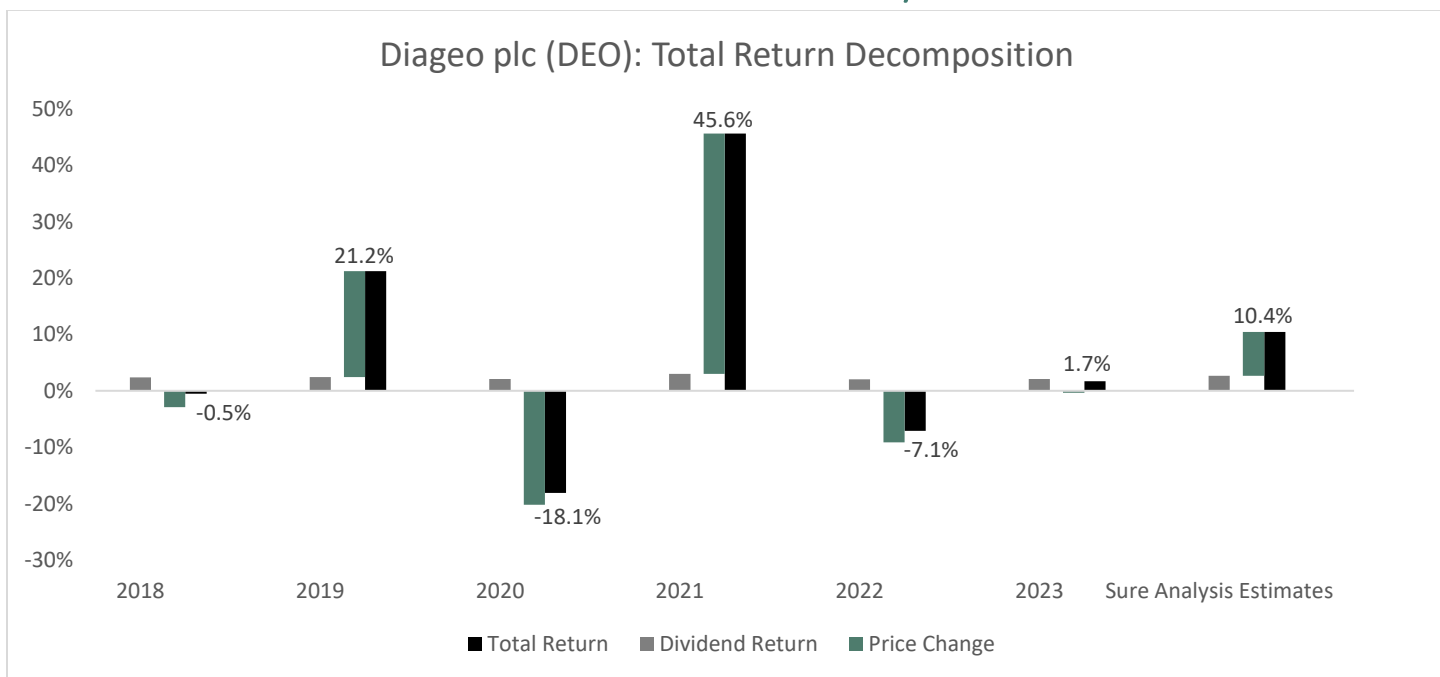
| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2029 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 53% | 57% | 65% | 57% | 56% | 54% | 63% | 62% | 53% | 55% | 47% | 41% |

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 under 50%, which we do not expect a material change through 2029.

