

November 3, 2018

Diageo: (DEO)

Louise Lapras

Sector: Consumer Defensive

Industry: Alcoholic Beverages

Current Price: \$136.52

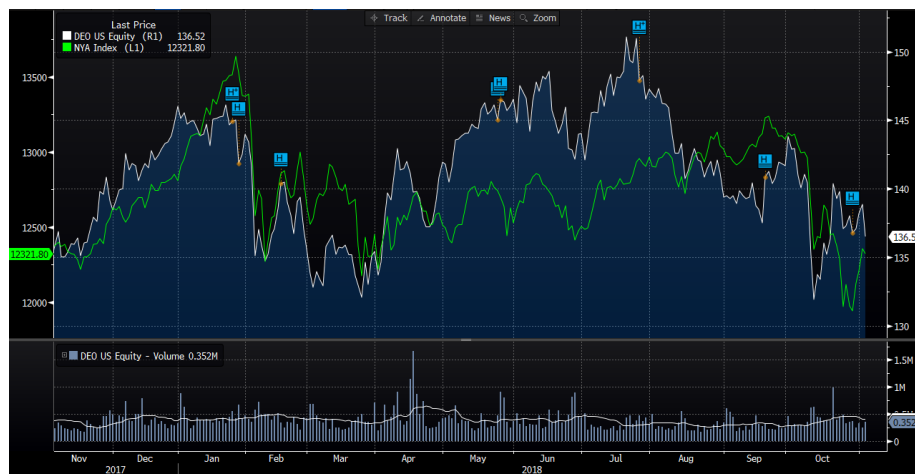
Target Price: \$162.29

Company Description: Diageo plc is a London-based British multinational alcohol company. It was the world's largest liquor producer until recently being overtaken by China's Kweichow Moutai in 2017. It is the world's biggest whisky producer.

Diageo's brands include Smirnoff, Johnnie Walker, Baileys, and Guinness. It also owns 37% of the Moët Hennessy division of French luxury goods company LVMH. Diageo sells its products in over 180 countries and has offices in around 80 countries.

BUY

Current Price:	\$136.52
Target Price:	\$162.29
Market Cap:	\$83.2B
Average volume:	335,338
ROIC:	14.3%
Adj. EBITDA:	35.5%
Mkt share (spirits):	25%



Thesis:

Diageo remains the powerhouse of international spirits industry, with a strong grip on a number of the most significant categories. The company has emerged strongly from the challenges posed by macroeconomics difficulties in emerging markets; in addition to the increasingly fragmented nature of mature markets filled with newly created liquor brands and craft start-ups. Diageo has been outperforming the market for 15 years that resulted in a significant growth on their net sales and net profit. The company is expected to keep growing steadily based on their recent quarter results.

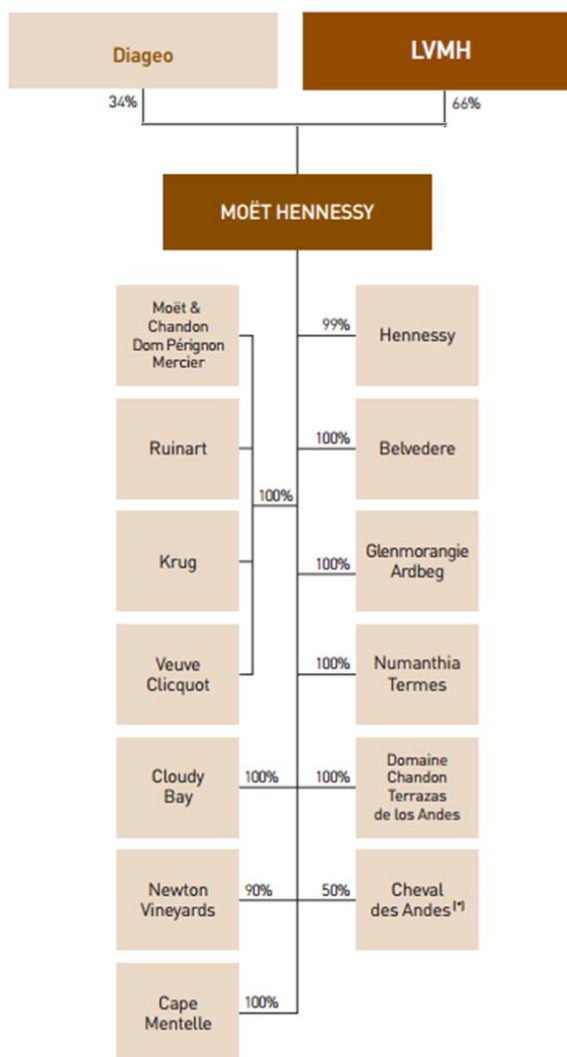
Catalysts:

- Mid Term(1-2 years): **Steady organic growth**
- Long Term(3+): **Expand geographically, focus on Asia Pacific, and China**

Business description:
























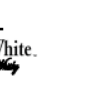



Diageo is a British alcoholic beverages company, headquartered in London, England. It was created in 1997 after the merger of Guinness and Grand Metropolitan, and went public on the London stock exchange the same year. Diageo is one of the largest alcoholic beverage makers in the world, with over 200 brands across spirits and beer, distributed in 180 countries. It owns and operate 150 production sites located all over the world.

Diageo owns two of the world's five largest premium spirits brands: Johnnie Walker and Smirnoff, and 22 of the world's top 100 premium spirits brands.

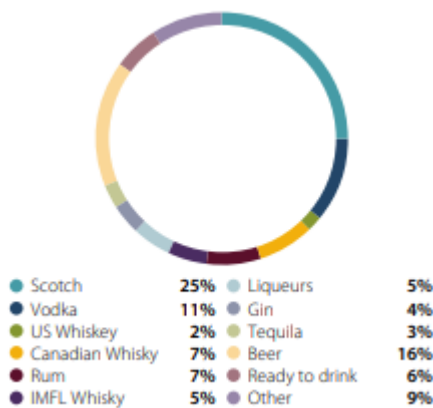


Diageo also owns 34% of the Moët Hennessy drinks division of LVMH, the French luxury goods company, and there have been rumors of willingness to reach 100% ownership on Diageo's part for years. However, LVMH never expressed any interest in selling its stake in Moët Hennessy. The brand would be a strategic addition to their portfolio, gathering the world's best-selling champagne and cognac.

Here are some of the most recognized brands fully owned by Diageo:

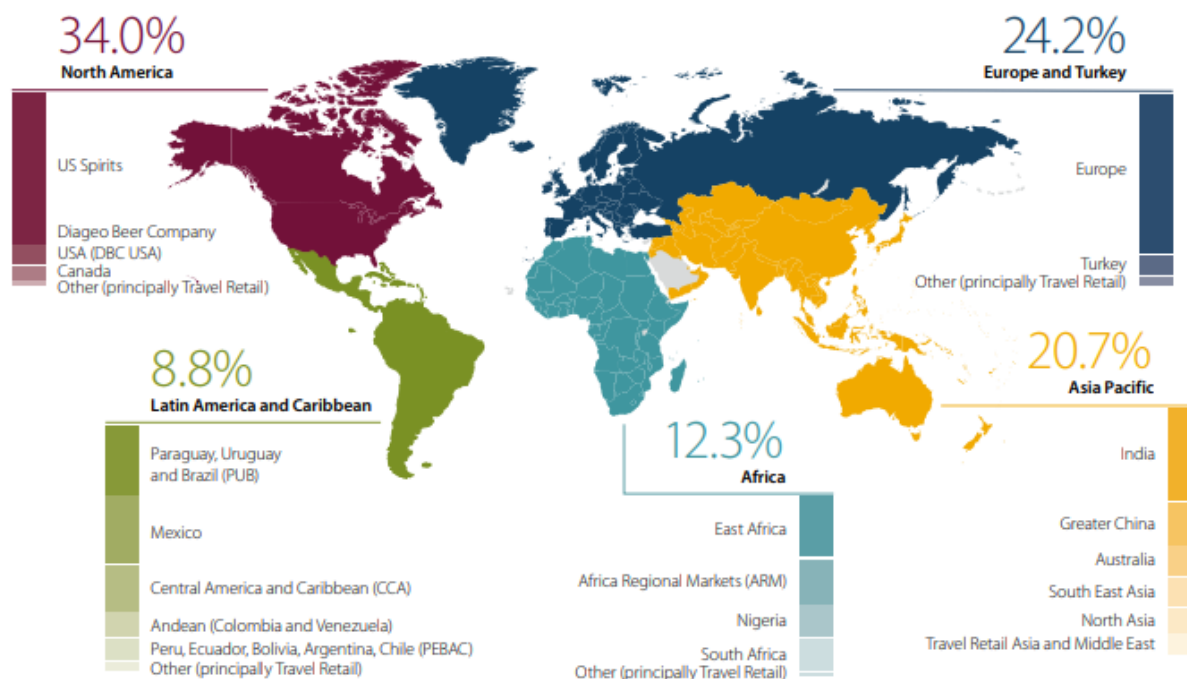
Global giants ⁽ⁱⁱⁱ⁾					
Our business is built around our six biggest global brands.					
					
