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Diageo Q1 FY26 preview: Softer start to FY26 but margin/cash driver fundamentals still intact

Equity Research

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Diageo Q1 FY26 preview: Softer start to FY26 but margin/cash driver fundamentals still intact

We update our Diageo model ahead of its Q1 FY26 trading update on 6 November. Given still generally tough end-market conditions for Spirits (e.g. -7.6% organic sales delivered by key peer Pernod Ricard in the period), we expect a subdued start to FY26 for DGE with -1.5% organic sales to \$4,841m (-2.9% reported). At this point we don't expect a material change to FY26 guidance (organic sales growth "similar" to the +1.7% in FY25, mid-single digit organic EBIT growth – both H2-weighted, c.\$3bn FCF). However, given the soft external momentum into the key Festive trading period, we prudently tweak down our estimates by c.1%. We now model +1.3% organic sales, +3.0% organic EBIT, margin +50bp and \$1.70 adj EPS vs. +1.8%/+4.0%/+60bp/\$1.72 previously.

The organic comps are volatile by region, but we expect no major changes vs. Q4/H2 FY25. For Q1, we model North America -3% (soft underlying Spirits market offset by tariff-related restocking of UK/EU products and good Guinness), Europe +0.5% (Guinness strength offset by weak Spirits), APAC -6% (dragged down by China Baijiu), Africa +4% and Latin America +4%.

Shares are -30% ytd and are -16% from mid-August highs as it has become clear that broader consumer demand remains subdued. DGE is not immune from these pressures, especially in the US, but we believe the extent of self-help potential, particularly around cost/margins and cash generation/deleveraging is under appreciated, while its portfolio diversity should allow it to outperform pure-play Spirits peers. Valuation on 13.8x cal.26 P/E and 11.2x EV/EBITDA for a >4% dividend yield is unchallenging relative to history and peers.

Recommendation: Buy
Closing Price: £18.02

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