Final Thoughts & Recommendation

Following fiscal year results, Diageo is now expected to offer a total annual return of 10.4% through fiscal 2029, up from our previous estimate of 9.0%. Our projected return stems from an 8% earnings growth rate, a 2.4% starting dividend yield, and a small tailwind from multiple expansion. Diageo had a solid fiscal year, with growth seen in all regions. North America was the worst performer, but it was still flat year-over-year following a difficult comparable period. The vast majority of the company's brands increased their market share or held steady. This speaks to Diageo's brand strength and customer loyalty. We have raised our five-year price target \$4 to \$252 to reflect earnings estimates for the new fiscal year, but we now view shares of Diageo as a buy due to projected returns.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Revenue | 16679 | 17042 | 15553 | 15284 | 16425 | 16655 | 14817 | 17139 | 20577 | 20619 |
| Gross Profit | 10128 | 9776 | 9247 | 9348 | 10167 | 10357 | 8949 | 10358 | 12623 | 12307 |
| Gross Margin | 60.7% | 57.4% | 59.5% | 61.2% | 61.9% | 62.2% | 60.4% | 60.4% | 61.3% | 59.7% |
| SG&A Exp. | 2634 | 2567 | 2317 | 2280 | 2541 | 2643 | 2321 | 2911 | 3623 | 3676 |
| D&A Exp. | 1023 | 693 | 702 | 458 | 666 | 484 | 2319 | 602 | 1103 | 1284 |
| Operating Profit | 4402 | 4408 | 4078 | 4514 | 4984 | 5232 | 2694 | 5022 | 5871 | 5581 |
| Op. Margin | 26.4% | 25.9% | 26.2% | 29.5% | 30.3% | 31.4% | 18.2% | 29.3% | 28.5% | 27.1% |
| Net Profit | 3790 | 3753 | 3329 | 3376 | 4081 | 4090 | 1776 | 3580 | 4327 | 4499 |
| Net Margin | 22.7% | 22.0% | 21.4% | 22.1% | 24.8% | 24.6% | 12.0% | 20.9% | 21.0% | 21.8% |
| Free Cash Flow | 1867 | 3015 | 3029 | 3315 | 3376 | 3336 | 2042 | 4076 | 3779 | 2222 |
| Income Tax | 727 | 734 | 736 | 928 | 805 | 1162 | 743 | 1221 | 1397 | 1169 |

Balance Sheet Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|--------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 39112 | 40577 | 38354 | 37532 | 38849 | 39661 | 40998 | 44223 | 44290 | 44929 |
| Cash & Equivalents | 1059 | 742 | 1466 | 1550 | 1143 | 1181 | 4090 | 3805 | 2771 | 1815 |
| Acc. Receivable | 3413 | 3040 | 2900 | 2771 | 2814 | 2754 | 2598 | 2515 | 3557 | 2536 |
| Inventories | 7191 | 7193 | 6164 | 6229 | 6557 | 6935 | 7105 | 8366 | 8604 | 9663 |
| Goodwill & Int. | 13440 | 17661 | 16652 | 16349 | 16437 | 15913 | 13909 | 14897 | 14436 | 14520 |
| Total Liabilities | 26185 | 26022 | 24650 | 21883 | 23536 | 26790 | 30610 | 32554 | 32750 | 33209 |
| Accounts Payable | 1538 | 1389 | 1465 | 1776 | 1979 | 2147 | 4533 | 2787 | 7140 | 3354 |
| Long-Term Debt | 15693 | 15470 | 13635 | 11764 | 12946 | 15911 | 20660 | 20382 | 19430 | 20814 |
| Total Equity | 11621 | 12220 | 11483 | 13417 | 13006 | 10596 | 8336 | 9545 | 9458 | 9866 |
| LTD/E Ratio | 1.35 | 1.27 | 1.19 | 0.88 | 1.00 | 1.50 | 2.48 | 2.14 | 2.05 | 2.11 |

Profitability & Per Share Metrics

| Year | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 9.8% | 9.4% | 8.4% | 8.9% | 10.7% | 10.4% | 4.4% | 8.4% | 9.8% | 10.1% |
| Return on Equity | 33.9% | 31.5% | 28.1% | 27.1% | 30.9% | 34.7% | 18.8% | 40.0% | 45.5% | 46.6% |
| ROIC | 13.5% | 12.8% | 11.6% | 12.3% | 14.7% | 14.3% | 5.9% | 11.3% | 13.7% | 14.2% |
| Shares Out. | 689 | 689 | 689 | 689 | 674 | 670 | 645 | 645 | 581 | 568 |
| Revenue/Share | 26.51 | 27.08 | 24.71 | 24.23 | 26.33 | 27.44 | 25.18 | 29.24 | 35.40 | 36.32 |
| FCF/Share | 2.97 | 4.79 | 4.81 | 5.26 | 5.41 | 5.50 | 3.47 | 6.95 | 6.50 | 3.91 |

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

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