DIAGEO PLC
Form 20-F
August 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: 30 June 2014

Commission file number 1-10691

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organisation)

Lakeside Drive, Park Royal, London NW10 7HQ, England

(Address of principal executive offices)

Paul Tunnacliffe, Company secretary

Tel: +44 20 8978 6000

E-mail: the.cosec@diageo.com

Lakeside Drive, Park Royal, London NW10 7HQ, England

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
American Depositary Shares	New York Stock Exchange
Ordinary shares of 28101/108 pence each	New York Stock Exchange*

*Not for trading, but only in connection with the registration of American Depositary Shares representing such ordinary shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the Annual Report: 2,754,218,534 ordinary shares of 28101/108 pence each.

Indicate by check mark if each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No o

If this report is an annual or transition report, indicate by check mark if each registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether each registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer x   Accelerated Filer o   Non-Accelerated Filer o

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP o	International Financial Reporting Standards as issued by the International Accounting Standards Board x	Other o

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 o Item 18 o

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2014 of Diageo plc (the 2014 Form 20-F).

Contents

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Introduction

Diageo is the world s leading premium drinks business. Its geographic breadth and range of industry leading brands across categories and price points is unparalleled.

Diageo plc is incorporated as a public limited company in England and Wales. Diageo was incorporated as Arthur Guinness Son and Company Limited on 21 October 1886. The group was formed by the merger of Grand Metropolitan Public Limited Company (GrandMet) and Guinness PLC (the Guinness Group) in December 1997. Diageo plc s principal executive office is located at Lakeside Drive, Park Royal, London NW10 7HQ and its telephone number is +44 (0) 20 8978 6000.

This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2014. The information set out in this Form 20-F does not constitute Diageo plc s statutory accounts under the UK Companies Acts for the years ended 30 June 2014, 2013 or 2012. KPMG LLP has reported on the accounts for the year ended 2014 and KPMG Audit Plc has reported on those accounts for the the years ended 30 June 2013 and 2012; their audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the years ended 30 June 2014, 2013 or 2012. The accounts for 2013 and 2012 have been delivered to the registrar of companies and those for 2014 will be delivered in due course.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo s control. For more details, please refer to the cautionary statement concerning forward-looking statements on pages 36-37.

The content of the company s website (www.diageo.com) should not be considered to form a part of or be incorporated into this report. This report includes names of Diageo s products, which constitute trademarks or trade names which Diageo owns or which others own and license to Diageo for use. In this report, the term company refers to Diageo plc and terms group and Diageo refer to the company and its consolidated subsidiaries, except as the context otherwise requires. A glossary of terms used in this report is included at the end of the report.

Diageo s consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed and adopted for use in the European Union (EU) and IFRS as issued by the International Accounting Standards Board (IASB). References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB. Unless otherwise indicated, all financial information contained in this document has been prepared in accordance with IFRS.

Information presented

As at 1 July 2013 the group adopted a number of new standards and amendments and the application of *IFRS11 - Joint arrangements* and the amendment to *IAS19 - Employee benefits* resulted in a restatement of comparative figures. The impact on the group s consolidated statement of comprehensive income and net cash flow for the years ended 30 June 2013 and 30 June 2012, and net assets as at 30 June 2013 and 30 June 2012 is provided in note 18 to the consolidated financial statements on pages 202 and 203.

Unless otherwise stated in this document, percentage movements are organic movements. These movements and operating margins are before exceptional items. Commentary, unless otherwise stated, refers to organic movements. Share, unless otherwise stated, refers to value share. See the Definitions and reconciliations of non-GAAP measures to GAAP measures for an explanation of organic movement calculations on page 102.

The brand ranking information presented in this report, when comparing volume information with competitors, has been sourced from data published by Impact Databank, IWSR, IRI, Beverage Information Group or Plato Logic. Market data information and competitive set classifications are taken from independent industry sources in the markets in which Diageo operates.

Disclosures not incorporated by reference

The following pages and sections of the Annual Report of Diageo plc for the year ended 30 June 2014, are not incorporated by reference into this report on Form 20-F and are furnished to the SEC for information only:

- disclosures in the section Strategic report Business description How we will deliver our ambition: Sustainability & Responsibility on pages 24 to 27.
- disclosures on page 30 in the section Strategic report Business description How we measure performance: Key performance indicators of non-financial key performance indicators.
- disclosures included under the titles Sustainability & Responsibility on pages 51, 54, 57, 60 and 63 in relation to each reporting segment in the Segment Review.
- disclosures in the section Strategic report Business review Sustainability & Responsibility review on pages 89 to 101.

Trend information

The following comments were made by Ivan Menezes, Chief Executive of Diageo, in Diageo s preliminary announcement on 31 July 2014:

This year our business has faced macroeconomic and market specific challenges that have impacted our top line performance. But we have gained share and expanded margin while continuing to invest in our brands, our markets and our people to create a stronger business that will deliver on the long term growth opportunities of this attractive industry.

Our regional performance has been mixed. In North America we have again delivered top line growth and significant margin expansion and our Western European business is now stable. Emerging market weakness, often currency related, but also including some specific issues, such as the anti extravagance measures in China, has led to weaker top line growth.

When I became CEO a year ago I aligned the business behind the key performance drivers which will deliver our strategy. We have made good progress. Reserve has performed strongly; innovation has driven incremental sales in all regions; route to consumer initiatives have been embedded across a number of markets with more to follow in fiscal 15; ruthless focus on driving out cost has driven margin improvement and we have reshaped the organisation and enhanced skills and capability across the whole team at Diageo. We have made progress in accelerating the performance of our premium core brands but these brands have been under pressure given the environment this year, although we have delivered share gains in a number of markets.

The tougher trading environment this year has confirmed my view that these six priorities give the business clarity and focus. We have simplified the organisation, freeing up everyone to act like an owner and sell or help to sell, changing behaviours across the business.

Therefore we start fiscal 15 as a more agile organisation, building on the changes in behaviours that have been made across the business this year. The catalysts for a near term recovery of consumer spend in the emerging markets are still weak however the future growth drivers for this industry, its aspirational nature as consumers in the emerging markets see increasing disposable income, are undiminished. Diageo has leading brand and market positions and financial strength and our recent acquisitions have given us a strong emerging market footprint. The opportunity for Diageo to realise our full potential and deliver our performance ambition remains an exciting one.

Historical information

The following tables present selected consolidated financial data for Diageo for the five years ended 30 June 2014 and as at the respective year ends. The data presented below has been derived from Diageo s consolidated financial statements, audited by Diageo s independent auditor and has been restated to reflect the adjustments resulting from the adoption of new accounting standards and an amendment to accounting standard.

Income statement data

					Year ended 30 June
	2014	**2013 (restated)**	**2012 (restated)**	**2011 (restated)**	**2010 (restated)**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Sales	**13,980**	15,276	14,392	13,043	12,793
Excise duties	**(3,722)**	(3,973)	(3,753)	(3,224)	(3,116)
Net sales	**10,258**	11,303	10,639	9,819	9,677
Cost of sales	**(4,029)**	(4,416)	(4,208)	(3,958)	(4,050)
Gross profit	**6,229**	6,887	6,431	5,861	5,627
Marketing	**(1,620)**	(1,769)	(1,671)	(1,520)	(1,406)
Other operating expenses	**(1,902)**	(1,738)	(1,652)	(1,789)	(1,683)
Operating profit	**2,707**	3,380	3,108	2,552	2,538
Non-operating items	**140**	(83)	147	(14)	(15)
Net interest and other finance charges	**(388)**	(457)	(441)	(449)	(490)
Share of after tax results of associates and joint ventures	**252**	217	229	192	155
Profit before taxation	**2,711**	3,057	3,043	2,281	2,188
Taxation	**(447)**	(507)	(1,011)	(321)	(461)
Profit from continuing operations	**2,264**	2,550	2,032	1,960	1,727
Discontinued operations	**(83)**		(11)		(19)
Profit for the year	**2,181**	2,550	2,021	1,960	1,708

Per share data	**pence**	**pence**	**pence**	**pence**	**pence**
Dividend per share	**51.7**	47.4	43.5	40.4	38.1
Earnings per share					
Basic					
Continuing operations	**93.0**	98.0	76.6	74.3	65.2
Discontinued operations	**(3.3)**		(0.4)		(0.8)
Basic earnings per share	**89.7**	98.0	76.2	74.3	64.4
Diluted					
Continuing operations	**92.6**	97.4	76.2	74.1	65.1
Discontinued operations	**(3.3)**		(0.4)		(0.8)
Diluted earnings per share	**89.3**	97.4	75.8	74.1	64.3

	million	**million**	**million**	**million**	**million**
Weighted average number of shares	**2,506**	2,502	2,495	2,493	2,486

Historical information (continued)

Balance sheet data

	2014	2013 (restated)	2012 (restated)	2011 (restated)	As at 30 June 2010 (restated)
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Non-current assets	**15,495**	16,481	15,098	12,633	12,509
Current assets	**7,469**	8,510	7,171	7,087	6,885
Total assets	**22,964**	24,991	22,269	19,720	19,394
Current liabilities	**(4,851)**	(5,519)	(4,762)	(4,903)	(3,934)
Non-current liabilities	**(10,523)**	(11,384)	(10,715)	(8,858)	(10,698)
Total liabilities	**(15,374)**	(16,903)	(15,477)	(13,761)	(14,632)
Net assets	**7,590**	8,088	6,792	5,959	4,762
Share capital	**797**	797	797	797	797
Share premium	**1,345**	1,344	1,344	1,343	1,342
Other reserves	**2,243**	3,154	3,213	3,300	3,245
Retained earnings/(deficit)	**2,438**	1,741	234	(195)	(1,377)
Equity attributable of equity shareholders of the parent company	**6,823**	7,036	5,588	5,245	4,007
Non-controlling interests	**767**	1,052	1,204	714	755
Total equity	**7,590**	8,088	6,792	5,959	4,762
Net borrowings	**(8,850)**	(8,403)	(7,573)	(6,480)	(6,980)

Notes to the historical information

1. Accounting policies The consolidated financial statements for the five years ended 30 June 2014 have been prepared in accordance with IFRS. The IFRS accounting policies applied by the group to prepare the financial information in this document are disclosed in the notes to the consolidated financial statements.