Local stars ⁽ⁱⁱⁱ⁾			Reserve ^(iv)		
Can be individual to any one market and provide a platform for our business to grow.			Exceptional spirits brands at above-premium price points to capture the global luxury opportunity.		
					
					
					
					

2018 net sales by category (%)



Present in over 180 countries, Diageo operates as a market-based business, and uses local market insights to elect the most relevant brands to meet the consumers' demand. As of June 30, 2018, 34% of sales came from North America, 24% from Europe and 21% from Asia Pacific.

% share of net sales by region⁽ⁱ⁾



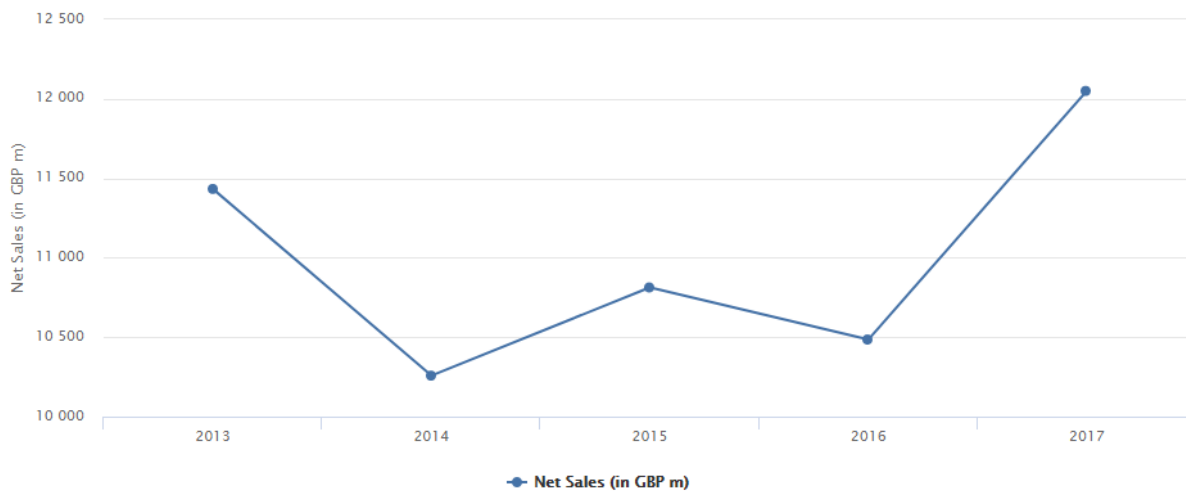
(i) Based on reported net sales for the year ended 30 June 2018. Does not include corporate net sales of £52 million.

