

Diageo plc

CORE HOLDING*

Recommended since 03.07.18

05.08.2022



Country	GB	Market capitalization (bn)	GBP	88.5	Perf. since reco. (%)	
Sector	Food & Beverage	Free float		97.1%	Diageo plc	42.3
Factset	DGE-GB	Closing price	GBP	38.83	Sector	25.5
ISIN	GB0002374006	ESG Risk score*	16.7	Low risk		

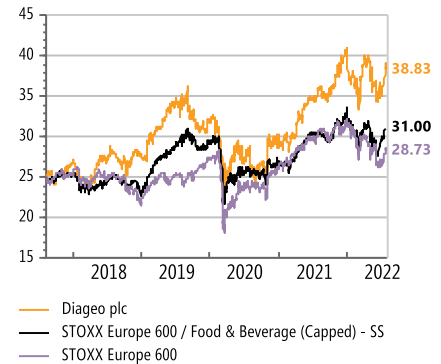
*From 2015, B&Cie separates its investment recommendations into Core Holdings (higher organic growth potential, high free cash flow, ROCE in excess of the cost of capital and balance sheet efficiency throughout the cycle) and Satellite Recommendations, which do not meet the above criteria but are likely to outperform in the short-to-medium term.

Profile

Global leader in spirits by volume, sales and EBIT, with a market share of 26% (vs. 17% for Pernod Ricard and 9% for Bacardi). Sales are evenly distributed: one quarter in Europe, one third in North America and 40% in emerging markets. Brands include whiskies (Lagavulin, J.Walker, Bushmills, J&B, etc.), vodka (Smirnoff), gin (Tanqueray), Tequila (José Cuervo), rum (Captain Morgan), liqueur (Baileys) and beer (Guinness). Owns 34% of Hennessy (cognac).

Market - competition - positions - barriers to entry

Diageo's leading position is built on its comprehensive portfolio of brands, a retail network spanning all markets, and strong positions in the premium segment, emerging markets and the US. A global presence and a healthy balance sheet make it the most defensive player in a resilient sector. Targeted acquisitions (emerging markets) and refocusing on its core business (sale of wine business) have helped speed up profitable growth!



Source: Factset

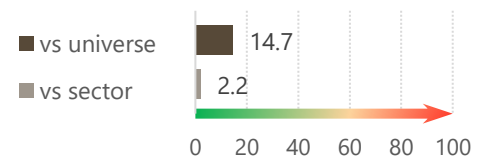
Investment case

- The global spirits market has been growing again between 2017 and 2019. Europe and the US benefited from strong demand for scotch, gin and tequila. The US boom in tequila (José Cuervo and Don Julio) and the revival in gin (Tanqueray) in the US and Europe combined with improved momentum in cognac and whisky in emerging markets, where premiumisation has been in full swing (thanks to the emergence of new middle classes). Note that a healthy travel retail market (with air traffic up 3-4% a year) also helped. Against this backdrop: (1) Diageo's organic sales growth quickened in 2017, 2018 and 2019, reaching 6%; (2) its positioning in the most promising categories (better price mix), its innovation and a cost-cutting plan all boosted its operating profitability, with the operating margin up 330 bps in the space of three years.
- After fiscal year 2020 (ending June 30), which saw two very different half-years (good performance in H1 but H2 impacted by Covid), Diageo was targeting an improvement in its organic sales growth and margin for 2021. H1 reached +16% with an acceleration in H2 and the margin, which had fallen to 18.2% in 2020, has risen to 29.4%. This good momentum accelerated further in 2022 with a well-balanced +21.4% organic growth (volumes +10.3% and price/mix +11.1%) and double-digit growth in all regions reflecting the recovery of the on-trade in the USA and Europe, the resilience of the off-trade, the return of travel retail and market share gains thanks to the growing share of spirits in the total alcoholic beverage market EBIT 2022 reached a record £4.80bn (+28%) margin +130bp at 31% thanks to a better distribution mix (return of on-trade) and operational leverage (+ volumes / + prices) which have well offset MP/freight cost inflation.
- For 2023, Diageo is targeting its medium-term objectives: +5/7% in organic sales growth and +6/9% for EBIT. Management is confident for the coming months, seeing no slowdown in its markets and no signs of trading down while price increases are holding up well. Normalization of commercial dynamics in the US (modest growth) and continued recovery in Europe & Asia are his scenario. It sees an improvement in its margin thanks to higher volumes, a more favorable channel mix, the trend towards premiumization and a less penalizing currency effect. The quality of the 2022 results (low sensitivity of demand to price increases) and the favorable outlook allow Diageo to offer visibility in an uncertain geopolitical/economic context.

ESG - risks and key points

- Thanks to its average exposure and serious approach to managing the relevant issues, Diageo is at low risk of suffering significant financial impacts as a result of ESG factors.
- Diageo is exposed to risks associated with the social costs of excessive alcohol consumption and government efforts to reduce those costs through taxation.
- Legislation on alcohol and dominant position -> risks linked to business ethics. Water is a necessary ingredient in preparing beverages.

