DIAGEO

Diageo plc (DGE:LSE, Market Capitalisation £67,938.2 mln)[1] is the largest and most prominent international alcoholic beverage company owning a portfolio containing a myriad of recognisable legacy brands including Smirnoff, Johnnie Walker, Gordon's, and Baileys. The sheer scale and equity of these brands in connection with over 200 others, has allowed Diageo in 2019 to boast a 25% share of the global spirits market by total volume (over twice as large as its nearest competitor)[2]. The size and breadth of its portfolio provides Diageo with the ability and capacity to be a trend setter, an innovator and ongoing presence in the lives of millions around the world who are increasingly enjoying quality, instead of quantity when it comes to their alcohol consumption.

Revenue By Category

Scotch / Whiskey: Johnnie Walker, Crown Royal, Grand Old Parr.
2020 Revenue £6,902 million, 39% of Revenue;

Beer: Guinness, Dragon Stout, Red Stripe.
2020 Revenue £2,655 million, 15% of Revenue;

Vodka: Smirnoff, Ketel One, Cîroc.
2020 Revenue £1,947 million, 11% of Revenue;

Rum: Captain Morgan, Cacique, Pampero Rum.
2020 Revenue £1,239 million, 7% of Revenue;

Liqueurs: Baileys, Sheridan's,
2020 Revenue £885 million, 5% of Revenue;

Tequila: Don Julio, Casamigos, DeLeón.
2020 Revenue £885 million, 5% of Revenue;

Gin: Tanqueray, Gordon's Gin, Jinzu.
2020 Revenue £885 million, 5% of Revenue;

Other: Smirnoff & Cola, Pimm's No. 1 & Lemonade, Gordon's Gin & Tonic.
2020 Revenue £2,301 million, 13% of Revenue.

Lockdown restrictions imposed by governments in response to COVID-19 has had a significant on the hospitality industry which has flow on effects to the alcoholic beverage industry. On-premise (restaurants, bars, etc.) sales in 2020 reduced as consumers were forced into accepting new routines. Diageo's revenue fell by -23.61% from 30 June 2019 to 30 June 2020 while its share price fell -20.48% during the same period, presenting an attractive opportunity for the Elevation Capital Global Shares Fund to reacquire a position in this truly global company (we previously owned Diageo from 2014 to 2018).

Despite the downturn in sales in both volume and dollar terms which is likely to persist until lockdown restrictions are eased, we have reason to remain optimistic about the company's long-term future. Diageo has increased its cash available for acquisitions which enables continued investment in high growth segments within the global drinks industry. We are confident that Diageo is well positioned to weather the economic downturn and emerge in a strong position globally once a "new normal" is established.

Company History

1759 Arthur Guinness signs 9,000 year lease on St. James' Gate brewery in Dublin

1934 MRMA Ltd is incorporated as a public company

1961 - 1962 MRMA Ltd shares first listed on the Stock Exchange
Name Change to Grand Metropolitan Hotels Ltd

1971 - 1973 Grand Metropolitan Hotels Ltd enters the brewing industry by acquiring Truman, Hanbury & Buxton Ltd
Acquires Watney Mann Ltd, of which International Distillers & Vintners Ltd is a subsidiary
Name change to Grand Metropolitan plc

1986 Guinness acquires the Distillers Company Ltd (DCL)

1987 United Distillers (UD) is formed from combining DCL and Arthur Bell & Sons, both owned by Guinness

1997 Diageo created after:
Guinness & Grand Metropolitan merge
United Distillers & Vintners (UDV) created from integration of UD and Grand Metropolitan International Distillers & Vintners businesses

2000 Diageo sells its food assets (the Burger King and Pillsbury companies) to focus soley on premium drinks

2001 Diageo acquires the Seagrams spirits and wine business

2008 Diageo & the Nolet Family form a 50/50 company which owns the perpetual exclusive rights to sell Ketel One Vodka

2013 Diageo acquires a stake in United Spirits Limited becoming the major shareholder in India's leading spirits company

UNITED SPIRITS
A DIAGEO Group Company

Custodian of Iconic Brands

JOHNNIE WALKER
KEEP WALKING

Established in 1820.