2. Impact of new accounting standards and amendments to accounting standards As reported in note 1 to the consolidated financial statements, the group has adopted IFRS 11 and the amendment to IAS 19.

IFRS 11 has changed the accounting for certain joint arrangements which were formerly consolidated on a line by line basis. As a result the group s share of net income from certain joint arrangements is now included in the line Share of after tax results of associates and joint ventures . The amendment to IAS 19 changed the calculation of the amounts for post employment arrangements included in operating profit, finance charges and the statement of comprehensive income. All comparative information has been restated.

The adoption of the changes reduced sales for the year ended 30 June 2013 by £211 million (2012 £202 million; 2011 £189 million; 2010 £165 million), reduced net profit for the year ended 30 June 2013 by £44 million (2012 £51 million; 2011 £57 million; 2010 £35 million) and reduced basic earnings per share for the year ended 30 June 2013 by 1.3 pence (2012 1.6 pence; 2011 1.9 pence; 2010 1.1 pence). The impact on the balance sheet data is not material. See note 18 to the consolidated financial statements for more information.

See note 18 to the consolidated financial statements for an analysis of the impact on the income statement for the years ended 30 June 2013 and 30 June 2012.

Historical information (continued)

3. Exceptional items Exceptional items are charges or credits which, in management s judgement, need to be disclosed by virtue of their size or incidence in order for thea user to obtain a properfull understanding of the financial information. Such items are included within the income statement caption to which they relate. An analysis of exceptional items is as follows:

					Year ended 30 June
	2014	**2013**	**2012**	**2011**	**2010**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Items included in operating profit					
Restructuring programmes	**(163)**	(69)	(96)	(111)	(142)
Pension changes past service credits		20	115		
Brand and tangible asset impairment	**(264)**	(50)	(59)	(39)	(35)
Duty settlements				(127)	
SEC settlement				(12)	
	(427)	(99)	(40)	(289)	(177)
Non-operating items	**140**	(83)	147	(14)	(15)
Items included in taxation					
Tax on exceptional operating items	**99**	27	19	51	39
Tax on sale of businesses		28		3	10
Loss of future tax amortisation			(524)		
Settlements with tax authorities				66	
	99	55	(505)	120	49
Exceptional items in continuing operations	**(188)**	(127)	(398)	(183)	(143)
Discontinued operations net of taxation (note 4)	**(83)**		(11)		(19)
Exceptional items	**(271)**	(127)	(409)	(183)	(162)

4. Discontinued operations In the year ended 30 June 2014 discontinued operations represents a charge after taxation of £83 million (2013 £nil; 2012 £11 million; 2011 £nil; 2010 £19 million) in respect of the settlement of thalidomide litigation in Australia and New Zealand and anticipated future payments to thalidomide organisations.

5. Dividends The board expects that Diageo will pay an interim dividend in April and a final dividend in October of each year. Approximately 40% of the total dividend in respect of any financial year is expected to be paid as an interim dividend and approximately 60% as a final dividend. The payment of any future dividends, subject to shareholder approval, will depend upon Diageo s earnings, financial condition and such other factors as the board deems relevant. Proposed dividends are not considered to be a liability until they are approved by the board for the interim dividend and by the shareholders at the annual general meeting for the final dividend.

The table below sets out the amounts of interim, final and total cash dividends paid by the company on each ordinary share. The dividends are translated into US dollars per ADS (each ADS representing four ordinary shares) at the actual rate on each of the respective dividend payment dates.

						Year ended 30 June
		2014	2013	2012	2011	2010
		pence	pence	pence	pence	pence
Per ordinary share	Interim	**19.70**	18.10	16.60	15.50	14.60
	Final	**32.00**	29.30	26.90	24.90	23.50
	Total	**51.70**	47.40	43.50	40.40	38.10
		$	$	$	$	$
Per ADS	Interim	**1.31**	1.10	1.05	1.01	0.89
	Final	**2.15**	1.89	1.72	1.59	1.48
	Total	**3.46**	2.99	2.77	2.60	2.37

Note: Subject to shareholders approval the final dividend for the year ended 30 June 2014 will be paid on 2 October 2014, and payment to US ADR holders will be made on 7 October 2014. In the table above, an exchange rate of £1 = $1.68 has been assumed for this dividend, but the exact amount of the payment to US ADR holders will be determined by the rate of exchange on 2 October 2014.

6. Net borrowings Net borrowings are defined as gross borrowings (short term borrowings and long term borrowings plus finance lease liabilities plus interest rate hedging instruments, cross currency interest rate swaps and funding foreign currency forwards and swaps used to manage borrowings) less cash and cash equivalents.

7. Share capital There were 2,754 million ordinary share of 28101/108 pence each in issue with a nominal value of £797 million throughout the five year period ended 30 June 2014.

Historical information (continued)

8. Exchange rates A substantial portion of the group s assets, liabilities, revenues and expenses are denominated in currencies other than pounds sterling. For a discussion of the impact of exchange rate fluctuations on the group s financial position and results of operations, see note 15 to the consolidated financial statements.

The following table shows period end and average US dollar/pound sterling noon buying exchange rates, for the periods indicated, expressed in US dollars per £1.

					Year ended 30 June
	2014	**2013**	**2012**	**2011**	**2010**
	$	**$**	**$**	**$**	**$**
Year end	**1.71**	1.52	1.57	1.61	1.50
Average rate*	**1.64**	1.57	1.59	1.59	1.57

* The average of the noon buying rates on the last business day of each month during the year ended 30 June.

The following table shows period end, high, low and average US dollar/pound sterling noon buying exchange rates by month, for the six month period to 31 July 2014, expressed in US dollars per £1. The information in respect of the month of July is for the period up to and including 31 July 2014.

						2014
	July	**June**	**May**	**April**	**March**	**February**
	$	**$**	**$**	**$**	**$**	**$**
Month end	**1.69**	**1.71**	**1.68**	**1.69**	**1.67**	**1.68**
Month high	**1.72**	**1.71**	**1.70**	**1.69**	**1.67**	**1.68**
Month low	**1.69**	**1.67**	**1.67**	**1.66**	**1.65**	**1.63**
Average rate**	**1.71**	**1.69**	**1.68**	**1.67**	**1.66**	**1.66**

** The average of the noon buying rates on each business day of the month.

The noon buying exchange rate as at 1 August 2014 was £1 = $1.68.

These rates have been provided for information only. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the consolidated financial statements. See note 1 to the consolidated financial statements for the actual rates used in the preparation of the consolidated financial statements.

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Strategic report

Business description

OUR BUSINESS

Diageo is a global leader in beverage alcohol with iconic brands in spirits, beer and wine. We invest behind our brands to drive growth, providing consumers with choice and quality across categories and price points.

Our business is built on foundations laid by the giants of our industry. Arthur Guinness, Alexander Walker and all those that followed in their footsteps, cared deeply about the people and businesses they fostered. They were driven to create products that would last for generations, the best conditions for their people, and the best financial performance. Today, we act like those entrepreneurs, passionate about our brands, our customers and consumers, our communities, and society as a whole. Our purpose is to help our consumers celebrate life, every day, everywhere, and to do so responsibly.

We give our people the freedom to do the best work of their careers. We take great pride in what we do, and in how we do it. Above all we value each other s commitment to delivering the best.

WE PRODUCE

Every year we produce more than 6.5 billion litres of our brands, from more than 100 sites in 30 countries.

Our supply functions are responsible for the distilling, brewing, bottling, packaging and distribution of our brands. We are committed to efficient, sustainable production to the highest quality standards, and are proud that our supply facilities are recognised as leaders in environmental sustainability. Our 21 markets are designated as import markets, import and third-party production markets or import and local production markets. Our export-led International Supply Centre (ISC), based in Europe produces many of our heritage brands, including our Scotch whisky products. It employs over 4,000 people across more than 55 sites in

WE MARKET

We are committed to ensuring that our brands are at the front of consumers minds whenever a purchase decision arises. The strength of our portfolio means that we have relevant brands at almost every price tier of every category.