Earnings Performance:

Looking at the company's recent quarter results. DEO has shown strong results, where organic net sales grew by 4.2% driven by the volume growth of 1.8% and strong price mix with broad-based growth across categories and regions. The organic operating margin have expanded by 81bps. The company has also delivered a strong free cash flow compared to the same time last year, the FCF was around £1B. EPS was up by 9.4% driven by the organic growth and lower financial charges. There was a return of £800M to shares holders in the first half through the share buy-back and increased in the interim dividend by 5%. Management announced another £2B to be used in 2019 for the same purpose. Looking regionally, there was a solid growth in the company's three focus areas. In scotch, both Lagavulin and Johnnie walker has continued to outperform. In the US spirits however, only vodka was shown a good sales growth in comparison to their other drink categories that have shown a slower growth, net sales of US Sprites yet were up by 2.9%. In India, net sales grew by 2% versus the second half of last year. There was a volume growth across all regions except for Asia Pacific, which continues

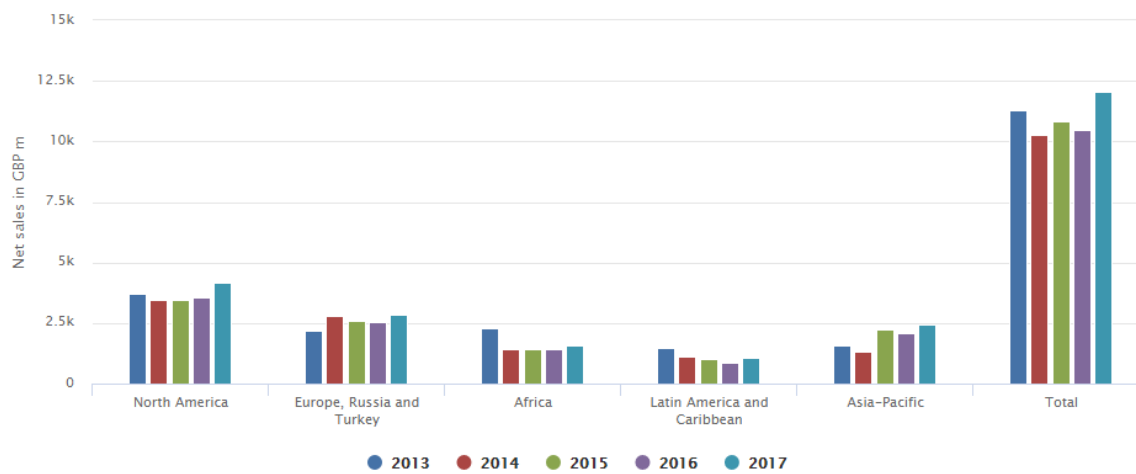
to be impacted by the short term volatility as well as continuing weakness in popular category in India. Europe and turkey continue to show a good performance mainly due to volume increase; and price mix that was largely to the positive impact of price in turkey being offset by negative price mix from Gordon's and Baileys in EU. Moving on to Africa, the performance was mixed with double digit growth in Nigeria, partially offsetting weaknesses in Africa regional markets. In Latin America and the Caribbean, net sales were up by 7%, driven mainly by the strong performance in Mexico. The largest category is scotch, which was up by 3% with broad-based growth across all regions except in Africa. Johnnie Walked delivered a strong performance with net sales up to 7% as well as scotch brands where net sales have increased by 8%, mainly driven by Black & White in Latin America, Caribbean and Asia Pacific. "Diageo has delivered another year of strong, consistent performance. Organic volume and net sales growth is broad based across regions and categories. We have expanded organic operating margin while increasing investment behind our brands ahead of organic net sales growth". Said Ivan Menezes CEO of Diageo.

Diageo Full-Year Net Sales 2013-2017



	2013	2014	2015	2016	2017
Net Sales (in GBP m)	11433	10258	10813	10485	12050

Diageo Full-Year Net Sales by Region 2013-2017



Industry background:

The alcoholic beverage market includes beer, wine and spirits. Where beer and cider consumption have made up to 89% of the global alcoholic consumption. Beer is the widest consumed alcoholic beverages throughout the world and the global production has been increasing during the last decades. USA is the second largest country in worldwide beer production, with an amount of 224M hectoliters per year, followed by China and then Germany. Similarly, the global wine market was led by France, Italy and Spain in the total amount produces. Over the past years, the spirit industry sales made up over a third of total alcohol sales worldwide. Diageo-owned Smirnoff was the best-selling brand worldwide with a sales volume of 25.7M 9 liters sold between 2015-2017.

