



Diageo plc: From Pub to Household Name

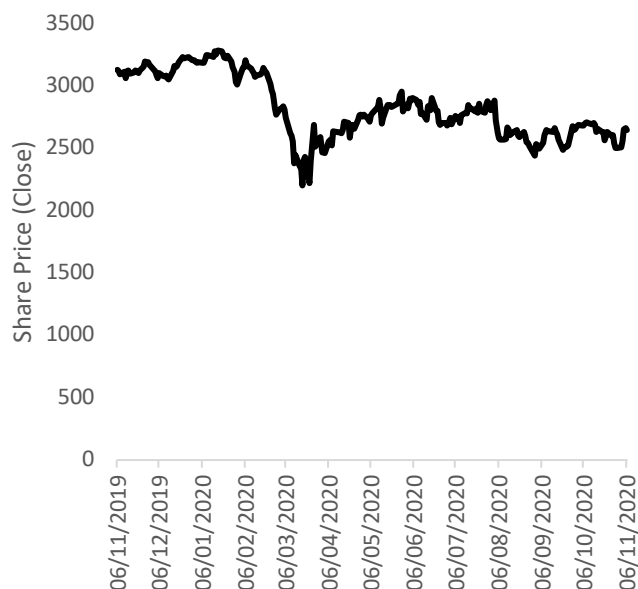
Company Overview:

DIAGEO

Company Name:	Diageo plc
Exchange:	LSE
Ticker:	DGE
Country:	United Kingdom
Sub Industry:	Beverages

Company Data:

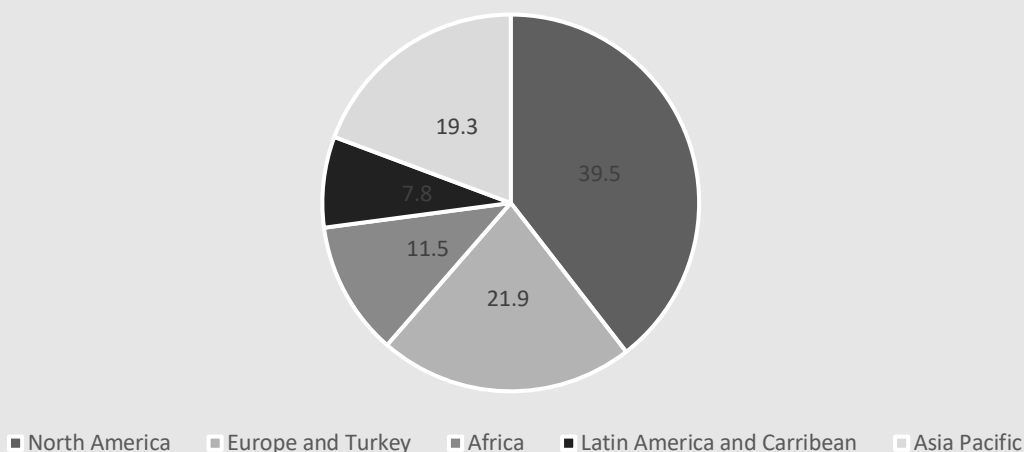
Price Rating:	Buy
Price Target:	2900p
Current Price:	2645.30p
Price Date:	6/11/20
52 Week Average:	\$2816.13p
Market Cap:	£61.8 (bn)
Enterprise Value:	£93.5 (bn)



Company Overview

- Drinks giant controls brands including Baileys, Captain Morgan's, Gordons, Guinness and Smirnoff, all of which are market leaders in their offerings. The company offers over 200 brands in total.
- Strong online element; offerings are amongst the easiest to resource online both directly and through supermarkets.
- Continued expansion; acquisition of Aviation Gin which itself has a strong online element, and the upcoming acquisition of Chase distillery.
- Balance sheet is highly diversified by geography. This is due to a mixture between globally leading brands alongside specialised offerings unique to specific regions. Diageo has over 150 sites in more than 180 countries.

Figure 1: Percentage Share of Net Sales by Region



Reasons to Invest in Diageo

Diageo primarily offers spirits such as vodka, gin and rum. Thus, the company is well poised to benefit from long - term substitution effects from wine and beer in favour of spirits (the proportion of spirits within total beverage alcohol has increased by 4% from 2005 to 2019). The pandemic has fuelled the transition from conventional drinking in pubs to RTDs. Thus, we have two tailwinds which combine to favour spirits in the form of RTDs. This presents a new opening for Diageo previously inaccessible due to nature of offerings. Diageo can now compete directly with canned beers with canned spirit and mixer offerings. Furthermore, this will not result in cannibalisation of sales because these drinks have lower alcohol percentages and therefore appeal to different customers. The resultant is an opportunity for growth which will be accelerated by the pandemic. Alongside this, there are a wide range of opportunities for growth in developing countries which run in parallel with Diageo's scale and scope enabling intimate knowledge of local markets juxtaposed with global reach.