The World's Best Selling Scotch Whiskey Brand.

Available in more than 180 countries worldwide.

Tanqueray

Established in 1830.

The World's most celebrated Gin.

Developed by Charles Tanqueray over 170 years ago.

Captain Morgan

Established in 1943.

A Buccaneering brand inspired by an extraorginary life.

GUINNESS
MADE OF MORE

Established in 1759.

Famous for its Irish provenanceand exceptional colour, this is the most prestigous of black beers enjoyed in over 150 countries.

Crown Royal

Created in 1830.

The World's leading Canadian Whiskey Brand.

Developed by Sam Bronfan as a gift for King George VI and Queen Elizabeth.

GORDON'S

Established in 1769.

Gordon's is the world's favourite Gin.

Today, Gordon's is enjoyed by millions of people in over 180 countries around the world.

SMIRNOFF

Established in 1864.

Developed in Moscow by Pyotr Smirnov, created using a unique process involving three distillations and ten stages of filtration.

BAILEYS

Established in 1974.

The world's best-selling cream liqueur.

Produced and bottled exclusively in Ireland, Baileys in enjoyed all around the world.

Don Julio

Established in 1942.

The world's first luxury Tequila.

Today, Gordon's is enjoyed by millions of people in over 180 countries around the world.

Global Prominence in all Categories

Brand strength is the efficacy of a brand's performance relative to its competitors. There are three pillars of brand strength:

- **Marketing Investment:** this relates directly to brand loyalty and relative marketing spend on maintaining market share;
- **Stakeholder Equity:** how the brand is perceived by various stakeholder groups with the customer being the most important;
- **Business Performance:** a brand with strong performance will experience sticky prices (i.e. no requirement to discount) while still achieving high volumes in sales.

Within Diageo, are some of the strongest brands in the world, underpinned by Diageo's marketing spend and over a millennia of cumulative brand histories with unwavering consumer support. In 2019, the best-selling brands globally by category were[3]:

Vodka
Brand: Smirnoff
Owner: Diageo
2019 Volume: 25.6 million 9L case sales

Smirnoff in 2019 volume terms, sold over double its closest competitor Absolut, owned by Pernod Ricard. Despite vodka losing market-share to gin, Smirnoff remains one of the most valuable brands in the spirits industry.

Scotch Whiskey
Brand: Johnnie Walker
Owner: Diageo
2019 Volume: 18.4 million 9L case sales

Johnnie Walker in 2019 volume terms, sold over double its closest competitor, Ballantine's, owned by Pernod Ricard. Johnnie Walker in 2021 is the world's sixth most valuable spirits brand.

Liqueur
Brand: Baileys
Owner: Diageo
2019 Volume: 7.4 million 9L case sales

In 2019, Baileys celebrated the sale of its two billionth bottle; 45 years after the brand's launch. Baileys is available in 160 countries. Per Diageo, 2,400 glasses of the cream liqueur are now consumed every minute of every day.

Gin
Brand: Gordon's
Owner: Diageo
2019 Volume: 6.7 million 9L case sales

Diageo has a grip on the growing Gin category. Not only is Gordon's the highest selling gin brand globally, Tanqueray in 2019 was third with 4.5 million 9L case sales and is gaining market share on Bombay Sapphire.

Canadian Whiskey
Brand: Crown Royal
Owner: Diageo
2019 Volume: 7.9 million 9L case sales

Crown Royal from 2015 to 2019 has increased total volume sold by +6.24% annually.

Indian Whiskey
Brand: McDowell's No. 1 Whiskey
Owner: United Spirits
2019 Volume: 30.7 million 9L case sales

Diageo first acquired a controlling stake in United Spirits in 2013 identifying an opportunity to expand market share in India, one of the most exciting growth markets in the world for alcoholic beverages.