Competition:

There are many players in the alcoholic industry, and very few of them can be hugely influential and powerful within the sectors they directly operate in. The scale of performance is reflective to the world economy as a whole, and that is why not many alcoholic beverage businesses like to go viral. Diageo showed a turbulent financial and business performance over their last years. They have taken and made huge changes in the global drink industry, in particular on their on-going shift in power and significance of China and the Asian Market as a whole. The company's grip on the global drinks market is reflected in the top 100 International Alcohol Beverage Brands report where nearly 5th of the brands are Diageo drinks, making it by far the biggest owner selling 3M cases or more yearly. Looking at the competitors list, Diageo is significantly large in their market cap and net income compared to its main competitors. The company has also a high gross margin and it is projected to keep increasing it for the future years.

Competitors									
Symbol	Name	Market Cap, \$K	P/E ttm	EPS ttm	Net Income(a) \$M	Beta	Dividend	Div Yield	Links
SAM	Boston Beer Company	3,487,752	46.70	6.58	99.05 M	0.55	0.00	0.00%	⌵
EAST	Eastside Distilling Inc	58,499	0.00	-1.32	-5.28 M	0.44	0.00	0.00%	⌵
THST	Truett Hurst Cl A Co	9,389	0.00	-0.13	-0.65 M	0.22	0.00	0.00%	⌵
BREW	Craft Brew Alliance	350,803	48.26	0.38	9.52 M	0.26	0.00	0.00%	⌵
DEO	Diageo Plc	86,423,632	0.00	0.00	4,070.63 M	0.62	4.18	3.06%	⌵
BF.A	Brown Forman Inc Cl A	22,876,780	29.42	1.58	717.00 M	0.82	0.63	1.33%	⌵
BF.B	Brown Forman Inc Cl B	22,684,336	29.40	1.58	717.00 M	0.84	0.63	1.34%	⌵
CCU	Compania Cervecerias Unidas S.A.	4,670,480	9.72	2.58	194.41 M	0.51	0.56	2.18%	⌵
STZ	Constellation Brands Inc	38,058,728	22.21	8.97	2,318.90 M	1.75	2.96	1.47%	⌵
STZ.B	Constellation Brd Cl B	37,702,540	22.19	8.97	2,318.90 M	0.12	2.68	1.35%	⌵
WVVI	Willamette Valley	36,754	15.74	0.47	2.99 M	0.47	0.00	0.00%	⌵

	Industry Revenue	FY Rev	% Tot R...↓
11)	DIAGEO PLC	12.16B	100.00%
12)	ANHEUSER-BUSCH I	43.80B	100.00%
13)	COCA-COLA CO/THE	27.34B	100.00%
14)	HEINEKEN NV	19.15B	100.00%
15)	NESTLE SA-REG	21.96B	31.03%

Debt:

Ratings agencies	S&P	Moody's	Fitch
LT rating	A-	A3	A-
Outlook	Stable	Stable	Stable
ST rating	A2	P2	F2
Date rating/outlook last changed	Sept 05	Oct 05	Aug 16

*Ratings correct as of 20th June 2017

Diageo is highly leveraged, with a net debt 2.15 times the reported EBITDA, amounting \$13B at the end of fiscal year 2018. Long-term debt alone represents 27% of total assets, and total debt are 33.32% of total assets. However, they have had a stable credit rating over the years, so

they are not buried in interests.

