

## Diageo

Price 1,867p

## H1 2015/16 results: first take

Fair Value 1830p (-2%)

NEUTRAL

Diageo's H1 2015/16 results came out 3% below market expectations. Despite an unsurprising weak performance in North America, the group's organic sales growth picked up nicely to +1.8% following a flattish trend in 2014/15 and H1 EBIT rose 2.4% organically. Nevertheless, the forex and scope effects were very penalising. On a reported basis, sales declined 5% to GBP5606m (consensus: GBP5,762m; our estimate: GBP5,671m), while EBIT dropped 6.6% to GBP1717m (consensus and our estimate: GBP1,769m), implying a margin down 60bps to 30.6%. We maintain our estimates before the conference call at 9am CET. The comments about the H2 outlook, especially in North America, will be of utmost importance.

## ANALYSIS

- H1 2015/16 sales decreased 5% to GBP5606m (consensus: GBP5,762m; our estimate: GBP5,671m), due to highly negative FX (-4.8%) and perimeter effects (-1.8%). The organic sales growth stood at 1.8% (volumes +1%; price/mix +0.8%), accelerating vs last year (flattish sales in 2014/15). H1 EBIT declined 6.6% (+2.4% organically) to GBP1717m (consensus and our estimate: GBP1,769m), implying a margin down 60bps to 30.6%. EPS pre-exceptionals dropped 4% to 51.3p. Interim dividend was up 5% to 22.6p.
- Sales analysis by region: All markets improved in H1 vs last year, except North America. Key takeaways are:
  - ✓ In North America (34% of group's sales), the group posted a 2% organic sales decline in H1 due to some innovation pipeline effects. This had been well flagged by the group during the 2014/15 results release.
  - ✓ In Europe (22% of group's sales), H1 organic sales grew 3% (+0.1% in 2014/15) driven by an improvement in Western Europe and a positive price/mix in Russia.
  - ✓ Africa (13% of group's sales) registered 3% organic sales growth (+5.9% in 2014/15). The underlying trend was good in Kenya and Ghana while South Africa and Angola were really challenging. Nigeria was impacted by a tough comparison base due to the launch of Orijin last year.
  - ✓ H1 organic sales were up 9% in LATAM (9% of group's sales). This was a strong improvement vs 2014/15 (-1%). The group was no longer impacted by destocking in the free trade zones/border areas. Mexico and Colombia were robust. In Brazil (an estimated 50% of the sales in the region), net sales were up 12% due to a positive shipment phasing ahead of an excise duty hike.
  - ✓ In Asia Pacific (22% of group's sales), H1 organic sales increased 2% following a 2.4% drop in 2014/15 as the group benefitted from a more favourable comparison base (-5.4% in H1 2014/15) and the end of destocking.
- Outlook: For the full year the group expects volume growth to drive a stronger top line performance, margin to slightly improve and strong cash conversion to continue. It remains confident in achieving its objective of mid single digit top line growth and 100bp of organic operating margin improvement in the three years ending 2018/19

## VALUATION

- At yesterday's share price, the stock is trading at 18.6x EV/EBIT 2015/16e and 17.7x EV/EBIT 2016/17e, respectively 5% and 7% above the peers' average.

## NEXT CATALYSTS

- Africa call on 3rd March
- LAC call on 12th May

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Bloomberg	DGE LN
Reuters	DGE.L
12-month High / Low (p)	2,023 / 1,640
Market Cap (GBP)	46,975
Ev (BG Estimates) (GBP)	55,332
Avg. 6m daily volume (000)	4 123
3y EPS CAGR	3.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.6%	0.2%	2.6%	0.6%
Food & Bev.	-2.2%	-1.3%	2.3%	-2.3%
DJ Stoxx 600	-7.1%	-8.5%	-11.8%	-7.0%

YEnd Jun. (GBPm)	06/15	06/16e	06/17e	06/18e
Sales	10,813	10,379	10,575	11,097
% change		-4.0%	1.9%	4.9%
EBITDA	3,390	3,292	3,409	3,622
EBIT	3,066	2,981	3,092	3,289
% change		-2.8%	3.7%	6.4%
Net income	2,225	2,152	2,267	2,450
% change		-3.3%	5.3%	8.1%

	06/15	06/16e	06/17e	06/18e
Operating margin	28.4	28.7	29.2	29.6
Net margin	23.8	24.9	23.2	23.0
ROE	24.0	20.4	20.0	19.9
ROCE	12.3	12.5	12.8	13.2
Gearing	102.9	79.0	69.2	59.3

(p)	06/15	06/16e	06/17e	06/18e
EPS	88.40	85.50	90.05	97.35
% change		-3.3%	5.3%	8.1%
P/E	21.1x	21.8x	20.7x	19.2x
FCF yield (%)	4.2%	3.5%	4.3%	4.6%
Dividends (p)	56.40	59.22	62.77	67.17
Div yield (%)	3.0%	3.2%	3.4%	3.6%
EV/Sales	5.2x	5.3x	5.2x	4.9x
EV/EBITDA	16.7x	16.8x	16.1x	15.0x
EV/EBIT	18.4x	18.6x	17.7x	16.5x



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SELL ratings 9%

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