

Diageo plc (DEO)

\$147.51 (As of 06/05/20)

Price Target (6-12 Months): **\$156.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/01/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: C

Growth: A

Momentum: D

Summary

Shares of Diageo have declined the industry in the past six months. The stock came under pressure when management withdrew its organic net sales and operating profit guidance for fiscal 2020, due to the uncertain COVID-19 impacts. Also, Diageo has decided not to buyback any shares for the rest of fiscal 2020. Apart from these, the company is undertaking other preventive measures, such as lowering discretionary expenses, suspending A&P costs and capital expenditure, and tightening control on working capital. However, its expansion and innovation strategy bode well. Diageo remains focused on expanding the fastest-growing premium spirits brands by resource optimization, which should drive growth and boost shareholder value. The company's focus on achieving growth via acquisitions is also yielding results.

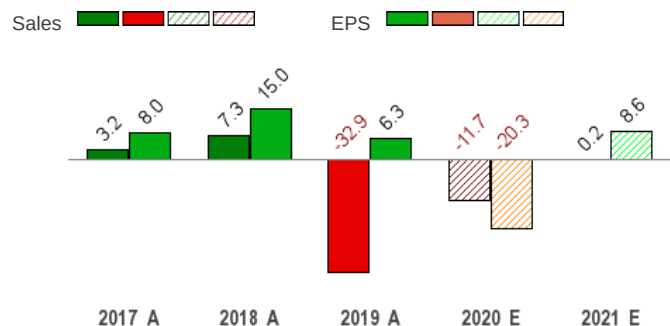
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$176.22 - \$100.52
20 Day Average Volume (sh)	493,822
Market Cap	\$86.2 B
YTD Price Change	-12.4%
Beta	0.59
Dividend / Div Yld	\$2.70 / 1.8%
Industry	Beverages - Alcohol
Zacks Industry Rank	Top 22% (55 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	NA
Last Sales Surprise	NA
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	NA
P/E F1	27.4
PEG F1	3.3
P/S TTM	NA

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					14,731 E
2020					14,707 E
2019					16,653 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$5.84 E
2020					\$5.38 E
2019					\$6.75 A

*Quarterly figures may not add up to annual.

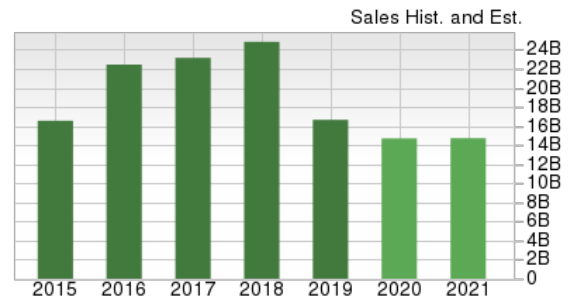
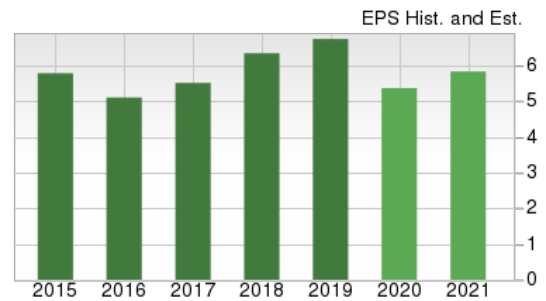
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/05/2020. The reports text is as of 06/08/2020.

Overview

London-based Diageo plc operates in approximately 180 countries and is involved in producing, distilling, brewing, bottling, packaging as well as distributing spirits, wine and beer. The company offers its products under globally recognized flagship brands, such as Smirnoff, Johnnie Walker, Captain Morgan, Baileys, Buchanan's, J&B, Tanqueray and Guinness. Among these, 14 brands – Johnnie Walker, Smirnoff, Baileys, Crown Royal, Captain Morgan, Jose Cuervo, JeB, Buchanan's, Windsor, Ketel One vodka, Cîroc, Tanqueray, Bushmills and Guinness – are classified as global strategic brands.