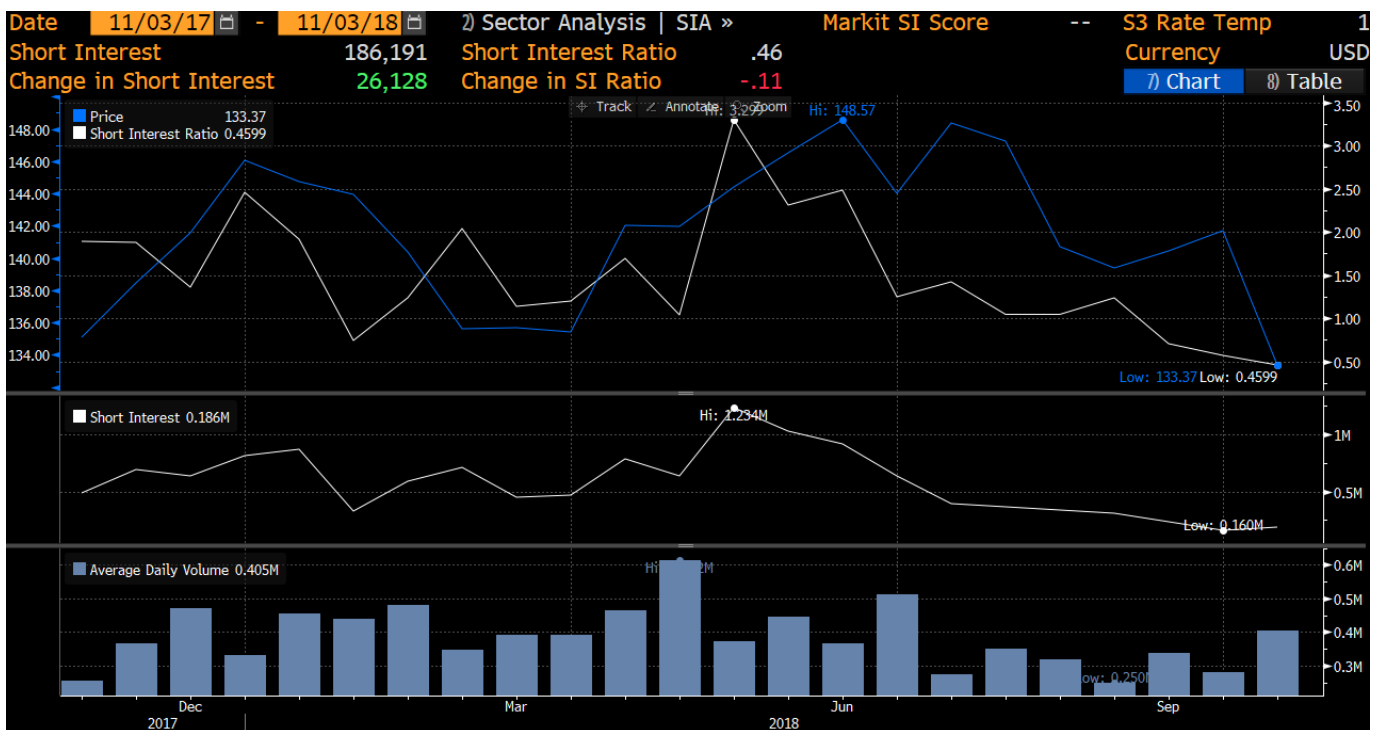
11) Profitability	12) Growth	13) Credit	14) Liquidity	15) Working Capital	16) Yield Analysis	17) DuPont Analysis		
In Millions of USD except Per Share			2013 Y	2014 Y	2015 Y	2016 Y	2017 Y	2018 Y
12 Months Ending			06/30/2013	06/30/2014	06/30/2015	06/30/2016	06/30/2017	06/30/2018
	Short and Long Term Debt		15,289.8	16,255.5	15,470.3	13,439.2	11,761.8	13,064.7
	Short-Term Debt		2,812.3	2,750.0	3,020.8	2,730.6	3,198.7	2,411.9
	Long Term Debt		12,477.5	13,505.4	12,449.5	10,708.6	8,563.2	10,652.8
	Total Debt/T12M EBITDA		2.70	3.08	3.07	3.06	2.32	2.36
	Net Debt/EBITDA		2.21	2.84	2.90	2.68	1.99	2.15
	Total Debt/EBIT		2.98	3.50	3.50	3.56	2.55	2.68
	Net Debt/EBIT		2.44	3.22	3.32	3.13	2.19	2.43
	EBITDA to Interest Expense		7.42	6.79	6.08	7.22	8.66	10.61
	EBITDA-CapEx/Interest Expense		6.16	5.38	4.87	6.12	7.51	9.13
	EBIT to Interest Expense		6.73	5.98	5.32	6.19	7.86	9.36
	EBITDA/Cash Interest Paid		6.69	5.37	5.36	6.92	7.92	10.02
	EBITDA-CapEx/Cash Interest Paid		5.55	4.25	4.29	5.86	6.87	8.63
	EBIT/Cash Interest Paid		6.07	4.73	4.69	5.93	7.19	8.84
	Cash Interest Paid		873.8	935.2	943.7	710.6	625.4	563.0
	Interest Expense		787.5	740.1	831.9	681.0	572.1	532.0