Economic Tailwinds are Present in the Drinks Industry

In 2020, the global alcoholic beverage industry was worth over US$ 1.5 trillion, of which the global spirits market was valued at ~US$ 500 bln[4], consumers are increasingly electing to drink spirits instead of wine and beer. What this means for Diageo, consumer trends and behaviour away from one category and toward another represents a compelling opportunity to further increase its market share. In 2021, the most prominent consumer trends in the spirits industry are:

Consumers are choosing to 'drink better':
In developed markets, consumers are changing their drinking habits from cost conscious to premium drinks in all categories fuelled by rising global incomes and a preference for partnering occasions with the "right drink". In emerging markets, rising prosperity is enabling consumers to trade up to higher quality spirit brands like those owned by Diageo. From 2015-2019, consumer spending on higher priced spirits grew 10x faster than the total spirits category.

Growing preference for spirits:
Consumers who drink alcohol are increasingly choosing spirits over beer and wine. This is a long-term trend that has culminated with higher priced spirits growing 10x faster than the total spirits category. In markets where spirits is a less mature category, mainstream spirits brands can offer quality and affordability. In more mature markets, premium core and reserve brands offer choice and new experiences.

New points of sale:
Like all industries, the global alcohol beverage industry has had to re-imagine its distribution network to reach consumers at a time of global lock downs. The global e-commerce market for spirits and wine is grew by 42% from 2020-2021. China is currently the largest market for e-commerce alcohol sales, but the growth in the U.S. e-commerce alcohol market was 80% from 2020-20219.

From 2013-2018, Gin, and in particular Ultra-Premium Gin, has experienced the highest annual growth rates of all spirit categories[5] as displayed in Figure 1. Outside of the alcoholic beverage industry, the US non-alcoholic and low-alcoholic spirits market is expected to grow annually by +38.80% by 2022 as consumers become increasingly concerned about their health. Non-alcoholic spirits offer consumers a new way to enjoy their favourite flavours without the hangover. As shown in Figure 2, the non-alcoholic drinks category is set to experience the highest amounts of growth in the Ready-to-Drink (RTD) and Spirits category[6].

2013-2018 Annual Sales Growth in Gin Categories (%)

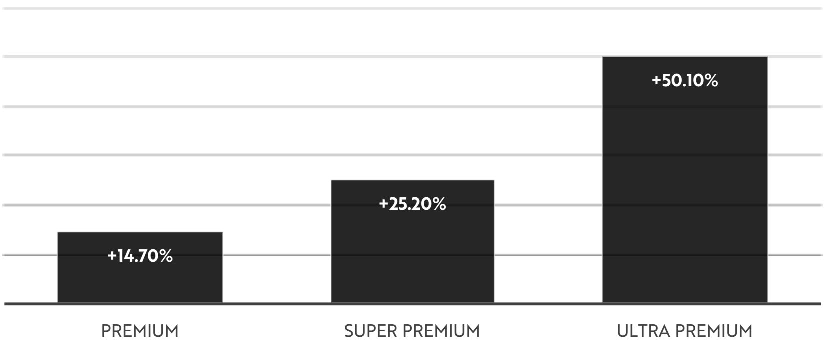
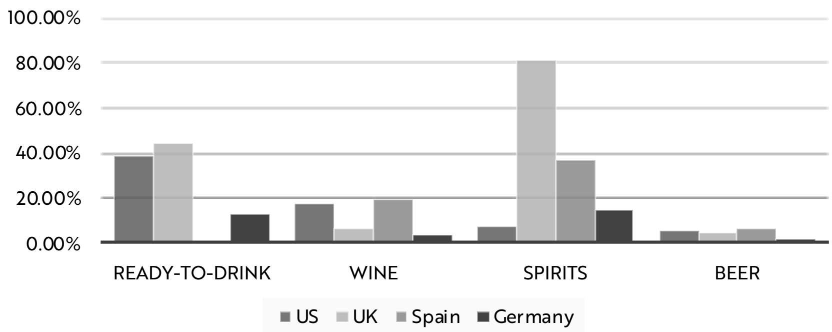


FIGURE 1

Forecast Annual Growth in Non-Alcoholic Drinks by Category (2019 - 2022)



SOURCE: FORBES

FIGURE 2

Diageo Buying into the Tailwinds

Acquisitions allow Diageo to move resources to targeted growth segments within the drinks industry. Instead of needing to develop its own brands, Diageo can leverage its financial stability and balance sheet to acquire companies that already possess market share, and in a mutually beneficial transaction the target is provided with additional resources and enhanced distribution channels to fuel further growth. In 2019 and 2020, Diageo announced three new acquisitions in the high-growth drinks segments as outlined on page 5. These acquisitions represent part of Diageo's larger strategy of expanding in scale and presence within the US market (Diageo's largest market by revenue and volume).