ESG risk vs. universe & sector (percentile)*



Source: Sustainalytics

Valuation** in GBP

Current price	Value Bordier Scenario
38.8	43.0

Our scenario assumes UK 10-year yields of 3%, a further rebound in sales in 2022, targeting 6% growth in 2025, and a 300 bps uplift in the margin over this timeframe to reach a normative long-term level of 32.5%.

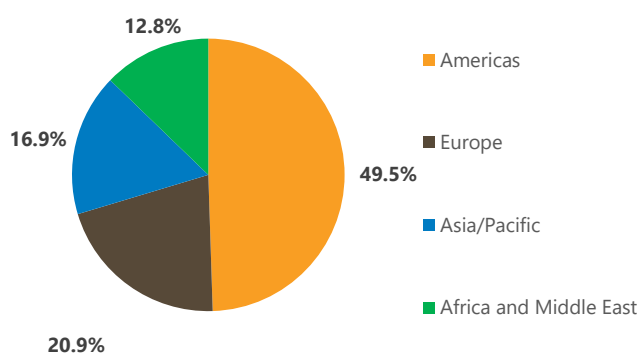
** The theoretical value reflects the company's business model, our baseline growth and profit scenario and market data, exogenous to the company (risk-free rate and equity risk premium). It does not in itself constitute a target price.

"Bordier Core Holding" indicators

In millions of GBP	2020	2021	2022e	2023e	2024e
Sales revenue	11'752	12'733	15'452	17'000	18'365
Sales growth %	-8.7%	8.3%	21.4%	10.0%	8.0%
o/w organic	-7.0%	16.0%	16.0%	7.0%	8.0%
o/w perimeter	0.3%	0.0%	0.0%	0.0%	0.0%
o/w forex	-2.0%	-7.7%	-2.0%	3.0%	0.0%
EBITDA	3'976	4'193	5'289	5'910	6'470
% of sales	33.8%	32.9%	34.2%	34.8%	35.2%
EBIT	3'494	3'746	4'797	5'360	5'870
% of sales	29.7%	29.4%	31.0%	31.5%	32.0%
Adjusted EPS	0.61	1.17	1.43	1.70	1.87
Adjusted EPS growth	-53.5%	92.1%	22.1%	19.3%	9.8%
FCF/Sales	7.8%	19.9%	20.0%	21.0%	21.7%
Dividend yield	1.8%	1.9%	2.0%	2.1%	2.3%
ROCE - WACC	0.0%	0.0%	0.0%	0.0%	0.0%
ROE (%)	20.8%	38.6%	40.2%	37.9%	33.8%
Gearing	156.9%	142.0%	110.2%	74.7%	47.9%

Source: Factset, Bordier estimates

Sales breakdown - 06/2022



Governance and ownership structure

Since 2012 CEO Ivan Menezes, CFO K. Mikells.

Key shareholders (if any):

Capital Research 5.1%; MFS 3.1%.

Any special characteristics of ownership (multiple voting rights, controlling holding company, shareholders' agreements, etc.):

None.

Ratios

	Diageo plc	Stoxx Europe 600 Sector	Stoxx Europe 600 Market
PE (x)***		Food & Beverage	Stoxx 600
2021	33.3	25.2	15.4
2022e	26.5	21.8	12.7
2023e	22.8	19.8	12.3
P/B (x)***			
2021	12.8	3.7	2.0
2022e	10.9	3.5	1.8
2023e	8.7	3.3	1.7
Beta (2Y, daily) vs market:			1.00

***) The valuation ratios set out are provided for information only. They do not constitute the criteria based upon which Core Holdings are selected, and may present significant premi-ums representing the quality of the company's business model.

Agenda

1H 2023 results on 01/26/2023.

Glossary

ESG Risk Score

At B&Cie, we take particular care to ensure that the companies in which we recommend investing are sustainable. Accordingly, our selection process takes account of risks relating to environmental, social and governance (ESG) issues. This approach is underpinned by research from Sustainalytics, the global leader in ESG and corporate governance analysis, whose methodology aims to identify major controversies and risks and assess a company's ESG risks relative to both its sector and the investment universe as a whole. The corresponding score is expressed as a percentile: the lower the overall risk score, the lower the risk within the investment universe.

b-Digital, b-Transition & b-Well

Over and above the conventional geographical and sectoral approaches to asset management, at B&Cie we believe the world of tomorrow is being shaped by structural trends. We have identified three main megatrends: ongoing digital globalisation of the economy; economic transition, particularly in the energy sector; and the quest for wellness. We believe selecting and investing in companies that play an active role in these transformations should lead to more resilient portfolios that generate higher long-term returns. Our investment recommendations in the digital globalisation space are labelled "b-Digital", those in the economic transition space "b-Transition" and those in the wellness space "b-Well". A given recommendation may fall under more than one theme, in which case it will carry the relevant matching labels.

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