On October 16, 2018, the company issued additional €2 billion worth of fixed rate, euro denominated bonds under the European Debt Issuance Program, of which 45% mature in 3 years, with a coupon rate of 0.25%, 30% matures in 7 years with a 1% coupon, and the remaining 25% mature in 9 years, with a 1.5% coupon.

Ownership:

80% of the stock are held by investment advisors, with no significant change year over year. 88% are held in the United States, and the remaining are mostly held in Europe. There is no significant influence by owners, as the number one owner is Bank of America, with 1.08% of the float. We can see that short interest are relatively stable, and do not have a large impact on price, as the short interest ratio is 0.46.

Compare Current Stats Against 10/29/17				Insider - Based on Last 6 Months			
Institutional - Based on Current Filings							
51) Institutional	10/29/17	Curr	Change	52) Insider	10/29/17	Curr	Change
11) % of Shares Held	12.65	12.36	-0.29	21) % of Shares Held	0.05	0.06	+0.01
12) % of Float Held	-7,921,663.4	-7,531,408.1	+3902549.3	22) % Chg Insider Positions	-0.09	+13.12	+13.21
13) # of Institutions	910	980	+7.69%	23) # of Insiders	9	10	+11.11%
14) # of Buyers	256	280	+9.38%	24) # of Buyers Opn Mkt	0	0	
15) # of Sellers	308	350	+13.64%	25) # of Sellers Opn Mkt	2	5	+150.00%
16) # of New Buyers	91	73	-19.78%	26) # of Shrs Bought Opn Mkt	0	0	
17) # of Selloffs	65	67	+3.08%	27) # of Shrs Sold Opn Mkt	24,129	76,663	+217.72%
18) % Chg in Inst Positions	-1.18	-3.22	-2.04	28) Avg Opn Mkt Buy Price	0	0	0.00
				29) Avg Opn Mkt Sell Price	130.71	143.61	+12.90
Top Geographic Ownership (%)				Top Ownership Type (%)			
53) Geographic	10/29/17	Curr	Change	54) Ownership Type	10/29/17	Curr	Change
31) UNITED STATES	90.55	88.44	-2.11	41) Investment Advisor	80.89	80.39	-0.50
32) SWITZERLAND	5.02	5.35	+0.33	42) Bank	9.74	9.87	+0.13
33) CANADA	3.58	3.6	+0.02	43) Hedge Fund Manager	4.31	3.48	-0.83
34) GERMANY	0.01	1.06	+1.05	44) Brokerage	1.41	2.12	+0.71
35) UNITED KINGDOM	0.03	0.69	+0.66	45) Insurance Company	1.58	1.66	+0.08
36) Unknown	0.48	0.45	-0.03	46) Pension Fund	0.93	1.43	+0.50
37) MEXICO	0.14	0.22	+0.08	47) Individual	0.43	0.45	+0.02
38) BRAZIL	0	0.12	+0.12	48) Holding Company	0.41	0.4	-0.01
39) JAPAN	0.03	0.02	-0.01	49) Corporation	0.11	0.11	0.00

