

20th May 2016

Food & Beverages

**Diageo**

Price 1,818p

**Adjusting our estimates**

Fair Value 1840p vs. 1790p (+1%)

**NEUTRAL**

We revise upwards our EBIT estimates by 3% on average over the next three years, to take into account the better performance of the high-margin US market. We expect organic sales in the country to increase 2.8% in 2015/16 and 4% in 2016/17 vs respectively +2% and +2.5% before. We maintain our Neutral recommendation, but we lift our Fair Value to 1840p.

**ANALYSIS**

- **Revising estimates up for North America.** We expect organic sales in the region to be up 2.8% in 2015/16 vs our previous estimate of +2%. This implies a strong acceleration over the second half of the year (+8% after -1.7% in H1) which reflects the launch of some innovations (especially Ciroc Apple), an easy comparison base (-3.1% in H2 2014/15) and increased marketing (benefits in H2 of the campaign "Going full captain"). We estimate that the group's value depletions in the country are running at +3% vs +4% for the market. In 2016/17, we forecast 4% organic sales growth vs +2.5% previously.
- **LATAM worst than expected.** During the conference call on Latin America, management said that the region should post low-single-digit sales growth this year. Our estimate calls for +1.5% (-6% in H2) vs +5.5% previously. Last year the company classified intercompany sales as external sales and now has to do some rebasement. Brazil is penalizing: consumer trends are weak and the group shipped in advance in H1 before the excise duty hike at the beginning of December.
- **Africa expected to be soft.** In Nigeria, there is a risk of a further devaluation and the product Oriijn is facing tough comps and increased price competition. We have slightly revised upwards our estimate for 2015/16 organic sales growth in the region at +3.2% (vs +2.5% before), which takes into account an acceleration in H2 driven by South Africa and African Regional Markets.
- **Asia Pacific accelerating in H2.** This is mostly driven by easy comps in Indonesia (the partial beer ban was implemented in H2 2014/15) and South-East Asia (destocking last year). India should be stronger due to renovation of the MacDowell's brand. In the years to come, the country should be a major growth contributor for the group, if we exclude the possible negative effect of spirits being excluded of the GST system. We make no change to our forecast of 3.5% organic sales growth in Asia Pacific.
- **A broadly similar trend in Europe in H1 and H2.** We expect sales to rise 2.9% organically in 2015/16 (+2.5% before). Like its peers, Diageo sees improvement in its Western European markets. In Russia the comparison base is favourable, but this should be partly offset by a slowdown in Turkey as a consequence of a significant excise duty hike in January.
- **EBIT revised upwards by 3% on average over the next three years. We continue to expect 2.8% group's organic sales growth in 2015/16, but with a better performance in the high margin US market. Our estimate for OSG in 2016/17 is now 3.8% vs 3.3% previously.** This year, EBIT should rise 3.1% organically, in line with the group's guidance of a slight improvement in margin. In reported, it should drop 1.9% due to FX and perimeter. In 2016/17, we expect reported EBIT to increase 5.2%. **Brexit is the main risk affecting our estimates.** The pressure on the pound could benefit Diageo, even though the company is lobbying for the UK to stay within the EU as it fears an exit could endanger scotch whisky exports.

**VALUATION**

- The group's trajectory is clearly improving, but it is already largely factored into the share price. At 18.0x EV/EBIT 2015/16e and 17.0x EV/EBIT 2016/17e, the stock is trading 0.5% and 5% respectively above the peers' average. We maintain our Neutral recommendation. Our Fair Value is revised upwards to 1840p.

**NEXT CATALYSTS**

- 2015/16 results due on July 28<sup>th</sup>

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Bloomberg	DGE LN
Reuters	DGE.L
12-month High / Low (p)	1,950 / 1,640
Market Cap (GBP)	45,759
Ev (BG Estimates) (GBP)	54,239
Avg. 6m daily volume (000)	3 891
3y EPS CAGR	3.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-6.6%	-0.6%	-4.4%	-2.1%
Food & Bev.	-4.4%	1.4%	-7.7%	-4.6%
DJ Stoxx 600	-4.4%	2.3%	-12.4%	-8.7%

YEnd Jun. (GBPm)	06/15	06/16e	06/17e	06/18e
Sales	10,813	10,479	10,747	11,245
% change		-3.1%	2.6%	4.6%
EBITDA	3,390	3,322	3,541	3,795
EBIT	3,066	3,007	3,164	3,345
% change		-1.9%	5.2%	5.7%
Net income	2,225	2,201	2,331	2,500
% change		-1.1%	5.9%	7.2%

	06/15	06/16e	06/17e	06/18e
Operating margin	28.4	28.7	29.4	29.7
Net margin	23.8	22.0	23.6	23.3
ROE	24.0	21.1	20.9	20.8
ROCE	12.3	12.6	13.1	13.6
Gearing	102.9	81.2	71.7	61.2

(p)	06/15	06/16e	06/17e	06/18e
EPS	88.40	87.40	92.58	99.28
% change		-1.1%	5.9%	7.2%
P/E	20.6x	20.8x	19.6x	18.3x
FCF yield (%)	4.3%	3.3%	4.4%	4.9%
Dividends (p)	56.40	59.22	62.77	67.17
Div yield (%)	3.1%	3.3%	3.5%	3.7%
EV/Sales	5.1x	5.2x	5.0x	4.7x
EV/EBITDA	16.3x	16.3x	15.2x	14.0x
EV/EBIT	18.0x	18.0x	17.0x	15.9x



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BUY ratings 57%

NEUTRAL ratings 33,8%

SELL ratings 9,2%

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