On 7 August 2019, Diageo acquired a majority shareholding in **Seedlip,** the world's first distilled non-alcoholic spirit. Seedlip was launched in 2015 with a mission to solve the dilemma of 'what to drink when you're not drinking'. Since inception, Seedlip has grown to a presence in more than 25 countries, over 300 Michelin-starred restaurants and is stocked in over 7,500 of the world's best bars, restaurants, hotels in retailers. The acquisition provided Diageo the opportunity to increase its earnings in the non-alcoholic spirit market, which is expected to grow by over +80% annually in the United Kingdom by 2022.

"We want to change the way the world drinks and today's news is another big step forward to achieving this. Distill Ventures' and Diageo's shared belief in our vision has enabled us to build a business that's ready for scale and I'm excited to continue working with Diageo to lead this movement."

- BEN BRANSON, FOUNDER OF SEEDLIP

On 17 August 2020, Diageo announced the acquisition of **Ryan Reynolds - Aviation Gin LLC** and **Davos Brands** for US$ 610 million. The acquisitions support Diageo's participation in the super-premium gin segment in the United States which is positioned to continue to experience secular growth as spirits continue to take market share away from Beer and Wine.

"Aviation American Gin is the second largest and one of the fastest growing brands within the super premium gin segment in the United States, having disrupted the gin category with its modern craft credentials. In 2019, it grew volumes at over 100%, adding the highest number of cases and contributing 40% of super premium gin segment growth. The brand is well positioned to continue recruiting consumers into gin with its accessible flavour profile and American provenance. The super-premium segment of the gin category is gaining momentum in the United States. Having more than doubled its share of the gin category between 2014 and 2019, it grew at a compound annual growth rate of 18.5% - making it the fastest growing spirits segment in the United States. A number of trends are supporting this growth, including consumer interest in quality ingredients like botanicals, in the variety of serves for gin and in craft spirits."

- RYAN REYNOLDS, OWNER

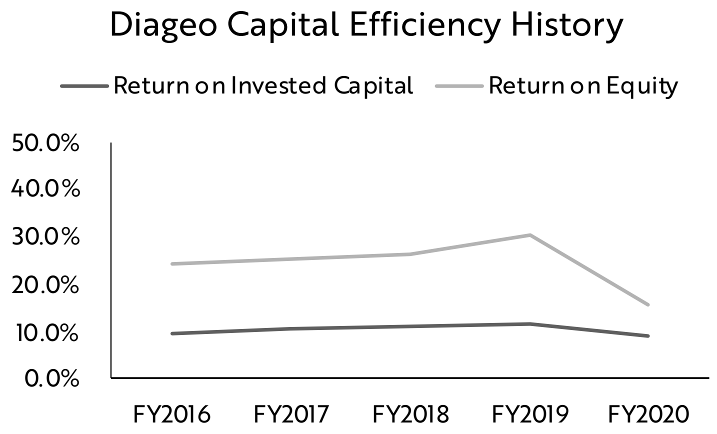
On 26 October 2020, Diageo announced the acquisition of **Chase Distillery**, a UK producer of seven gins, four vodkas and an elderflower liqueur. The UK is the largest gin market in Europe, growing annually at +17.40% between 2014 and 2019. The acquisition further bolsters Diageo's exposure to one of the fastest growing spirits categories.

"We are thrilled to be bringing such a quintessentially British portfolio of high quality, crafted brands into our family. We are excited about the growth opportunity within the premium plus segment and are very much looking forward to working with the Chase team to build on the portfolio's considerable potential."