We work tirelessly to engage and delight existing and new consumers, constantly innovating with our products and how we market. For decades our brands have been at the forefront of marketing innovation and the same remains true today. We take seriously our obligations to market our brands responsibly, and to help our consumers make informed decisions about drinking, or not drinking. We are committed to the development and implementation of programmes to educate consumers

WE INNOVATE

Innovation is critical to our continued growth. We are committed to finding breakthrough innovations and ideas to serve our customers and consumers. We identify new consumer trends, and innovate at scale boldly. Innovation is a permanent engine of growth for our business and we are restless in our search for new products. We are open-minded to where these ideas will come from, combining our world-leading technical and research capability with investments in smaller start-ups. In each of the last five years our innovation pipeline has delivered

WE SELL

Everyone at Diageo is encouraged to sell or to help to sell. This is just one expression of the world-class customer focus that is at the heart of our business. Our founders and all those who followed, were obsessed with providing the best quality products to their customers in markets at home and abroad. Today we are no different. In each of our 21 markets, we are passionate about ensuring our products are available to consumers in every appropriate shop or bar. We are continually working to deliver amazing consumer experiences and to extend our sales reach.

Scotland, England, Ireland, Italy and the Netherlands.	about responsible drinking.	double digit growth for Diageo.

Business description (continued)

Production

Diageo owns manufacturing production facilities across the globe, including maltings, distilleries, breweries, packaging plants, maturation warehouses, cooperages, vineyards, wineries and distribution warehouses. Diageo s brands are also produced at plants owned and operated by third parties and joint ventures at a number of locations internationally.

Diageo has been investing in restructuring programmes that increase the efficiency of its supply operations. The most significant programmes are referred to in note 4 to the consolidated financial statements.

The locations, principal activities, products, packaging production capacity and packaging production volume of Diageo s principal production centres in the year ended 30 June 2014 are as follows:

Location	Principal products	Production capacity in millions of equivalents units*	Production volume in 2014 in millions of equivalent units
United Kingdom Spirits	Scotch whisky, Irish whiskey, gin, vodka, rum, ready to drink	87	52
UK, Ireland (Guinness)	Beer	8	7
Ireland (Baileys)	Irish cream liqueur	12	7
Italy (Santa Vittoria)	Vodka, wine, rum, ready to drink	10	6
Turkey	Raki, vodka, gin, liqueur, wine	8	5
United States, Canada, US Virgin Islands	Vodka, gin, tequila, rum, wine, Canadian whisky, American whiskey, progressive adult beverages, ready to drink	44	34
United States	Wine	2	1
Brazil	Cachaça, vodka	9	6
Jamaica	Beer	1	1
Australia	Rum, vodka, ready to drink	4	2
Singapore	Finishing centre	4	2
Nigeria	Beer	7	5
South Africa	Beer and spirits	4	3
East Africa (Uganda, Kenya, Tanzania)	Beer and spirits	10	7
Africa Regional Markets (Ethiopia, Cameroon, Ghana, Seychelles)	Beer	5	3

* Capacity represents ongoing production capacity at any production centre. The production capacities quoted in the table are based on actual production levels for the year ended 30 June 2014 adjusted for the elimination of unplanned losses and inefficiencies.

Spirits

Spirits are produced in distilleries located worldwide. The group owns 29 Scotch whisky distilleries in Scotland, an Irish whiskey distillery in Northern Ireland, two whisky distilleries in Canada and a whiskey distillery in the United States. Diageo produces Smirnoff internationally. Ketel One vodka is purchased as finished product from The Nolet Group. Gin distilleries are located in both the United Kingdom and the United States. Baileys is produced in the Republic of Ireland and Northern Ireland. Rum is blended and bottled in the United States, Canada, Italy and the United Kingdom, and is distilled and blended in the US Virgin Islands and in Australia, Venezuela and Guatemala. Raki is produced in Turkey, while Chinese white spirits are produced in Chengdu, in the Sichuan province of China. In August 2012, Diageo acquired 100% of Ypióca Bebidas S.A. which owns a farm and a distillery in Ceará State in Brazil and produces cachaça. Diageo s maturing Scotch whisky is located in warehouses in Scotland (primarily at Blackgrange), its maturing Canadian whisky in La Salle and Gimli in Canada and its maturing American whiskey in Kentucky and Tennessee in the United States. In May 2014 the company announced its intention to invest an estimated $115 million over three years to build a distillery and six barrel storage warehouses in Shelby County, Kentucky. This distillery is expected to be in operation by the end of 2016.

Business description (continued)

In January 2014, plans were announced to double the production capacity of the Clynelish distillery in Scotland, expected to be producing from August 2016, as well as to construct a bioenergy plant to power the distillery.

In April 2013, it was announced that Teaninich in Scotland would be the location for a new malt whisky distillery. Currently the group is focusing on expansion of the existing distillery at Teaninich, which is expected to double the capacity of the distillery and is expected to be operating from January 2015. The group has since commenced planning for the new build distillery at Teaninich, as well as an associated bioenergy plant, with completion date still to be determined. The major expansion of Scotch whisky production in the Speyside area will continue with the construction of a new bio energy-plant at Glendullan to treat by-products and produce biogas which will be used to power the distillery, and a planned expansion to double the capacity of the Mortlach distillery at Dufftown.

Elsewhere in Scotland, the company is completing a major expansion of the Glen Ord Distillery, near Muir of Ord, doubling its capacity and is progressing with the second phase of construction of a new warehousing facility at Cluny near Kirkcaldy.

These activities are part of a multi-year investment plan launched in June 2012 at a cost of over £500 million where the group plans to lay down maturing scotch inventory to meet projected long term demand.

Beer

Diageo s principal brewing facilities are at the St James s Gate brewery in Dublin, Ireland and in Nigeria, Kenya, Ghana, Cameroon, Ethiopia, Tanzania, Uganda, Seychelles, and Jamaica. In addition, Diageo also owns a 25% equity interest in Sedibeng brewery in South Africa and an effective 25.5% interest in Guinness Anchor Berhard which operates a brewery in Malaysia. Guinness is also brewed by a number of third parties around the world under licence arrangements. Guinness flavour extract is shipped from Ireland to all overseas Guinness brewing operations.

Guinness Draught in cans and bottles is packaged at Runcorn and Belfast in the United Kingdom. The Runcorn facility performs the kegging of Guinness Draught which is transported to Great Britain in bulk.

Wine

Diageo s principal wineries are in the United States but the group also has operations in Argentina and Turkey. For European markets, wines are mainly bottled in Diageo s facilities in Italy. Wines are sold both in their local markets and overseas.

Ready to drink

Diageo produces a range of ready to drink products mainly in the United Kingdom, Italy, South Africa, Australia, the United States and Canada.

Property, plant and equipment

Diageo owns approximately 92% of the manufacturing, distilling, brewing, bottling and administration facilities it uses across the group s worldwide operations. It holds approximately 4% of properties on leases in excess of 50 years. The principal production facilities are described above. As at 30 June 2014, Diageo s land and buildings are included in the group s consolidated balance sheet at a net book value of £942 million. Diageo s two largest individual facilities, in terms of book value, are the Leven bottling, blending and warehousing facility in Scotland and St James s Gate brewery in Dublin. Of the net book value of Diageo s land and buildings approximately 43% are properties located in Great Britain, 16% in Ireland and 12% in the United States.

On 2 July 2014 Diageo acquired a majority holding in United Spirits Limited (USL). USL is a leading spirits producer in India and own 31 production sites across 29 states of India. The aggregate bottling capacity is 84 million actual cases per year. In addition, USL uses approximately 60 third party sites in India and 3 sites overseas to manufacture its products with a capacity to produce some 77 million cases per year. USL is currently in the process of completing the disposal of Whyte & Mackay which is not included in the figures above.

Raw materials and supply agreements

The group has a number of long term contracts in place for the purchase of significant raw materials including glass, other packaging, spirit, cream, rum and grapes. Forward contracts are in place for the purchase of cereals to minimise the effects of short term price fluctuations.

Cream is the principal raw material used in the production of Irish cream liqueur and is sourced from Ireland. Grapes are used in the production of wine and raki and are sourced from suppliers in the United States, Argentina and Turkey. Other raw materials purchased in significant quantities for the production of spirits and beer are molasses, cereals, sugar and a number of flavours (such as juniper berries, agave, aniseed, chocolate and herbs). These are sourced from suppliers around the world.

The majority of products are supplied to customers in glass bottles. Glass is purchased from a variety of multinational and local suppliers; the largest suppliers are Ardagh Packaging in the United Kingdom and Owens Illinois in the United States.

Business description (continued)

Competition

Diageo s brands compete on the basis of consumer loyalty, quality and price.

In spirits, Diageo s major global competitors are Pernod Ricard, Beam Suntory, Bacardi and Brown Forman, each of which has several brands that compete directly with Diageo s brands. In addition, Diageo faces competition from local and regional companies in the countries in which it operates.

In beer, Diageo competes globally as well as on a regional and local basis (with the profile varying between regions) with several competitors, including AB InBev, Heineken, SABMiller, Molson Coors and Carlsberg.

In wine, the market is fragmented with many producers and distributors.