The company operates through five regions:—

- **North America** includes four operating units — U.S. Spirits, Diageo-Guinness USA, Diageo Chateau & Estate Wines Co. and Diageo Canada.
- **Europe** comprises Great Britain, Ireland, Iberia, France, Germany, Benelux, Italy, Nordics, Greece, Switzerland, Austria, the Western European reserve brands, Diageo Guinness Continental Europe, European wines and the Western European operations of Global Travel. Western Europe.
- **Africa** is one of the oldest and largest markets for the Guinness brand. The company operates either through subsidiaries or under license.
- **Latin America and the Caribbean** region, which includes Mexico, Diageo distributes mainly through a mixture of Diageo companies and third-party distributors. In addition, Diageo owns a controlling interest in Desnoes & Geddes Limited, the Jamaican brewer of Red Stripe lager.
- **Asia Pacific** includes operations in India, China, Australia, New Zealand, South Korea, Japan, Thailand, Vietnam, Singapore, Malaysia and other Asian markets.



Reasons To Buy:

- ▲ **Solid First-Half Fiscal 2020 Results:** Diageo has been gaining from strong fundamentals, continuous innovation and focus on expansion despite soft industry trends. These factors largely fueled the company's results in recent years. The company reported strong results in first-half of fiscal 2020, wherein sales and earnings improved year over year. Earnings gained from organic operating profit growth and the capital return program. Meanwhile, top-line improvement was backed by solid organic growth, benefiting from broad-based sales gains across all regions and categories. Organic sales increased 4.2%, driven by 0.2% rise in organic volume and 4% growth in price/mix.

Volume growth was mainly attributed to rapid growth in tequila, Canadian whiskey and Chinese white spirits. Price/mix was particularly aided by premiumization, improved revenue-management capabilities and sustained innovation, with the launch of Crown Royal Regal Apple and Tanqueray Flor de Sevilla in the prior years.

- ▲ **Organic Operating Profit Growth Aid Earnings:** Diageo's organic operating profit grew 4.6%, higher than organic net sales growth, owing to improved price/mix and productivity benefits from everyday cost efficiencies. Further, organic operating margin expanded 13 bps, driven by the focus on productivity, revenue-management initiatives and the mitigation of cost inflation.
- ▲ **Portfolio Management & Premiumization Bode Well:** Diageo explores opportunities to expand geographically through acquisitions to further strengthen its exposure in the fast-growing categories. In sync with this strategy, the company has acquired a number of companies and brands, including Don Julio, United Spirits and Casamigos, as well as increased shareholding in Shui Jing Fang. Additionally, the company has been divesting assets to enhance its portfolio — including the divestiture of 19 brands to Sazerac. These actions enable Diageo to focus on the premium and above-premium brands, with stronger growth and profit opportunities. Moreover, the company is set to grab a share of the momentum in the fast-growing hard seltzer category by promoting the Smirnoff Seltzer with endorsements. Notably, seltzers are stealing a large share from the beer, and wine & spirits categories, with a significant share sourced from the beer category.
- ▲ **Solid Financial Strength:** Diageo boasts strong financials evident from solid generation of operating and free cash flows. Cash flow provides management the opportunity to invest in product innovations, acquisitions and brand development in addition to regularly paying dividends and repurchasing shares. In the first half of fiscal 2020, Diageo delivered net cash from operating activities of £1.3 billion and free cash flow of £966 million. In sync with its disciplined approach to capital allocation, primarily to enhance shareholder value, the company returned £1.1 billion to in the first half of fiscal 2020 through share repurchases. It also increased the annual dividend by 5%.

Diageo's strong fundamentals and continued innovation and expansion largely aided top and bottom lines in recent years. Notably, it reported sales and earnings growth in first-half of fiscal 2020.

Reasons To Sell:

- ▼ **COVID-19 Compels Diageo to Withdraw Guidance:** Shares of Diageo have decreased 8.9% in the past sixmonths compared with the industry's decline of 17.7%. The stock further came under pressure owing to the ongoing coronavirus pandemic, which led management to withdrawn its organic net sales and operating profit guidance for fiscal 2020. Further, Diageo has decided not to buyback any shares under its three-year share repurchase plan worth up to £4.5 billion, for the rest of fiscal 2020. Apart from these, the company is undertaking other preventive measures, such as lowering discretionary expenses, suspending A&P costs and capital expenditure, and tightening control on working capital.
- ▼ **Valuation Looks Stretched:** Considering price-to-earnings (P/E) ratio, Diageo looks overvalued when compared with the braoder sector and the S&P 500. The stock has a trailing 12-month P/E ratio of 21.85x, which is below the median level of 24.08x and the high level of 27.49x scaled in the past year. On the contrary, the trailing 12-month P/E ratio is 21x for the sector and 20.53x for the S&P 500. Given these factors, we believe that the stock is quite stretched from the P/E aspect.
- ▼ **Higher Costs Remain a Headwind:** Though Diageo's margin performance was significantly aided by favorable price/mix and efficiencies from the productivity program; it continued to witness pressures from cost inflation and higher marketing expenses. Notably, the company gross margin contracted 65 basis points (bps) in first-half fiscal 2020 driven by inflation in cost of goods sold (COGS) and nearly flat volumes. During the first half, the company witnessed inflationary pressures from commodity costs, including Agave and glass. Further, operating margin gains were partly offset by cost inflation and increased marketing expenses. Notably, marketing spends increased 6% in the first half, reflecting a 25-bps increase as a percentage of sales, on higher marketing investments for attractive growth categories and regions.
- ▼ **Higher Taxes May Hurt Performance:** The beer and beverage industry remains susceptible to unfavorable changes in taxes. In many regions, these taxes constitute a major chunk of the cost of beer that is charged to customers. Thus, any rise in excise taxes or indirect taxes on Diageo's products is likely to shift consumers' preferences to other beverages and weigh upon the overall consumption of the company's products, thus hurting its revenues and margins. Consequently, adverse taxation amendments remain a hurdle for the company's profitability.

Diageo cut net sales view for fiscal 2020 on the ongoing trade conflicts in key markets and the spread of coronavirus in China. It expects net sales for fiscal 2020 at the lower end of 4-6% growth range.

Last Earnings Report

Diageo 1H20 Earnings Solid, Cuts View

Diageo plc reported interim results for the first half of fiscal 2020, ended Dec 31, 2019, wherein pre-exceptional earnings per share improved 4.2% year over year to 80.2 pence (in local currency). This was backed by higher operating profits and the capital return program.

However, the company cut net sales view for fiscal 2020 on the ongoing trade conflicts in key markets and the spread of coronavirus in China. The company expects the persistence of increased levels of volatility in India, Latin America and the Caribbean, and Travel Retail to hurt sales for fiscal 2020.

For fiscal 2020, it now expects net sales at the lower end of 4-6% growth mentioned earlier. The company had earlier expected sales growth at the mid-point of the aforementioned range. However, it continues to anticipate organic operating profit growth of about 1% ahead of organic net sales. This is consistent with its medium-term target stated earlier. Based on current rates, the company now expects foreign exchange to hurt net sales by £110 million and operating profit by £40 million in fiscal 2020.

First-Half Fiscal 2020 Highlights

On a reported basis, net sales and operating profit moved up 4.2% and 0.5%, respectively, owing to organic growth. Top-line growth also included slight negative impacts of the sale of a portfolio of 19 brands to Sazerac in December 2018.

Organic sales also rose 4.2%, benefiting from broad-based sales growth across all regions and categories, as well as rise in organic volume. This was, however, offset by challenges in India, Latin America and the Caribbean, and weak Travel Retail. Notably, organic volume was up 0.2% and price/mix grew 4%. Organic sales growth was above the company's medium-term target of mid-single digits.

Volume growth was mainly attributed to rapid growth in tequila, Canadian whiskey and Chinese white spirits. Price/mix was particularly aided by premiumization, improved revenue-management capabilities and sustained innovation, with the launch of Crown Royal Regal Apple and Tanqueray Flor de Sevilla in the prior years.

Gross margin contracted 65 bps in the first half, hurt by inflation in cost of goods sold (COGS) and nearly flat volumes. This was partly negated by favorable price/mix. During the first half, the company witnessed inflationary pressures from commodity costs, including Agave and glass.

Improved price/mix and productivity benefits from everyday cost efficiencies aided organic operating profit, which grew 4.6%, higher than organic net sales growth. Further, organic operating margin expanded 13 bps, driven by the focus on productivity, revenue-management initiatives and the mitigation of cost inflation.

Financials

In the first half of fiscal 2020, Diageo delivered net cash from operating activities of £1.3 billion, marking a decline of £0.3 billion year over year. Furthermore, the company reported strong free cash flow of £966 million, down from the last year due to one-time tax payments.

Diageo remains committed to its disciplined approach to capital allocation primarily to enhance shareholder value. In sync with that, it returned £1.1 billion to shareholders in the first half of fiscal 2020 through share repurchases.

The company earlier announced plans to repurchase shares worth up to £3 billion for the year ending on 30 Jun, 2019. It now increased the interim dividend by 5%.