- DAYALAN NAYAGER, MANAGING DIRECTOR, DIAGEO

Key Financial Metrics Highlight Diageo's *Long-Term Investment* Attractiveness

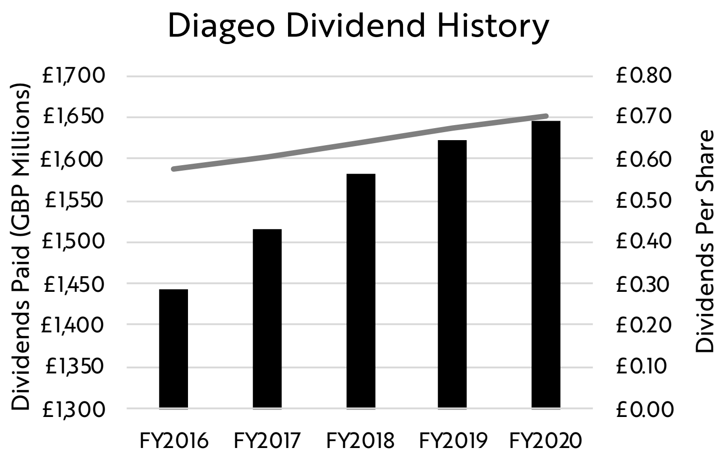
Capital efficiency ratios shed light on managements ability to generate cash flow from the assets held within the company. Diageo has delivered growing Returns on Equity (ROE) from FY2016 to FY2020, the reduction in Return on Invested Capital (ROIC) is attributable to an increase in long-term debt facilities as Diageo issued new debt to provide it with financial flexibility to weather the current volatile markets and allow the company the ability to maintain an aggressive acquisition strategy. Diageo is rated A- by S&P , signalling the stability of the company's cashflows overtime.



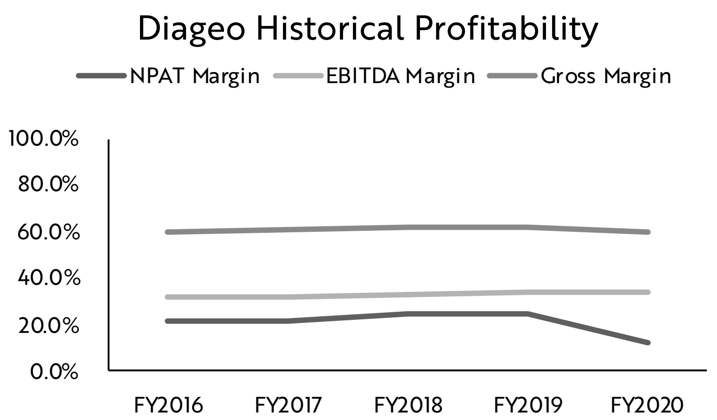
"The A3 long term issuer rating reflects Diageo's strong business profile, including large scale, strong branding and pricing power, global distribution network and leading market positions which enabled the company to consistently grow its revenues and profits over the last years."

- MOODY'S

Diageo's Board and Management team has maintained a long-standing commitment to dividends for shareholders. Its large scale, strong branding and pricing power affords the company the luxury of maintaining a consistent dividend payout that shareholders have come to value. From FY2016 to FY2020, the company maintained a dividend payout ratio above 50%. The total dividend payout by Diageo has increased at an annual rate of +6.06% from FY2010 to FY2020.



Excluding the contraction in Net Profit After Tax (NPAT) in FY2020 on account of the lock down restrictions placed on businesses and consumers, Diageo has maintained consistent operating margins. The company has well refined production processes and benefits from economies of scale evidenced by a five-year average Gross Margin of 61.02% and an average five-year EBITDA margin of 30.16%. This compares favourably to the industry average[12] Gross & EBITDA margins of 47.60% and 20.90% respectively.



How is Diageo Thinking about ESG

As a custodian of capital, we understand our role in rewarding and investing in management teams who are actively attempting to make positive change to maintain the sustainability and biodiversity of our planet while balancing this change with a strong balance sheet and on-going economic returns to ensure the company is sustainable. Failure to comply with ESG is, in our view, one of the most prominent risks given a dynamic regulatory environment increasing focus on ESG as well as what we believe will be a reluctance for capital markets to allocate capital to businesses without clear and concise ESG policies that can be tangibly identified and measured.

Accordingly, based on its current ESG framework, Diageo is rated highly by both S&P Capital IQ and SustainAnalytics (a Morningstar company) for its policies and frameworks despite being in the alcohol beverage industry.