Research and development

Innovation forms an important part of Diageo s growth strategy, playing a key role in positioning its brands for continued growth in both the developed and emerging markets. The strength and depth of Diageo s brand range provides a solid platform from which to drive innovation. Diageo continuously invests to deepen its understanding of shopper trends and changing consumer habits to inform product and packaging development. Supporting this, the group has ongoing programmes to develop new products across beverage alcohol categories which are managed internally by the innovation and research and development function, which also takes advantage of a substantial open innovation network.

In the year ended 30 June 2014, the group s research and development expenditure amounted to £24 million (2013 £21 million; 2012 £18 million), representing principally the cost of developing new products, from idea generation through to full product development. Research and development expenditure is generally written off in the year in which it is incurred.

Trademarks

Diageo produces, sells and distributes branded goods and is therefore substantially dependent on the maintenance and protection of its trademarks. All brand names mentioned in this document are trademarks. The group also holds numerous licences and trade secrets, as well as having substantial trade knowledge related to its products. The group believes that its significant trademarks are registered and/or otherwise protected (insofar as legal protection is available) in all material respects in its most important markets. Diageo also owns valuable patents and trade secrets for technology and takes all reasonable steps to protect these rights.

Regulations and taxes

Diageo s worldwide operations are subject to extensive regulatory requirements regarding production, product liability, distribution, importation, marketing, promotion, sales, pricing, labelling, packaging, advertising, labour, pensions, compliance and control systems and environmental issues. In the United States, the beverage alcohol industry is subject to strict federal and state government regulations covering virtually every aspect of its operations, including production, distribution, marketing, promotion, sales, pricing, labelling, packaging and advertising.

Spirits, beer and wine are subject to national import and excise duties in many markets around the world. Most countries impose excise duties on beverage alcohol products, although the form of such taxation varies significantly from a simple application to units of alcohol by volume, to advanced systems based on imported or wholesale value of the product. Several countries impose additional import duty on distilled spirits, often discriminating between categories (such as Scotch whisky or bourbon) in the rate of such tariffs. Within the European Union, such products are subject to different rates of excise duty in each country, but within an overall European Union framework, there are minimum rates of excise duties that can be applied.

Import and excise duties can have a significant impact on the final pricing of Diageo s products to consumers. These duties have an impact on the competitive position as compared to other brands. The group devotes resources to encouraging the equitable taxation treatment of all beverage alcohol categories and to reducing government-imposed barriers to fair trading.

Advertising, marketing and sales of alcohol are subject to various restrictions in markets around the world. These range from a complete prohibition of alcohol in certain countries and cultures, through the prohibition of the import of spirits, wine and beer, to restrictions on the advertising style, media and messages used. In a number of countries, television is a prohibited medium for spirits brands and in other countries, television advertising, while permitted, is carefully regulated. Many countries also regulate the use of internet-based advertising and social media in connection with alcohol sales.

Spirits, beer and wine are also regulated in distribution. In many countries, alcohol may only be sold through licensed outlets, both on and off trade, varying from government or state operated monopoly outlets (for example, Canada, Norway and certain US states) to the common system of licensed on trade outlets (for example, licensed bars and restaurants) which prevails in much of the Western world (for example, most US states and the European Union). In about one-third of the states in the United States, price changes must be filed or published 30 days to three months, depending on the state, before they become effective.

Labelling of beverage alcohol products is also regulated in many markets, varying from health warning labels to importer identification, alcohol strength and other consumer information. As well as producer, importer or bottler identification, specific warning statements related to the risks of drinking beverage alcohol products are required to be included on all beverage alcohol products sold in the United States and in other countries where Diageo operates. Expressions of political concern signify the uncertain future of beverage alcohol products advertising on network television in the United States. Any prohibitions on advertising or marketing could have an adverse impact on sales of the group.

Regulatory decisions and changes in the legal and regulatory environment could increase Diageo s costs and liabilities or impact on its business activities.

Acquisitions and disposals

Diageo has made a number of acquisitions of brands, distribution rights and equity interests in premium drinks businesses. For a description of principal acquisitions since 1 July 2011, see note 9 to the consolidated financial statements. Diageo has not made any material disposals since 1 July 2011.

Business description (continued)

OUR STRUCTURE

Diageo s strength is in its geographic reach. We operate as 21 geographically based markets around the world and have a presence in over 180 countries. We employ 28,000 talented people across our global business. 39% of Diageo s business is in the emerging markets in Latin America, Asia, Africa, Eastern Europe and Turkey. This presence is balanced through our strong businesses in the world s most profitable beverage alcohol market, the United States, and an integrated Western European business.

DIAGEO REPORTS AS FIVE REGIONS

	North America	Western Europe	Africa, Eastern Europe and Turkey	Latin America and Caribbean	Asia Pacific
FINANCIALS BY REGION					
Volume (EUm)	49.3	33.0	36.0	23.0	14.8
Net sales* (£m)	3,444	2,169	2,075	1,144	1,347
Operating profit (£m)**	1,460	639	554	328	283
% SHARE BY REGION					
Volume (%)	32	21	23	15	9
Net sales* (%)	34	21	21	11	13
Operating profit (%)**	45	19	17	10	9

Reported net sales for the year ended 30 June 2014.

* Excluding corporate net sales of £79 million;

**Excluding exceptional operating charges of £427 million and corporate costs of £130 million.

% SHARE OF NET SALES BY OUR 21 MARKETS***

EACH OF OUR 21 MARKETS IS ACCOUNTABLE FOR ITS OWN PERFORMANCE AND FOR DRIVING GROWTH	North America	Western Europe	Africa, Eastern Europe and Turkey	Latin America and Caribbean	Asia Pacific
>20%	US Spirits & Wines	Western Europe			
3-6%	Diageo-Guinness USA (DGUSA)		Nigeria, East Africa, Turkey, Africa Regional Markets	WestLAC, Paraguay, Uruguay & Brazil	Global Travel Asia & Middle East
2-3%	Canada		Russia & Eastern Europe, South Africa		South East Asia, Australia, North

			Asia, Greater China
<2%		Mexico, Venezuela, Colombia	India

Reported net sales for the year ended 30 June 2014.

***Throughout this Annual Report 2014, reference to Diageo s 21 geographically based markets will be stated as 21 markets .

Business description (continued)

BRAND PERFORMANCE

These brands deliver approximately two-thirds of our net sales. They have broad consumer appeal across geographies, and while each of them has a rich heritage, they all continue to innovate and expand to meet new and emerging consumer trends.

Brand	Category	Key markets	Volume movement	Organic net sales movement	Reported net sales movement
Johnnie Walker	Scotch whisky No.1 SCOTCH WHISKY IN THE WORLD*	United States, Global Travel & Middle East, Brazil, Mexico, China, Thailand, South Africa, Taiwan	(6)%	(4)%	(9)%
Crown Royal	Canadian whisky No.1 CANADIAN WHISKY IN THE WORLD**	United States, Canada	(4)%	1%	(3)%
J B	Scotch whisky No.5 SCOTCH WHISKY IN THE WORLD*	Spain, France, South Africa, United States, Turkey, Belgium, Portugal	(7)%	(8)%	(11)%
Buchanan s	Scotch whisky No.3 PREMIUM SCOTCH WHISKY IN LATIN AMERICA AND CARIBBEAN*	United States, Mexico, Venezuela, Colombia	(13)%	6%	(24)%
Windsor	Scotch whisky No.2 SUPER PREMIUM SCOTCH WHISKY IN ASIA PACIFIC*	Korea, China	(5)%	1%	1%
Bushmills	Irish whiskey		8%	7%	4%

	No.3 IRISH WHISKEY IN THE WORLD*	United States, Russia, Ireland, France, Great Britain			
Captain Morgan	Rum No.2 BRAND IN THE RUM CATEGORY IN THE WORLD**	United States, Canada, Great Britain, Germany, Russia, South Africa	6%	6%	1%
Smirnoff	Vodka No.1 PREMIUM VODKA IN THE WORLD**	United States, Great Britain, Canada, Brazil, South Africa, Australia	(1)%	(2)%	(7)%
Cîroc	Vodka No.2 ULTRA PREMIUM VODKA IN THE UNITED STATES***	United States, Brazil, Great Britain	2%	2%	(2)%
Ketel One vodka	Vodka No.2 SUPER PREMIUM VODKA IN THE UNITED STATES***	United States, Canada, Australia, Brazil	3%	6%	2%

Business description (continued)

Brand	Category	Key markets	Volume movement	Organic net sales movement	Reported net sales movement
Baileys	Liqueur No.1 LIQUEUR IN THE WORLD**	United States, Great Britain, Canada, Germany, Spain	(2)%	1%	(3)%
Don Julio	Tequila No.1 ULTRA PREMIUM TEQUILA IN THE WORLD*	United States, Colombia, Australia, Canada	27%	27%	22%
Tanqueray	Gin No.1 IMPORTED GIN IN THE UNITED STATES****	United States, Spain, Canada, Great Britain, Australia, Italy	4%	6%	3%
Guinness	Beer No.1 STOUT IN THE WORLD*****	Great Britain, Ireland, Nigeria, United States, Indonesia, Cameroon	(5)%	(1)%	(5)%

Organic equals reported movement for volume. See page 102 for definition of organic movement.

