



# APERTURE

INSIGHTFUL AND RELEVANT RESEARCH UPDATES

## Diageo FY 2024 Results

Share Price	US\$124.64
Fair Value	US\$157.46
Date	01 August 2024

### RESULTS SUMMARY

Full year 2024 proved to be a challenging period for both the beverage industry and Diageo. The company faced a volatile operating environment characterised by pressure on consumer discretionary spending and lingering supply chain issues. As a result, Diageo's financial results and operational performance fell short of expectations. Revenue for FY 2024 decreased by 1.3%, totalling US\$20.3bn. Positively, productivity improvements and cost-saving measures led to an 8.2% increase in operating profit (US\$6bn). Higher finance charges, exceptional once-off items and increased taxes caused net income to decline by 7% to US\$4.2bn. While cash flow from operations remained strong, higher debt levels pushed the debt leverage ratio to the upper end of management's target range of 2.5 – 3 times net debt to EBITDA.

Volumes fell by 8.3m equivalent units in FY 2024, primarily due to challenges in the Latin America and Caribbean (LAC), North America (NAM), and Africa regions, while other regions maintained stable volumes. Nearly half of the volume decline stemmed from inventory normalisation efforts in LAC. In NAM, volumes declined by 2.3m equivalent units due to a cautious consumer environment and ongoing retailer destocking as retailers take a cautious approach to the consumer recovery. In Africa, volumes declined due to price increases driven by currency devaluation. Diageo remains confident that volumes will recover as the consumer environment improves. However, this confidence was not well-received by the market, with the company's share coming under pressure following the results announcement.

### OUR LONG-TERM INVESTMENT VIEW

- Diageo is the world's leading branded spirits manufacturer and second largest alcoholic beverages company with an attractive portfolio of brands that include Johnnie Walker blended scotch, Smirnoff vodka, Crown Royal Canadian whiskey, Captain Morgan rum, Bailey's Irish Cream and Guinness stout.
- In addition to their own brands, Diageo own 34% of premium champagne and cognac maker Moët Hennessy, a subsidiary of French luxury-goods maker LVMH Moët Hennessy – Louis Vuitton.
- Our investment case is predicated on four key points:
  - Diverse portfolio that speaks to different income levels and drinking occasions
  - Strong brands with demonstrated pricing power
  - Spirits gaining market share from beer & wine
  - Sales and earnings mix with meaningful growth markets exposure
- We expect the business to grow the spirits category in under-represented regions with the support of established brands and global marketing scale. Additionally, the group's premiumisation strategy will continue to enhance margins in developed markets over the medium-term.
- Capital allocation remains a key area of focus as the business divests out of underperforming brands, while making bolt-on acquisitions in key strategic areas.

## UNPACKING THE FY 2024 RESULTS

### High level numbers

- **Net sales** declined 1.3% to US\$20.3bn. Organic volumes declined 3.5% while price/mix effects resulted in organic sales declining by 0.6%.
- Focusing on what they can control i.e. costs resulted in **operating profit** increasing by 8%. Diageo are improving productivity and costs in the right way by renegotiating supplier contracts, reducing waste and employing automation. As a result, operating margin improved through the year. Higher interest rates, once-off non-operating items and higher tax charges had a material impact on the bottom line. **Net profit** declined 7%.
- **Earnings per share** declined 11.8% to 173.2 US cents per share.
- **Operating cash flow** improved by 12.9% to US\$4.1bn. This was predominantly driven by an improvement in working capital. However, working capital improved due to the de-stocking taking place in NAM, LAC, and Europe to a smaller extent.
- **Net Debt to EBITDA** increased by US\$700m resulting in the net debt to EBITDA ratio now being right at the top of the 2.5–3 times range. Without growth in EBITDA, the business is going to struggle to justify higher debt levels. Returning cash to shareholders by increasing debt is viewed in a dim light.
- Cash returned to shareholders exceeded US\$1.1bn, predominantly coming from share buybacks. Given the valuation, it appears that buybacks have been done at an opportune time.
- The board has recommended a **5% higher final dividend at 62.98 US cents per share**. This brings the total dividend for the year to 103.48 US cents, a 5% increase on the prior year.