Diageo Grain to Glass Sustainability:

Consumer goods companies are constantly under pressure and scrutiny to improve practices and move toward a more sustainable future. Diageo recognise that preserving the natural resources which the company relies on is a positive not only for the environment but also for the company. By improving its water usage efficiency, the company will benefit from reduced costs while at the same time benefiting the planet. Diageo has set 2030 targets of 30% improvement in water use efficiency across its global producers / distillers and 40% improvements in water stressed areas. Diageo is also committed to reinventing its packaging and production processes to champion sustainability. By 2030, the company is seeking to reduce total packaging weight by 10%, increase recycled content to 60% for all packaging and achieve 100% of all its plastic bottles being made with recycled content. The four pillars of sustainability Diageo have identified are:

Diageo in 2019 was ranked 12th on the Gartner Global Supply Chain. The ranking recognised Diageo's approach to a customer-driven supply chain and highlights leading capabilities in customer excellence and in digital technology with the company's use of digital image recognition to measure on-shelf availability. The company also received a perfect score for Corporate Social Responsibility.

Valuation

Each category of beverage Diageo owns has different macroeconomic tailwinds impacting growth. For example, Vodka is losing overall market share year-on-year while Gin, and in particular Super-Premium Gin, is displaying robust growth year-on-year. For this reason, we have attempted to apply beverage specific multiples to each segment of Diageo's business.

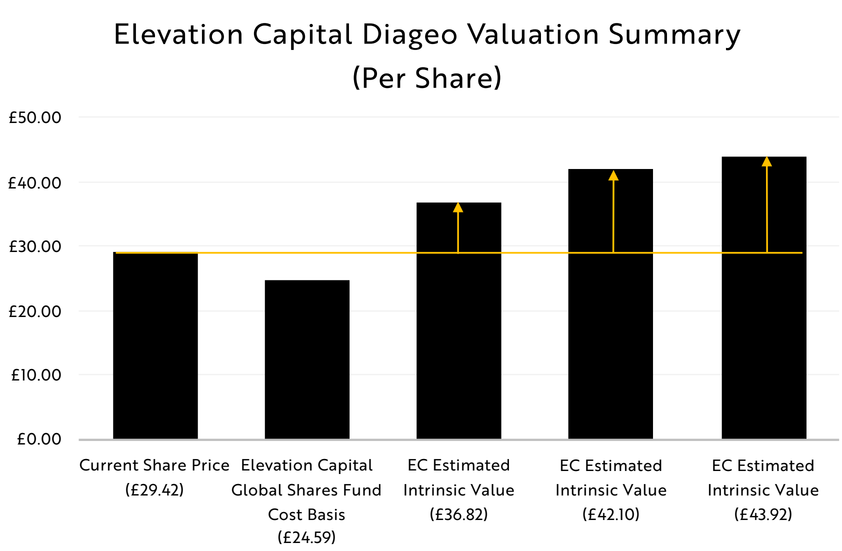
It is important to note, that Diageo has increased its debt facilities to continue to expand its global portfolio. At Elevation Capital, we take a long-term horizon with all of our investments. By the end of 2023, we expect Diageo will have repaid £4,243 bln in debt. (Note, this forecast does not include the dividends that Diageo will continue to pay in coming years).

Diageo does not report EBITDA by brand nor category, thus EBITDA has been estimated using a blanket 5Y Average EBITDA Margin for all categories. To account for the unfavourable year the drinks industry has experienced due to global lockdowns and restrictions on public gatherings, we have excluded 2020 EBITDA and utilised the following data: FY2019, FY2019 (with debt reduction) & Historical 3-Year Normalised EBITDA (2017-2019). We have then applied average EV/EBITDA multiples from selected transactions.

Utilising industry average EV/EBITDA M&A multiples and separating the Beer segment from Diageo as shown in the table below, we arrive at a valuation range for Diageo of £36.82 to £43.92, presenting upside of between +25.15% to +43.11% from the 9 March 2021 share price and +49.75% to +78.63% from the Elevation Capital Global Shares Fund cost basis.