*IWSR; **Impact Databank; ***Nielsen; ****Beverage Information Group; *****Plato Logic.

Read more on pages 65-67.

Business description (continued)

OUTSTANDING BREADTH AND DEPTH ACROSS PRICE POINTS

We have brands at almost every price tier of every category. The range of our price points means we are able to capture consumption shifts across the price spectrum. The breadth and depth of our business provides resilience, and enables us to sustain our performance over time.

	Ultra premium*	Super premium	Premium	Standard	Value
Scotch whisky	Johnnie Walker Blue Label	The Singleton of Glen Ord	Johnnie Walker Black Label	J B	VAT69
Other whisk(e)y	Crown Royal Extra Rare	Bulleit Bourbon	Bushmills Black Bush	Seagram s 7 Crown	Rowson s Reserve
Vodka	Cîroc	Ketel One vodka	Smirnoff Iced Cake Flavoured Vodka	Smirnoff	Popov Vodka
Rum	Ron Zacapa Centenario XO	Pampero Aniversario Ron Extra Añejo	Captain Morgan Private Stock	Captain Morgan Black Spiced	Cacique Moneda De Oro
Liqueur	Grand Marnier Cuvée du Cent Cinquantenaire	Grand Marnier Cuvée Louis Alexandre	Sheridan s Original Layered Liqueur	Baileys	Emmets
Tequila	DeLeón tequila	Tequila Reserva de Don Juilo			
Gin	Tanqueray No. TEN		Tanqueray	Gordon s	Gilbey s
Local spirits	Shui Jing Fang		Yenì Raki	Ypióca	Vodka Hà N i
Beer		Kilkenny	Guinness	Meta Beer	Dubic Extra Lager

*Ultra premium includes prestige.

OUR PERFORMANCE AMBITION

Diageo s Performance Ambition is to create one of the best performing, most trusted and respected consumer products companies in the world.

DIAGEO S STRATEGY AIMS TO DELIVER OUR PERFORMANCE AMBITION THROUGH:				
1. Prioritised investment in:		2. Targeted investment in:		
a. Premium core spirits* (read more on page 23)	b. Reserve (read more on page 23)	a. Other spirits*	b. Beer	c. Wine

*Spirits include ready to drink (RTDs)

We measure progress against our Performance Ambition using the following financial and non-financial indicators:

#1 Efficient growth	#2 Consistent value creation	#3 Strong reputation	#4 Fully engaged employees
Organic net sales Operating margin Earnings per share Free cash flow	Return on average invested capital Total shareholder return	Alcohol in society Water efficiency	Employee super- engagement

See our Key Performance Indicators (KPIs) on pages 28-30.

Business description (continued)

OUR BUSINESS MODEL

Diageo has grown through investment in our brands and route to consumer, and by acquisitions to broaden our geographical footprint and our category depth and range. Our business model is designed to drive returns for shareholders, while creating value for our customers, employees and the communities in which we operate.

1. STRONG PLATFORM	2. AGILE OPERATING MODEL	3. FOCUSED INVESTMENT
Broad portfolio*:* Diageo has world-leading brands across categories and price points.	***21 markets***	***Performance drivers****:* Diageo has identified six performance drivers which are key to achieving our aims. Each market focuses on the priorities that will drive performance in that market: premium core brands; reserve; innovation; route to consumer; cost; and talent. Read more on page 23.
Geographic reach*:* we have geographic reach through the breadth and depth of our global and local brands.	***Participation strategy***: our participation strategy is to invest behind the biggest growth opportunities, by category and channel, for our brands in our 21 markets.	***Sustainability & Responsibility priorities****:* Diageo has six priorities that support our sustainable growth while meeting key stakeholder expectations: alcohol in society; water and the environment; community empowerment; people; governance and ethics; and value chain partnerships. Read more on pages 24-27.
Financial strength*:* our competitive advantage is reflected by our strong financial returns and consistent financial performance.	***Supply management****:* our 21 markets are designated as import markets, import and third-party production markets or import and local production markets.	
Leading capabilities*:* Diageo s focus is on brilliant execution: efficiency in supply and procurement; breakthrough marketing; scalable innovation; and winning relationships with our customers and consumers through distribution and sales.	***Consumer insights****:* our deep consumer insights help us to anticipate and respond to rapidly changing dynamics across all markets, and continue to nurture and grow some of the world s best-loved brands.	
Global functions*:* Diageo s 21 markets are supported by a global structure and shared services designed to share best practice, impart knowledge and help build capability at a local level, as well as apply governance of controls, compliance and ethics.		
Values*:* at the heart of everything we do are our company values: passionate about customers and consumers; be the best; freedom to succeed; proud of what we do; valuing each other.		
4. VALUE CREATION: Shareholder value; investment in the business; customer, employee and social value.		

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Business description (continued)

CHAIRMAN S STATEMENT

IN BUILDING REPUTATION, DIAGEO STARTS FROM A POSITION OF STRENGTH.

Diageo has an enviable history of entrepreneurialism that has built the leadership of our brands and business over many generations. Critical to our future success as a global consumer goods company operating in over 180 countries, is our ability to maintain that entrepreneurial spirit.

Interim dividend per share

19.7p (9%)

31 December 2012: 18.1p

[redacted]

32.0p (9%)

30 June 2013: 29.3p

[redacted]

51.7p (9%)
Full year 2013: 47.4p
*Includes recommended final dividend.

Ivan and the Executive Committee have set out the clear and stretching ambition to create one of the best performing, most trusted and respected consumer products companies in the world. To deliver this ambition, and with the support of your Board, Ivan has put in place a strategic framework to guide commercial execution and the allocation of our resources.

Performance and dividend

This financial year has seen a number of macroeconomic and one off challenges impact our performance. Cyclical weakness and volatility have slowed the growth of the emerging markets, and, while growth in the developed markets is improving, the pace of economic recovery remains uneven. We were quick to adapt to changing market and competitive dynamics, managing our cost base and shifting our organisation, culture and behaviours. The business is now well placed to step up our performance to drive efficient growth and consistent returns for shareholders.

This confidence in Diageo s future prospects has enabled the Board to recommend a final dividend of 32 pence per share, to be paid to shareholders on 2 October 2014. This brings the total dividend for the year to 51.7 pence per share, an increase of 9% over the prior year.

Strategic progress

Diageo has an enviable history of entrepreneurialism that has built the leadership of our brands and business over many generations. Critical to our future success as a global consumer goods company operating in over 180 countries, is our ability to maintain that entrepreneurial spirit. We continue to build our agility at a market level, empowering our local businesses to act with speed and authority. This journey was started in 2011 and culminated in the removal of our regional hub structures in Africa, Latin America and Asia this year, thus allowing for faster and more efficient decision making.

The reorganisation programme announced in January will improve operational efficiencies and will also drive out cost. It has identified annual savings of £200 million by the end of fiscal 2017.

Diageo continued to expand its global presence this year, and I am particularly pleased with the progress made in achieving a majority stake in United Spirits Limited (USL), through the acquisition of an additional 26% shareholding on 2 July 2014. This acquisition takes Diageo s holding in USL to 54.78%.

Business description (continued)

Trust and respect

Trust and respect have never been more important for a global business. In building reputation Diageo starts from a position of strength. We believe that alcohol can play a positive role in society and in order to achieve this we need to continue partnering with others to help reduce the harmful use of alcohol. As part of the United Nations (UN) charter to reduce non-communicable diseases, the World Health Organization (WHO) has set a voluntary target of a 10% reduction in the harmful use of alcohol by 2025. Diageo shares this goal. We believe we are making good progress, including importantly our efforts to consistently deliver the Global Beer, Wine and Spirits Producers Commitments a co-ordinated industry response to the WHO s call to action. We will continue to challenge ourselves and the industry to drive large scale progress.

While we continue to focus on maintaining a positive role for alcohol in society, we will not forget the business fundamentals that are an important part of our commitment to international frameworks such as the UN Global Compact. I am pleased that in this period of change for the business we have not lost sight of maintaining the highest standards of conduct, taking pride in embedding integrity in our daily business activities and in our relationships with others.

For many, Diageo is a badge of quality: our name engenders trust with our suppliers, customers, consumers and other stakeholders. In addition to building a strong culture of governance and ethics, earning the trust of our stakeholders requires us to make positive impacts at each stage of our value chain. We do this by supporting small scale farmers growing our grains or by supporting women and men working in the hospitality industry selling our brands. Beyond this, we work to protect resources such as water which we and our local communities need. In addition to meeting stakeholder expectations, this work also brings commercial benefits, including securing resources and raw materials, recruiting and retaining a talented and diverse workforce, creating operational efficiencies and ultimately maintaining our licence to operate around the world.

As Diageo grows in many parts of the world, we must continue to ensure that the way we do business supports and contributes to shared value for Diageo and the people and societies we work with.

Business environment

Creating an environment, whether at a global or national level, where businesses can drive growth and prosperity is a core responsibility for governments and businesses alike. It is particularly important for us in our home market to have clarity on any issues with the potential to add unnecessary cost and complexity to our business. Business does not like ambiguity. As the United Kingdom enters a potentially significant period domestically, and in relation to the EU, we will continue to seek the reassurances we need in areas of critical importance to the future success of our business, and of our great industry.

