Diageo PLC

Diageo's destocking hangover puts new chief under pressure

Recent profit warning brings back memories of stockpiling issues as group adjusts to end of pandemic drinking boom

Destocking issues have weighed on spirits sales as retailers wait to sell off inventories that were filled when demand was still running high © Jens Kalaene/picture-alliance/dpa/AP Images

Madeleine Speed in London NOVEMBER 24 2023

Debra Crew's first capital markets day as chief executive of Diageo should have been an opportunity to set out her vision for the world's biggest spirits maker. Instead, the former Reynolds Tobacco boss was besieged by analysts demanding clarity after the company issued a profit warning on the back of falling sales in Latin America days earlier.

"The stock opened down 10 per cent and dropped a further 5 per cent during the conference call," said Bernstein analyst Trevor Stirling. "It's not a great start. Diageo and Debra will be in the penalty box until the second half of next year."

In her first six months in the role, Crew has faced a unique series of challenges, starting with the untimely death of her predecessor, Sir Ivan Menezes. Within weeks, Crew, a former US military intelligence officer who joined Diageo in 2019 as a board member, had to deal with an escalating legal tussle with Sean Combs, known as Diddy, who has accused the company of racial discrimination. Diageo has vehemently denied the allegations and the case could proceed to a court trial.

Another blow came in the shape of the surprise sales slump in Brazil and Mexico, which forced the maker of Guinness and Tanqueray into a profit warning that sent its share price sliding 15 per cent.

During the emergency update and at last week's capital market's day, Crew struggled to convince analysts that Diageo's problems are confined to the Latin American market, which accounts for 11 per cent of sales value and where sales are now expected to fall 20 per cent in the first half of next year.

"This is not how you want to start off — with a profit warning as soon as you stand up in the top job," said Citi analyst Simon Hales. "It raises questions: have you really got your arms around the businesses?"

The debacle has shone a spotlight on Diageo's supply chain and distribution systems, which have come under strain since the Covid-19 spirits super cycle, and the consumer downturn that has followed.


New Diageo boss Debra Crew is a former US military intelligence officer © Diageo

During the pandemic and immediately after restrictions ended, drinkers knocked back more high-end booze thanks to the savings they had built up during lockdowns. Now the boom is coming to an end and demand has started to drop back to pre-Covid levels.

As a result, spirits companies including Pernod Ricard and Rémy Cointreau, have flagged how destocking issues are weighing on US sales, as retailers hold off on ordering while they run down inventories built up when demand was still running high.

Diageo said this same issue is what caused the slump in Latin America, which was its best performing region during the pandemic, adding that because the group has limited visibility of its inventory levels there compared with its other markets, the extent of the knock to sales came as a surprise.

Analysts and shareholders have not been entirely satisfied by Crew's explanation, even after she and Alvaro Cardenas, Diageo's president in Latin America, discussed the issue at length at last week's event.

Roseanna Ivory, a fund manager at Diageo shareholder Abrdn said that while the explanation "does sound credible", the magnitude of the share price reaction "can be attributed to some lingering questions as to whether management could have seen it earlier or flagged weakness to the market sooner".

“The company also has a history where previous new CEOs have had to weather lengthy destocking issues,” she added.

When Menezes took over the business in 2013, the culture of the organisation was to make your end of year targets by getting distributors to buy extra stock, Bernstein’s Stirling claimed. Menezes set out to change this, but for the first three years of his tenure sales were hit by a painful period of destocking. Diageo declined to comment.

In 2015, Diageo was investigated by the Securities and Exchange Commission for shipping excess inventory to distributors in an effort to boost its results — a practice known as “channel stuffing”. In 2020, the group paid a $5mn fine after the SEC charged the US business with “materially misleading” investors about demand for its drinks by concealing the sales of unwanted stock.

There is no suggestion of Diageo channel stuffing in Latin America, rather some analysts point out that wholesalers in Latin America would have good reason to stockpile spirits — as an inflation and currency hedge.

“They’ve increased the amount of inventory they hold knowing it was an inflating asset. That carry trade has worked out nicely for wholesalers,” said Citi’s Simon Hales.

At last’s week’s capital markets day, analysts asked how the drinks giant could be sure the weakness in Latin America would not spread to other regions. Crew stressed that inventory visibility in other parts of the world is far stronger, reducing the likelihood that this situation is repeated elsewhere.

Guinness maker Diageo is the world's biggest spirits group © Simon Dawson/Bloomberg

Compounding questions over how widespread a destocking problem could become, Diageo has been grappling with concerns of slowing sales growth in its crucial US business, the potential of its star spirit tequila and even its premiumisation strategy.

In 2021, Menezes upgraded the group's sales growth guidance for the first time in a decade to a range of 5-7 per cent. Some analysts think it will be a stretch and that Crew should manage expectations.

"Surely rule one of being a CEO is the first thing you do is take the guidance down," said James Edwardes Jones at RBC Capital, but added that this would have been difficult as Crew would not want to be disrespectful of her predecessor, given the circumstances.

Hales said that without an adequate explanation of the scale of the problem in Latin America, the starting point for the group's medium term guidance was unclear. "They admit they don't know the answer to how many cases of Johnnie Walker are sitting at those tier retailers," he said. "That's going to keep people away from the stock."

Abrdn's Ivory said that short-term share price performance will be "heavily influenced" by US consumer demand and the associated inventory levels "given that they account for half of Diageo's profits", adding that any signs of softening could drive further share price weakness.

Diageo's shares have fallen around 20 per cent since the start of the year.

In the 12 months to June, Diageo's US spirits sales fell 1 per cent, while sales of its leading tequila brands, which are the group's key US growth drivers, slowed down to 19 per cent for the full year compared with 28 per cent in the six months to December 2022.

Meanwhile, the premiumisation strategy Menezes spearheaded at Diageo, based on the premise that consumers will drink less, but more expensive spirits, is also in question. The premiumisation trend across spirits has started to slow significantly, with volumes of higher-priced alcohol only increasing by 1 per cent between the first half of 2022 and 2023, according to IWSR.

"They made all these efforts to become a luxury company, doesn't that put them more at risk?" asked Edwardes Jones.

A former executive colleague who worked closely with Crew when she ran the North American business described her as "measured and strategic", adding that he thought the profit warning in Latin America was a case of "clearing the decks".

"She'll want to . . . make sure everything is out there and work from a base of what we can all understand," he said. "She's always leaned on being on the transparent side of things."