Diageo Valuation Summary
(all numbers in £ millions except share prices)

EBITDA		FY2019	FY2019 (Less Debt Reduction)	Historical 3Y Normalised (2017-2019)
Beer		647	647	607
Wine, Spirits & Other		3,395	3,395	3,018
Total		**4,042**	**4,042**	**3,625**
EV/EBITDA Multiples				
Wine, Spirits & Other		30.20x	30.20x	30.20x
Beer		24.77x	24.77x	24.77x
Implied Enterprise Value		**118,536**	**118,536**	**106,174**
Net Debt		17177	12934	17177
Minority Interest		1668	1668	1668
Pensions		749	749	749
Leases		470	470	470
Total Equity Value		**£98,472**	**£102,715**	**£86,110**
Shares Outstanding		2339	2339	2339
Implied SOTP Share Price		**£42.10**	**£43.92**	**£36.82**
Current Share Price	£29.42			
Implied Upside		+43.11%	+49.28%	+25.15%
Global Shares Fund Cost Basis	£24.59			
Implied Upside		+71.25%	+78.63%	+49.75%



Conclusion

Diageo is one of the largest drinks and spirits companies globally. With a presence in over 180 countries, and brands that are synonymous with respective drinks categories. Diageo has managed its cash position and operating margins well, affording the ability to quickly conduct merger & acquisitions to bolster its position in the fastest growing drinks industries; most recent notable acquisitions are Seedlip, Aviation Gin (Davos Brands), and Chase Distillery. We believe that Diageo is currently trading at a discount to its intrinsic value derived by the value of each individual brand contained within the company (£36.82 [+48.40%] to £43.92 [+77.02%]). The company as at 9 March 2021, has returned +18.32% for the Fund. However, as a "new normal is established" and consumers are once again able to enjoy alcohol at bars and restaurants again, we believe that we have reacquired Diageo at an opportunistic time, and stand to benefit from the economic tailwinds once the ability to consume alcohol and attend events is once again permitted on a global basis.

Any data not referenced was sourced from Diageo Annual Reports & Earnings Conference Calls.

1 CapitalIQ as at 20 January 2020.
2 BLS Capital. (2019). Diageo.
Accessed at: http://www.blscapital.dk/en/company/diageo-2/#:~:text=With%20its%2025%20percent%20market,with%20only%20few%20major%20players.
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4 IWSR. (2019). Provenance and profits: The future of the gin industry.
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5 Forbes. (2019). Low- and no-alcohol beverages are a growing trend worldwide, says new report.
Accessed at: https://www.forbes.com/sites/thomaspellechia/2019/02/20/lowno-alcohol-beverages-are-in-the-worldwide-future-says-latest-report/?sh=4a6e68d81c85
6 Companies used to compute industry average:
2502.T, ABI.BR, BFb.N, COU.AT, CARlb.CO, CPRI.MI, HEIN.AS, MBWS.PA, PERP.PA,RCOP.PA, SWAG.DE, TAP.N, UBBW.NS
7 Refer to Reference #1.

This summary report was written in January 2021-March 2021.

ELEVATION CAPITAL
GLOBAL SHARES FUND

Independent Thinking - Disciplined Investing

[In-de-pend-ent Think-ing] indəˈpendənt THiNkiNG verb
Is essential to long-term investment success. We are often contrarian and do not pay attention to index compositions when making investment decisions. We believe that when you're several thousand miles away from Wall Street in a different nation, it's easier to be independent and buy the things that other people are selling, and sell the things that other people are buying.

[Dis-ci-plined In-vest-ing] disciplinəd invesˈting verb
The market presents opportunities every day, but disciplined investing is as much about the opportunities you do not take. We also believe that cash is sometimes the most attractive investment.

MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2017, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2013, NEW ZEALAND

NOMINEE - MORNINGSTAR INTERNATIONAL EQUITIES CATEGORY FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

NOMINEE - FUNDSOURCE INTERNATIONAL EQUITY SECTOR FUND MANAGER OF THE YEAR 2012, NEW ZEALAND

The Blade L04, 12 St Marks Road, Remuera, Auckland 1050, New Zealand | www.globalsharesfund.co.nz | +64 9 379 6493 | info@elevationcapital.co.nz