Board appointments

I am delighted that we have two new Non-Executive Director appointments to the Board, effective 1 September 2014, in Alan Stewart and Nicola Mendelsohn. Alan is Chief Financial Officer Designate of Tesco. He has extensive financial experience in retail as Chief Financial Officer at Marks & Spencer and Group Finance Director at WH Smith. He will bring to the Board a strong track record in accountancy and financial management together with experience in retail, travel and banking. Nicola Mendelsohn is currently Vice President, EMEA of Facebook Inc. and has senior experience at the forefront of digital marketing and communications. Nicola s admirable record in championing women in business will also be an inspiration to our people and the way that we work at Diageo.

Looking ahead

The current emerging market weakness does not reduce our confidence in the long term growth opportunities of these markets and we continue to invest to build our brands and routes to consumer for the future. This, together with Diageo s enviable strengths and the focus that Ivan and the Executive Committee will bring to bear, lead the Board to approach the year ahead with confidence.

Our people

Finally, I would like to thank every one of our employees for their hard work during a challenging year. It is the people in Diageo who will achieve our Performance Ambition, and I am confident that their talents and skills will enable us to build on the entrepreneurial spirit of the founders of our brands and ensure that, wherever we are in the world, the name Diageo is synonymous with commercial success, trust and respect.

Dr Franz B Humer,

Chairman

Business description (continued)

CHIEF EXECUTIVE S STATEMENT

I AM CONFIDENT THAT WE HAVE THE STRATEGY TO DELIVER, AND WILL DRIVE EFFICIENT GROWTH.

Top-line growth was affected by a slowdown in the emerging markets and currency weakness. Despite this, our increased focus on cost ensured we delivered our three-year margin expansion goal of 200 basis points.

I am honoured to be Chief Executive of Diageo; a global leader with outstanding brands, which have been the choice of consumers across many generations.

Today, Diageo is in good health, with high and improving margins and a robust balance sheet. Our business is balanced across geographies and we continue to build our global footprint accessing long term growth markets. While some of these economies have been challenging, we have the experience of managing volatility and we remain confident in the long term consumer trends, as well as our ability to grow market share.

This year we created a framework to guide delivery of our strategy called our Performance Ambition. The organisation is now focused on six performance drivers: premium core brands; reserve; innovation; route to consumer; cost; and talent. We have also restructured our business. The organisation we take into the next financial year is more agile and accountability lies directly in our 21 markets, making the link between our markets and global functions clearer. The benefits of this will come through in the coming years.

Given the attractiveness of our sector, our clear strategy, our operational focus and the demographic and consumer trends ahead of us, I have no doubt that we can achieve our ambition to become one of the best performing, most trusted and respected consumer products companies in the world.

Results

In fiscal 2014 top-line growth was affected by a slowdown in the emerging markets and currency weakness. Despite this, our increased focus on cost ensured we delivered our three-year operating margin expansion goal of 200 basis points. Performance was also impacted by some specific events, such as the anti extravagance measures in China. Our decision in Venezuela to convert our results at an exchange rate which some have judged conservative, but which I feel is appropriate, has reduced the risk that currency volatility will have on our performance in that country.

North America remains the engine of our business, accounting for about a third of our net sales and 45% of our operating profit. This year we again delivered solid growth and significant margin improvement.

Our Western Europe business reported stronger performance, as we expected. Western Europe is still challenging but there has been some recovery and the integrated model put in place in 2011 is proving effective.

In Africa, Eastern Europe and Turkey we posted modest growth, despite facing challenges in beer in Nigeria and following the imposition of duty on Senator keg in Kenya. Performance was up in Turkey following stabilisation of the raki category and continued growth of our scotch brands.

Latin America and Caribbean delivered a good performance despite currency fluctuations, and a slowdown in consumption has impacted wholesalers and distributors operating in the free trade area. In a challenging operating environment, local brands performed well in Venezuela, and Brazil and Colombia also delivered a solid performance.

Performance in Asia Pacific reflected the introduction of anti extravagance measures in China and the weaker trading environment in South East Asia. To counter the effects of the government anti extravagance campaign in China we rolled out innovations in Shui Jing Fang and broadened the range of price points away from dependence on super premium baijiu. Korea, Japan, Middle East, Taiwan and India delivered good growth.

Business description (continued)

Focusing on delivery

For our premium core brands this has been a year of progress. Improving brand equities and recruiting the next generation of consumers through world class marketing will pay dividends in the long term. We have delivered great launches in innovation, for example, Captain Morgan White in the United States and Jebel Gold in East Africa. I am also excited by the opportunity we have with our single grain whisky, Haig Club, our business partnership with David Beckham. Reserve has been an area of focus for us and we are now the leader in super and ultra premium spirits. We continue to roll out our route to consumer programme, and improvement here will be as big a driver of growth as innovation. Our focus on costs is yielding real results, as demonstrated in the delivery of our margin goal. Talent remains central to our growth plans, and is critical for each market.

Investing for growth

Our investment in the long term supply of premium core spirits continues, with investment in our operations in the United States and Scotland during the year, enabling our business to be well positioned to capture growth from the increase in future demand, particularly in bourbon and scotch. By acquiring an additional 26% of United Spirits Limited (USL) on 2 July 2014, taking our shareholding to a majority holding of 54.78%, we have taken a leadership position in India which will provide a transformational platform for growth in this very attractive spirits market. We will consolidate USL from the start of fiscal 2015, and with our combined strength, the Indian market will become one of Diageo s largest markets next year and a major contributor to our growth ambitions.

Trust and respect

We manage the Company s most material social and environmental impacts with a goal of creating shared value for both our business and our diverse stakeholders around the world. Core to this is a priority around alcohol in society. I m proud of the approach we have taken as an industry, over many years, to promote responsibility and to help tackle alcohol misuse, but we still have work to do. Making a tangible difference in alcohol-related harm is not only smart business, it is the right thing to do and we will continue to enlist partners to help us build insights and scale. In addition to this, framing our behaviours with strong codes of governance and ethics, developing talent and skills in local communities and ensuring the long term sustainability of resources, are critical for businesses operating at scale across multiple markets, particularly in emerging economies. Being a force for good is essential for delivering commercial and financial benefits, retaining and attracting the best people and being true partners in the communities in which we operate.

Our people

One of the special things about Diageo is our people and the culture that we have created. In simplifying the organisation we have freed our people up to act like owners and be bold in execution, which is changing behaviours across the organisation, and encouraging people to be even more commercially minded.

We attract the best talent in our industry and we are committed to creating the best conditions for people to thrive and succeed. To my 28,000 colleagues around the world I would like to take the opportunity to thank them for their commitment and contribution during the year.

Outlook

Finally, to you, our shareholders, as well as our wide range of stakeholders, it has been a privilege to lead Diageo during the past year. I am confident that we have the strategy to deliver, and we will drive efficient growth. The future growth drivers for our industry, and the aspirational nature of our brands, as consumers in the emerging markets realise increasing disposable income, are undiminished. The opportunity for Diageo to grasp its unfulfilled potential is an exciting one.

Ivan Menezes,

Chief Executive

Business description (continued)

HOW WE WILL DELIVER OUR AMBITION: PERFORMANCE DRIVERS

Diageo s performance drivers are key to achieving our Performance Ambition and each market focuses on the priorities which are relevant to driving growth in that market.

1. STRENGTHEN AND ACCELERATE GROWTH OF OUR PREMIUM CORE BRANDS

Our premium core brands are broadly distributed and enjoyed by consumers in the developed world and have wide appeal to the increasing number of middle class consumers in emerging markets. They include iconic brands such as Johnnie Walker, Smirnoff, Captain Morgan and Baileys.

2. WIN IN RESERVE IN EVERY MARKET

The growth of luxury consumption is a global phenomenon. There are forecast to be 400 million new consumers in this category by 2020. Winning in reserve, our luxury portfolio is a priority for Diageo and during the last five years we have transformed our luxury brand building capabilities. We have doubled the net sales of our reserve business, which now accounts for 13% of our total net sales and we are now the leaders in the super and ultra premium segments. This year Diageo has extended this leadership across key categories.

3. INNOVATE AT SCALE TO MEET NEW CONSUMER NEEDS

We believe our ability to innovate gives Diageo competitive advantage. It s a proven driver of growth and is critical to performance in each of our markets. For each of the last five years innovation has accounted for at least half of Diageo s net sales growth, and has grown double digit. As a result of defining our Performance Ambition we have put renewed focus on bigger, more scalable ideas, identifying and delivering results through impactful innovations.

4. BUILD AND THEN CONSTANTLY EXTEND OUR ADVANTAGE IN ROUTE TO CONSUMER

Our route to consumer performance driver is about enabling and empowering our markets to drive broader distribution and higher rates of sale for our brands in an efficient way. The global programme, that was rolled out this year, looks at how we can profitably extend where our brands appear and improve the quality of how our brands appear at every appropriate drinking or buying occasion. Each market is responsible for its own Route to Consumer programme, and for building an efficient local platform that creates competitively advantaged consumer and shopper experiences.