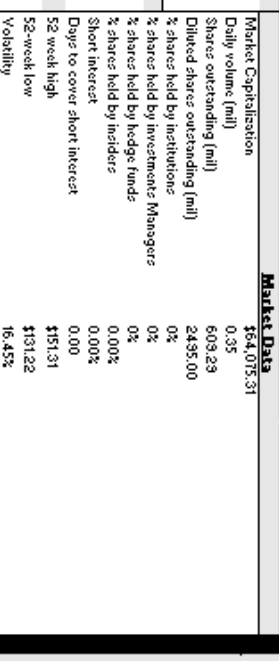


Conclusion:

Diageo has shown an over-performance in its net sales, net profits and operating profits 10 years in a row. Diageo has outperformed the FTSE 100 over the last ten years in terms of overall growth rate of 5.7% vs 2.4%, growth quality 79% vs 50%, profitability 12.3% vs 10% and dividend growth 7.5% vs 5.4%. Its leadership position in the spirits market enable Diageo to over-perform the market, alcoholic beverages being the second most returning industry, after tobacco. This is why I recommend Diageo as a strong long-term buy.

NEUTRAL

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Quarter ending		Part Earning Surprises		Market and Credit Scores		Industry and Segment Information	
Revenue		EBITDA		Recommendation (STARS) Value--0		LTM Revenues by Geographic Segments	
6/30/2017	N/A	-2423.64z		Recommendation (STARS) Description--0		Great Britain--3%	
3/30/2017	N/A			Quality Ranking Value--0		North America--34%	
12/31/2017	N/A			Quality Ranking Description--0		Europe and Turkey--24%	
3/31/2018	N/A			Short Score--0		Netherlands--0%	
6/30/2018	N/A			Market Signal Probability of Default % (Non-Ratings)--0.06%		India--17%	
Mean	N/A	-2423.64z		CreditModel Score (Non-Ratings)--a		East of World--51%	
Standard error	0.4%	N/A		CreditModel Score (Non-Ratings)--a		Asia Pacific--21%	
						Peer	
						Neatle S.A.	
						..	

Management	Position	Total Compensation	Growth	Stock Price	Growth During Year
Mancuso, Ivan	CEO & Executive Director	187% per annum over 5y	1.5%	per annum over 5y	
Mikellia, Kathryn	CFO & Executive Director	57,088 per annum over 2y	12.35%	per annum over 2y	
Marriott, Yvonne	Corporate Information Officer				
McCarthy, Stephen	General Counsel & Company Secretary				
Sailer, Sjl	Chief Marketing Officer				
Day, Tom	Chief Sales Officer				
Porter's 5 Forces (Scores are percentages)					
<hr/>					
		The Coca-Cola Company			
		Brown-Forman Corporation			
		Heineken N.V.			
		Anheuser-Busch InBev S.A.M.V.			
		Coronation Brands, Inc.			
		..			

Profitability			
	DEO (TUM)	DEO Historical	Pearce's Media (UTM)
Return on Capital (GAAP)	10.3%	8.46%	7.77%
Operating Margin	24%	21.31%	17.55%
Revenue/Capital (GAAP)	0.45	0.33	0.44
ROE (GAAP)	21.7%	24.0%	17.6%
Net margin	23.7%	20.1%	16.4%
Revenue/Book Value (GAAP)	1.170718257	1.13	1.63
Invested Funds			
	DEO (TUM)	DEO Historical	Pearce's Media (UTM)
Cash/Capital	4.4%	5.3%	6.5%
W/C/Capital	15.1%	14.3%	1.2%
Operating Assets/Capital	68.8%	70.3%	54.8%
Goodwill/Capital	11.8%	3.2%	18.1%
Capital Structure			
	DEO (TUM)	DEO Historical	Pearce's Media (UTM)
Total Debt/Market Capitalization	0.47	0.43	0.57
Cost of Debt	4.7%	5.3%	4.2%
DOFS Rating (F-score, Z-score, and default Probability BB)	6.3%	12.1%	6.3%
WACD			