For fiscal 2020, the company now expects net capital expenditure of £700-£750 million as it is ahead of the plan, with the implementation of some IT projects. This reflects a modest increase from the previous guidance.

Medium-Term View Intact

Diageo reiterated its growth targets for the medium-term between fiscal 2020 and 2022, which was initially announced in May 2019. The company continues to expect organic net sales growth in mid-single digits for the period. Further, it expects organic operating profit to sustainably grow by 1% ahead of net sales to 5-7%.

Quarter Ending 06/2019

Report Date	Jul 25, 2019
Sales Surprise	NA
EPS Surprise	NA
Quarterly EPS	NA
Annual EPS (TTM)	NA

Recent News

Diageo Hurt by Coronavirus Impact, Withdraws FY20 View - Apr 9, 2020

As the novel coronavirus outbreak shows no signs of stopping anytime soon, Diageo global business updates and the impact of government restrictions on its operations. To this end, management has withdrawn its organic net sales and operating profit guidance for fiscal 2020.

Moving on, Diageo notes that the interim dividend of 27.41 cents per share, which was announced on Jan 30, has been paid out to shareholders on Apr 9 and the US ADR holders will receive it on Apr 14. Given the unprecedented impacts of COVID-19, Diageo has decided not to buyback any shares under its three-year share repurchase plan worth up to £4.5 billion, for the rest of fiscal 2020. Apart from these, the company is undertaking other preventive measures, such as lowering discretionary expenses, suspending A&P costs and capital expenditure, and tightening control on working capital.

Diageo Commits Alcohol Supplies for Making Hand Sanitizers Amid Coronavirus – Mar 23, 2020

Diageo revealed it will donate up to two million liters of alcohol to manufacturing partners to overcome the shortage of hand sanitizers for healthcare workers due to the wide spread global coronavirus pandemic. The company stated that this donation will be enough to make 8 billion 250ml bottles of hand sanitizers, which will be primarily supplied to frontline healthcare professionals in the fight against COVID-19. The company will provide Grain Neutral Spirit, a 96% strength ethyl alcohol, for no cost to manufacturers of hand sanitizers in various countries to overcome the shortage of hand sanitizers. This spirit is used to produce vodka and gin.

Diageo's FY20 Profits to be Hurt by Coronavirus Outbreak – Feb 26, 2020

The outbreak of COVID-19 virus in China has given rise to a tough situation for companies operating in the region. In this situation, Diageo has assessed how much impact the deadly coronavirus outbreak will have on its fiscal 2020 results. Notably, public health measures undertaken across impacted countries in Asia Pacific, primarily in China, have resulted in restrictions on public gatherings, the postponement of events and the closure of many hospitality and retail outlets. Several countries and many businesses have also imposed restrictions on travel. Diageo mentioned that bars and restaurants have largely been closed in China and there has been a significant decrease in dine-out. Also, it cited significant disruption since the end of January as majority of consumption is in the on-trade.

Consequently, it expects China operations to witness softness in the near term, which should have a pronounced impact on fiscal 2020 results. The company anticipates the negative impact of coronavirus outbreak on its fiscal 2020 organic net sales to be £225-£325 million and organic operating profit to be £140-£200 million. Nevertheless, management expects a gradual improvement with consumption returning to normal levels toward the end of fiscal 2020.

Valuation

Diageo shares are down 12.4% in the year-to-date period and nearly 14.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples are down 21% and 9.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are down 16.7% and 6.3%, respectively.

The S&P 500 index is down 1% in the year-to-date period but up 10.5% in the past year.

The stock is currently trading at 25.38X forward 12-month earnings, which compares to 28.52X for the Zacks sub-industry, 20.31X for the Zacks sector and 23.07X for the S&P 500 index.

Over the past five years, the stock has traded as high as 26.07X and as low as 14.61X, with a 5-year median of 20.77X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$156 price target reflects 26.84X forward 12-month earnings.