### Category and Regional Performance

- **Scotch:** Performance was heavily impacted by LAC inventory reductions. However, Diageo gained category share in 9 out of the 10 largest measured scotch markets, including the US. Johnnie Walker led share growth, driving over half of scotch organic net sales. The focus for FY25 is to continue building on Johnnie Walker's success while developing opportunities in Single Malts, led by The Singleton.
- **Tequila:** Global rollout continued with 12% organic net sales growth outside NAM and LAC, leading to substantial market share gains across Europe, India, Africa, and Global Travel. Don Julio and Casamigos are expanding their presence globally. In the US, Don Julio gained spirits share, growing 15 times faster than the total US spirits industry in the second half.

- **North America (NAM):** Organic net sales declined, reflecting a cautious consumer environment compounded by lapping inventory replenishment in the prior year. However, Diageo improved its market share performance in the second half of the fiscal year, finishing with holding or maintaining US Total Beverage Alcohol market share in brands covering 90% of US net sales.
- **Europe:** Delivered resilient performance growth and share gains in a challenging environment. Strong growth in Guinness was a key driver.
- **Asia Pacific (APAC):** Growth was driven by Chinese white spirits and strong performance in India with continued premiumisation. Tequila also continued to gain momentum in the region.
- **Africa:** Despite a tough macroeconomic backdrop, the region benefited from price increases and delivered double-digit growth on Guinness and Malta Guinness. Beer was the key driver of performance.
- **Latin America and Caribbean (LAC):** Organic net sales declined 21.1% year-on-year in FY24. The company has worked to manage inventories and ended FY24 with levels more appropriate for the current consumer environment. Brazil, the largest market in the region, saw category improvement in the second half of the year compared to the first half, with Diageo gaining market share.

### Looking ahead

Management expect the challenging consumer environment to persist into FY25, with consumers and retailers remaining cautious due to high interest rates. They anticipate continued negative pressure on organic operating margin in the near term. However, the company is focusing on strengthening business resilience, driving productivity, mitigating cost inflation, and investing strategically for long-term sustainable growth. In the medium term, management remains confident in the long-term fundamentals of the Total Beverage Alcohol industry and Diageo's position within it. They believe demographic trends, rising incomes in developing countries, spirits gaining share from beer and wine, and long-term premiumisation will drive attractive underlying growth.

Diageo aims to achieve a 6% Total Beverage Alcohol share by 2030, focusing on sustaining momentum in global brands like Guinness, Johnnie Walker, and Don Julio, while driving regional growth opportunities. The company plans to lead and shape key consumer trends, including convenience, moderation, and food-pairing

However, Casamigos saw a 22% decline in organic net sales after years of extraordinary growth.

- **Beer:** Delivered 14% organic net sales growth, with 5% volume growth. This was primarily driven by continued momentum in Guinness, which grew 15%, and strong double-digit growth in Malta and Senator in Africa. Guinness held or grew share in its top three markets – US, Great Britain and Ireland.
- **Chinese White Spirits:** Organic net sales grew 27%, rebounding from a 14% decline in the previous year due to Covid-19 restrictions.
- **Other Whisk(e)y:** Delivered strong organic net sales growth fuelled by Bulleit, McDowell's No.1, Royal Challenge, and the successful launch of Buchanan's Pineapple in North America.

occasions, with a pipeline of innovations across multiple markets.

Management is confident that when the consumer environment improves, the actions they are taking will return the company to growth, getting back into their medium-term guidance range for organic net sales growth, with organic operating profit growth broadly in line with organic net sales growth.

Diageo remains a solid business as demonstrated by their fundamentals and ability to navigate difficult market cycles in the past. We believe that they are capable of doing so again, however, we are constantly monitoring and debating their progress. From a valuation perspective, Diageo is trading in very attractive territory as indicated by our fair value.

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