1. Pandemic Implications

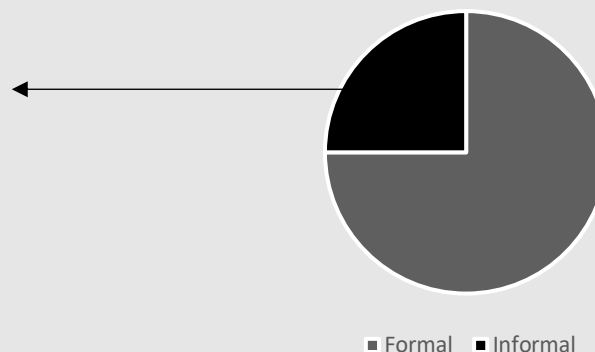
- The pandemic has caused pub shutdowns and therefore consumers are forced to buy alcohol from supermarkets or online. The percentage of Diageo offerings within supermarket alcohol aisles is greater than the proportion of Diageo offerings within pubs due to pub selections being more comprehensive. Consumers may be forced to try Diageo's offerings as a result and therefore market share can be gained via substitution effects.
- Transition to on - the - go beverages (RTDs) coinciding with pub closures.
- Earnings evidence during the pandemic consolidates the trend to spirit offerings because of homemade cocktails. The company expects 'lower organic net sales and margin dilution' in the first half of next year however a significant improvement on 2020 earnings. This trajectory coinciding with the stock price at 2645.30p (6.1% shortfall from 52 - week average of 2816.13p) represents a significant discount for a strong long - term proposition.

2. Transition from Informal Alcohol to Formal Alcohol

- There has been increasing tendency to revert away from informal alcohol in developing countries in line with rising incomes. Informal alcohol accounts for 25% of worldwide sales and therefore the entirety of this market can be targeted by Diageo utilising its global reach and prominent market position.

Figure 2: Formal to Informal Alcohol Ratio

The size of the worldwide alcohol market is \$1,513,925 million in 2020. 37% is comprised of spirits. The total potential gain in addressable market from informal alcohol would be a quarter of this figure which equates to a revenue stream valued at \$140,039 million.

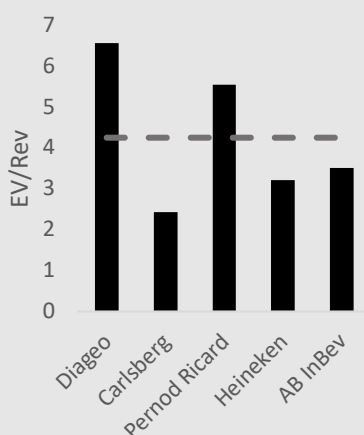
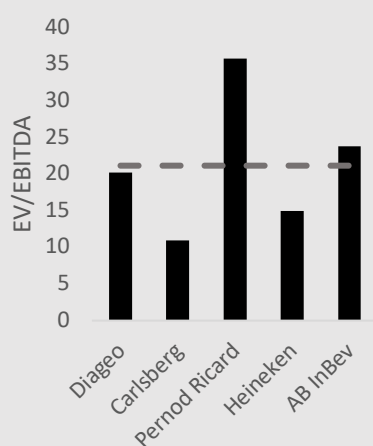


Diageo Valuation Methodology

Intrinsic valuation involved speculative inputting with too many unknowns regarding the trends we have established. We used comparable valuation in replace.

- Pernod Ricard's offerings are more similar in nature, focusing on spirits. AB InBev, Carlsberg and Heineken have advantages with scale and competitive positioning.
- Only Diageo can exploit the consumer trends mentioned with sufficient economies of scale. Therefore, we believe attributing the highest valuation to Diageo as a multiple of revenue is justifiable. Furthermore, the EV/EBITDA metric implies undervaluation relative to competitors and a significant shortfall compared with direct competitor Pernod Ricard.

Figures 2 and 3: Comparable Analysis



5 Year Revenue Growth Rate:	5.30 %
Gross Margin:	60.4%
EBIT Margin:	29.7%
Adj. EPS:	109.40p
Forecasted Growth Rate:	6.90%
Terminal Growth Rate:	5.00%
Discount Rate:	3.9%
Effective Tax Rate:	21%

Future Catalysts:

- **Inorganic Growth:** Company is actively acquiring and pandemic may present discount required for aggressive inorganic growth.
- **Informal Alcohol Trend:** This is a long - term catalyst.

Investment Risks:

- **Covid - 19:** Risks from pandemic are ongoing and will likely reduce sales compared with past 5 years. Informal alcohol trend may be decelerated.
- **Regulatory Environment:** Emphasis on responsible drinking from governments and subsequent tax policies may constrict demand.

Disclosure:

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