The table below shows summary valuation data for DEO

Valuation Multiples - DEO					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	25.38	28.52	20.31	23.07
	5-Year High	26.07	28.52	22.37	23.07
	5-Year Low	14.61	18.8	16.65	15.23
	5-Year Median	20.77	23.2	19.66	17.49
P/S F12M	Current	5.85	14.28	9.78	3.59
	5-Year High	6.95	20.67	11.16	3.59
	5-Year Low	3.51	13.04	8.1	2.53
	5-Year Median	5.04	17.34	9.89	3.02
EV/EBITDA TTM	Current	19.75	36.27	34.51	11.82
	5-Year High	23.12	53.27	45.11	12.85
	5-Year Low	14.43	27.03	27.19	8.25
	5-Year Median	18.94	43.34	38.37	10.8

As of 06/05/2020

Industry Analysis Zacks Industry Rank: Top 22% (55 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Craft Brew Alliance, Inc. (BREW)	Outperform	1
Ambev S.A. (ABEV)	Neutral	3
BrownForman Corporation (BF.B)	Neutral	3
AnheuserBusch InBev SANV (BUD)	Neutral	3
Pernod Ricard SA (PDRDY)	Neutral	3
Constellation Brands Inc (STZ)	Neutral	2
Molson Coors Beverage Company (TAP)	Neutral	3
Heineken NV (HEINY)	Underperform	3

Industry Comparison Industry: Beverages - Alcohol				Industry Peers		
	DEO	X Industry	S&P 500	BUD	HEINY	TAP
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	4	-	-	3	3	3
VGM Score	B	-	-	F	A	D
Market Cap	86.19 B	9.44 B	23.09 B	115.30 B	55.94 B	9.18 B
# of Analysts	4	2	14	2	2	7
Dividend Yield	1.83%	0.00%	1.82%	2.30%	1.88%	5.38%
Value Score	C	-	-	D	B	B
Cash/Price	0.02	0.04	0.06	0.00	0.04	0.08
EV/EBITDA	NA	9.48	13.17	5.12	10.65	10.13
PEG Ratio	3.30	4.88	3.13	NA	NA	2.36
Price/Book (P/B)	8.06	2.72	3.15	1.36	2.89	0.71
Price/Cash Flow (P/CF)	20.96	16.63	12.43	9.05	11.23	4.94
P/E (F1)	27.38	29.53	22.80	33.34	29.08	14.18
Price/Sales (P/S)	NA	1.76	2.52	2.24	NA	0.72
Earnings Yield	3.65%	3.18%	4.19%	3.01%	3.44%	7.05%
Debt/Equity	1.14	0.47	0.76	NA	0.77	0.62
Cash Flow (\$/share)	7.04	1.53	7.01	6.32	4.32	8.59
Growth Score	A	-	-	F	B	F
Hist. EPS Growth (3-5 yrs)	NA%	7.53%	10.87%	-5.30%	NA	7.06%
Proj. EPS Growth (F1/F0)	-20.37%	-19.08%	-10.79%	-57.97%	-31.28%	-34.14%
Curr. Cash Flow Growth	-1.12%	0.66%	5.48%	11.61%	2.45%	-5.29%
Hist. Cash Flow Growth (3-5 yrs)	-0.55%	3.18%	8.55%	0.84%	5.02%	11.28%
Current Ratio	1.15	1.39	1.29	0.83	0.68	0.59
Debt/Capital	53.21%	32.78%	44.75%	53.57%	43.57%	38.29%
Net Margin	NA%	-0.05%	10.59%	6.51%	NA	-0.21%
Return on Equity	NA%	8.69%	16.26%	12.29%	NA	7.01%
Sales/Assets	NA	0.50	0.55	0.43	NA	0.44
Proj. Sales Growth (F1/F0)	-11.69%	-3.30%	-2.61%	-19.84%	-18.10%	-8.89%
Momentum Score	D	-	-	D	D	D
Daily Price Chg	1.17%	0.21%	2.89%	3.91%	-0.01%	0.21%
1 Week Price Chg	1.40%	2.02%	4.60%	14.62%	10.48%	3.07%
4 Week Price Chg	7.56%	11.86%	15.60%	34.76%	21.21%	12.77%
12 Week Price Chg	17.50%	16.09%	29.34%	29.93%	17.65%	10.42%
52 Week Price Chg	-13.78%	-7.73%	2.76%	-32.01%	-10.59%	-26.53%
20 Day Average Volume	493,822	39,803	2,537,324	3,499,577	102,572	2,921,725
(F1) EPS Est 1 week change	-0.69%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.88%	0.00%	-0.08%	-11.83%	0.00%	-0.43%
(F1) EPS Est 12 week change	-22.75%	-23.01%	-16.19%	-49.41%	-36.10%	-23.28%
(Q1) EPS Est Mthly Chg	NA%	0.00%	0.00%	81.25%	NA	-0.85%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	A
Momentum Score	D
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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