5. DRIVE OUT COSTS TO INVEST IN GROWTH

By reducing costs we can invest more in the areas that we believe will drive future growth. We are committed to a long term, cost conscious culture which results in ongoing, year-on-year improvements in our cost base and margins.

6. ENSURE WE HAVE THE TALENT TO DELIVER OUR PERFORMANCE AMBITION

Our Performance Ambition can only be achieved by having the right people with the right capabilities in place across our business who can deliver our plans. Ensuring that we have the best talent now and in the future is one of our biggest challenges and one of our greatest opportunities.

Business description (continued)

HOW WE WILL DELIVER OUR AMBITION: SUSTAINABILITY & RESPONSIBILITY

Strong communities supported by local economic growth and a stable supply of natural resources are critical to Diageo s financial performance. This makes doing business in a sustainable and responsible way, including creating a positive role for alcohol in society, critical to achieving our Performance Ambition.

Through Diageo s Sustainability & Responsibility (S&R) Strategy, we manage the company s most material social and environmental impacts with a goal of creating shared value for both our business and our diverse stakeholders around the world.

At the core of our approach is a commitment to create a positive role for alcohol in society, which is fundamental to Diageo s purpose of celebrating life, every day, everywhere, and a critical expectation of our business.

Meeting stakeholder expectations also involves creating a positive role for our business and the industry as a whole. This includes protecting the watersheds on which our operations and communities rely, and investing in community programmes that empower stakeholders throughout our value chain. It also includes managing impacts that are fundamental for any consumer products company, such as governance and ethics, people and labour, and other environmental issues such as greenhouse gas emissions, waste and packaging.

Diageo s S&R Strategy supports our ambition to be one of the best performing, most trusted and respected consumer products companies in the world. It brings commercial benefits, including securing resources and raw materials, recruiting and retaining a talented and diverse workforce, creating operational efficiencies and ultimately maintaining our licence to operate around the world. S&R projects also save costs.

For example, a water recovery project at our Tusker brewery, which operates in a water-stressed part of Kenya, started paying returns in just six months and now generates savings of £500,000 per year.

Key stakeholders and their expectations

We define our stakeholders as all those who affect or are affected by Diageo s business. They include internal and external stakeholders, ranging from employees, investors, customers and suppliers, to governments and regulators, not-for-profit organisations, consumers and local communities. In 2013, we invited more than 40 stakeholders to share their expectations of Diageo in terms of our social and environmental impact. Communicating about the risks of alcohol consumption and tackling alcohol misuse were among the most frequently cited. A common piece of feedback was that all leaders in the alcohol industry should work together to have a greater collective impact on reducing alcohol misuse.

Empowering stakeholders in our value chain through skills and education particularly for smallholder farmers and women was also frequently cited as an important contribution to socio-economic development, while a third key expectation concerned water security, particularly in water-stressed areas. Stakeholders noted the need to continue to work on the issue within our operations but also to collaborate with local communities and raw material suppliers.

Business description (continued)

Defining our material issues

To identify and prioritise our material impacts, we coupled feedback from external stakeholders, our Board and management team, with commercial analysis. The results are shown in materiality matrix, with external stakeholder interests illustrated on the y axis and business interests on the x axis. Business interests represent the impact each issue might have on factors including equity, market share, price, operating profit, our reputation and employee engagement.

We recognise that this matrix is not fully comprehensive but it is illustrative of the variety of concerns stakeholders may have in the more than 180 countries in which we sell our products. We will continue to update it as we engage individuals and organisations around the world. We are currently in the process of developing targets for the most material issues, and we aim to announce them in December 2014.

1. ALCOHOL IN SOCIETY

Diageo s iconic brands are enjoyed by millions every day and it has always our priority to ensure that they are enjoyed responsibly. While drinking alcohol can play a positive role in social occasions and celebrations for those who choose to drink, Diageo recognises that the misuse of alcohol can cause serious problems for individuals, communities and society. Following a United Nations (UN) political declaration on the prevention and control of non-communicable diseases, the World Health Organization (WHO) has set a target of reducing alcohol- related harm by 10% across the world by 2025. Diageo shares this goal: every one of our responsible drinking programmes, partnerships and campaigns are in service of this.

In 2012, 13 leading alcohol beverage companies, including Diageo, announced the Global Beer, Wine and Spirits Producers Commitments to Reduce Harmful Drinking. Built on long-standing industry efforts, these commitments represent the largest ever industry-wide initiative to implement effective ways to address harmful drinking. The initiative identified five broad areas in which to progress over five years from January 2013: (1) reducing underage drinking; (2) strengthening and expanding marketing codes of practice; (3) providing consumer information and responsible product innovation; (4) reducing drink driving; and (5) enlisting the support of retailers. Diageo and the other signatory companies have pledged to ensure that progress in implementing the commitments is transparent and independently assured.

Beyond these commitments, our approach to creating a positive role for alcohol in society focuses on promoting rigorous company and industry standards for responsible marketing; continuing to support effective programmes and partnerships to tackle drink driving and excessive drinking; and advocating effective, evidence-based policy.

The Diageo Marketing Code and Digital Code are our mandatory minimum standard for responsible marketing, and we review them every 12-18 months to ensure they represent best practice. In addition to abiding by these codes, all brands operate under the Diageo Alcohol Beverage Information Policy which mandates what information Diageo provides on labels, including, among other provisions, a link to our responsible drinking website, www.DRINKiQ.com.

Business description (continued)

2. WATER AND THE ENVIRONMENT

Diageo uses a wide range of resources in its business. Some, like fossil fuel, are finite; others, like cereals, are vulnerable to the effects of climate change. Water, the main ingredient in all of our products, is becoming increasingly scarce in many parts of the world.

While our S&R Strategy includes targets and policies aimed at reducing the emissions of greenhouse gases, reducing the amount of waste sent to landfill, and improving the sustainability of our packaging, we and our stakeholders recognise that water stewardship is the most material aspect of our environmental strategy.

This year, 23 of our sites, producing about one third of Diageo s packaged volume, were designated as being located in areas which are water-stressed*, which means they have a higher water supply risk. More than half of these sites are in Africa, where the UN predicts that nearly 50% of the population will face water scarcity by 2025. Water challenges in these areas will therefore affect not only Diageo s business but also our business partners and the local communities who rely on water for their livelihoods.

Our approach to water stewardship focuses on driving progress against targets for water efficiency, water wasted in water-stressed areas and water quality. We also invest in infrastructure and sanitation through our Water of Life programme to provide access to clean water in local communities, primarily in Africa.

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*See page 40 for a map of our water-stressed sites.

3. COMMUNITY EMPOWERMENT

Like most businesses, we create wealth directly for our local stakeholders through our daily business operations, including providing jobs, sourcing locally, and paying local duties. However, creating wealth in a lasting way requires partnering with others to address development challenges such as education and health, and advocating high standards of governance in the communities where we operate.

We invest in a variety of programmes that aim to empower our stakeholders, which represent our long-standing commitment to investing in communities. Our approach not only seeks to maximise the positive impact Diageo and its business partners can have on society, it also seeks to strengthen our value chain. In addition to helping to provide access to water for local communities through Water of Life, key programmes include partnerships and training for smallholder farmers supplying our ingredients; Diageo s Learning for Life programmes that provide education and vocational training in the hospitality, retail and alcohol industries; and Plan W programmes that focus on empowering women in our local communities. We also support local charities and disaster relief efforts through company contributions as well as through the Diageo Foundation, a UK-registered charity.

4. OUR PEOPLE

From the moment they join Diageo, we want our employees to feel engaged: aligned with our strategy, connected to our values and motivated to achieve their potential. And above all, we want them to be safe. Our Zero Harm philosophy is aimed at eliminating workplace accidents and we have a target of having fewer than one lost-time accident per 1,000 people by 2015 as a milestone towards that ambition.

We support our employees through clear policies, competitive reward programmes, coaching and development opportunities, and health and wellbeing initiatives. We continually monitor the impact of these programmes on employee engagement, conducting an annual values-based survey, which is now in its 13th year. The survey allows Diageo at group, market, functional and team levels, to assess how well we are bringing our values to life and engaging employees.

Maintaining a culture that embraces diversity from recruitment through to senior leadership is particularly important to Diageo s people strategy. We have a goal to have 30% of senior management positions held by women.

5. GOVERNANCE AND ETHICS

People want to trust the company behind the brands that they love. Diageo s risk and compliance programme and strong corporate governance structure are designed to earn and keep that trust by protecting our reputation, supporting our core values and ensuring we act lawfully and with integrity in everything we do.

To help our employees make the right decisions at work, we train them on our Code of Business Conduct which is underpinned by our global policies.

A network of control, compliance and ethics managers in each market and function carry out targeted, risk-based training to employees to support understanding and application of the policies that are most important to them. We also support our managers and senior leaders with specific and tailored tools and training to help them embed our culture of integrity. We take seriously the disciplinary consequences of breaches of our Code or policies.

Our response to proven breaches varies depending on their severity, however this year 146 people exited the business as a result of such breaches.

Business description (continued)

6. VALUE CHAIN PARTNERSHIPS

Our brands rely on a long and complex value chain that joins us with our suppliers, customers, and consumers. Our reputation and the sustainability of our business model, depend on our ability to recognise and mitigate the potential risks along this chain.

Diageo s Partnering with Suppliers Standard sets out the minimum social, ethical and environmental standards required of suppliers as part of their contract with us, as well as aspirations for our long-term partners to work towards. We work through the Supplier Ethical Data Exchange (SEDEX), a not-for-profit organisation that enables suppliers to share assessments and audits of ethical and responsible practices with their customers.

The process by which we manage social and ethical risks in our supply chain has four stages: an initial screening, a prequalification questionnaire which covers social and ethical risks including human rights, a qualification process where potentially high-risk suppliers are required to register with SEDEX, and independent audits of suppliers who represent the highest risk.

Beyond upholding high standards across our whole supply chain, we are particularly keen to foster broader partnerships with agricultural suppliers, since the long term prosperity of our business is closely linked with our ability to work with farmers in ways that are sustainable, secure, and mutually beneficial.

To this end, we have continued actively using local raw materials like sorghum and cassava, which are more resilient and better adapted to their local climates. We also focus on sourcing locally. For example, we have a target of sourcing 70% of agricultural materials locally across Africa (including Nigeria, Ghana, Cameroon, Kenya, Uganda, Tanzania, Ethiopia and South Africa) by the end of 2015.

To sustain partnerships with farmers, Diageo and its other agricultural value chain partners help provide access to training, seeds and advanced credit. In many cases, this allows farmers to make longer term, sustainable investments.

Read our S&R Review on pages 89-101.

Business description (continued)

HOW WE MEASURE PERFORMANCE: KEY PERFORMANCE INDICATORS

We use the following nine key performance indicators (KPIs) to measure our financial and non-financial performance.

Their relevance to our strategy and our performance against these measures are explained below:

Relevance to strategy

#1 Efficient growth

#2 Consistent value creation

#3 Strong reputation

#4 Fully engaged employees

Remuneration

Some KPIs are used as a measure in the incentives plans for the remuneration of executives. These are identified with the symbol ®.

See our Directors remuneration report from page 125 for more detail.

FINANCIAL	FINANCIAL	FINANCIAL
ORGANIC NET SALES GROWTH (%) ® #1	**ORGANIC OPERATING MARGIN IMPROVEMENT (BPS) ® #1**	**EARNINGS PER SHARE BEFORE EXCEPTIONAL ITEMS (PENCE) ® #1**

Definition Sales growth after deducting excise duties, excluding the impact of exchange rate movements, acquisitions and disposals.	**Definition** The percentage point movement in operating profit before exceptional items, divided by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.	**Definition** Profit before exceptional items attributable to equity shareholders of the parent company, divided by the weighted average number of shares in issue. For reward purposes this measure is further adjusted for the impact of exchange rates and other factors not controlled by management, to ensure focus on our underlying performance drivers.
Why we measure This measure reflects our performance as the result of the choices made in terms of category and market participation, and Diageo s ability to build brand equity, increase prices and grow market share.	**Why we measure** Diageo is focused on delivering efficient growth. The movement in operating margin measures the efficiency of the business. Consistent operating margin improvement is a business imperative, driven by investment choices, our focus on driving out costs across the business and improving mix.	**Why we measure** Earnings per share reflects the profitability of the business and how effectively we finance our balance sheet. It is a key measure for our shareholders.
Performance Organic net sales were up 0.4%, reflecting a mixed performance with growth in North America, stability in Western Europe and weakness in emerging market economies.	**Performance** This year the biggest drivers of margin improvement have been overhead savings and marketing procurement savings, delivering our commitment to 200 basis points of operating margin expansion in three years.	**Performance** Eps before exceptionals was down 7.6 pence to 95.5 pence per share as foreign exchange movements reduced eps by 10 pence per share.
See page 43 for more detail	See page 43 for more detail	See page 44 for more detail

Business description (continued)

FINANCIAL	FINANCIAL	FINANCIAL
FREE CASH FLOW* (£ MILLION) ® #1	**RETURN ON AVERAGE INVESTED CAPITAL (%) #2**	**TOTAL SHAREHOLDER RETURN (%) ® #2**
Definition Free cash flow comprises the net cash flow from operating activities aggregated with the net movements in loans receivable and other investments, and with the net purchase of property, plant and equipment, and computer software.	**Definition** Profit before finance charges and exceptional items divided by average invested capital. Invested capital comprises net assets aggregated with exceptional restructuring costs and goodwill at the date of transition to IFRS, excluding post employment liabilities and net borrowings.	**Definition** Percentage growth in the value of a Diageo share (assuming all dividends and capital distributions are re-invested).
Why we measure Free cash flow is a key indicator of the financial management of the business and reflects the cash generated by the business to fund payments to our shareholders and acquisitions.	**Why we measure** Return on average invested capital (ROIC) is used by management to assess the return obtained from the group s asset base. Improving ROIC builds financial strength to enable Diageo to attain its financial objectives.	**Why we measure** As a public limited company, Diageo has a fiduciary responsibility to maximise long-term value for shareholders. We also monitor our relative TSR performance against our peers.
Performance Lower operating profit, principally reflecting the strength of sterling and increased restructuring costs, was the biggest driver of lower free cash flow year on year.	**Performance** Lower operating profit, primarily due to adverse exchange movements, the investment in United Spirits Limited and increased working capital led to the reduction in ROIC.	**Performance** Diageo recorded a total shareholder return of 2% as dividends received increased 9% and earnings moderated in the financial year, given weaker economies in the emerging markets and some market specific challenges.
See page 45 for more detail	See page 45 for more detail	

Business description (continued)

NON-FINANCIAL	NON-FINANCIAL	NON-FINANCIAL
ALCOHOL IN SOCIETY (RESPONSIBLE DRINKING PROGRAMMES) #3**	**WATER EFFICIENCY*** (L/L) #3**	**EMPLOYEE SUPER-ENGAGEMENT (%) #4**
Definition Programmes run or funded by Diageo that aim to prevent excessive drinking, tackle drink driving, address underage drinking, help retailers ensure responsible sales or otherwise promote a positive role for alcohol in society.	**Definition** Ratio of the amount of water required to produce one litre of packaged product.	**Definition** A key element of Diageo s people strategy is employee engagement. As part of our annual values- based survey, Diageo measures super-engagement, a more stretching measure than engagement, requiring employees to assign the highest possible ranking to all six of the core engagement questions.
Why we measure Harm related to alcohol misuse is our most important social issue. Supporting programmes that promote a positive role for alcohol in society, addresses risks such as: harm to consumers and communities; reputational damage; limitations to our licence to operate; and the loss of trust and respect from our stakeholders around the world.	**Why we measure** Water is the main ingredient in all of Diageo s brands. To sustain our production growth around the world and respond to the growing global demand for water, Diageo aims to improve water use efficiency and minimise the amount of water used at production sites, particularly in water-stressed areas.	**Why we measure** We want to understand what drives high engagement, a key performance enabler. All feedback from our annual values survey is carefully reviewed both qualitatively and quantitatively. The results inform leadership development, employee engagement strategies and ways of working.
Performance Since 2013, we have increased the number and geographic scope of programmes we support by expanding our efforts and partnerships in emerging markets**.** Note: In 2011, we started actively tracking our global performance for public reporting.	**Performance** Diageo used 6.9 litres of water to produce one litre of packaged product, a 2.4% decrease from 2013. While some savings are the result of major investments, most come from operational improvements related to equipment, processes, culture and behaviours.	**Performance** For a second year running, 92% of employees took part in the survey. In the 2014 survey 38% of all employees were measured as being super-engaged, in a year when employees experienced change in the business.
See page 89 for more detail	See page 90 for more detail	See page 95 for more detail

* Looking ahead to 2015, the free cash flow measure will be replaced by an operating cash conversion measure, to align with the fiscal 2015 Annual Incentive Plan.

** We are moving towards a new metric in future years that will demonstrate the impact of our programmes on awareness, attitudes or behaviour.

*** In accordance with Diageo s environmental reporting methodologies data for each of the three years in the period ended 30 June 2013 have been restated and total water used excludes irrigation water for agricultural purposes on land under the operational control of the company.

Business description (continued)

Risk factors

Diageo believes the following to be the principal risks and uncertainties facing the group. If any of these risks occur, Diageo s business, financial condition and performance could suffer and the trading price and liquidity of securities could decline.

In the ongoing uncertain economic environment, certain risks may gain more prominence either individually or when taken together. For example, demand for beverage alcohol products, in particular luxury or super premium products, may decrease with a reduction in consumer spending levels. Costs of operations may increase if inflation were to become prevalent, or upon an increase in the costs of raw materials. These conditions may also lead to intensified competition for market share, with potentially adverse effects on volume and prices. The financial and economic situation may have a negative impact on third parties with whom Diageo does, or may do, business. Any of these factors may affect the group s performance, financial condition and liquidity. Diageo has taken and may take further steps to manage its business through this challenging economic environment and to position its business to benefit from economic recovery as and when that may occur in the markets in which Diageo operates, but there can be no assurance that the steps taken will have the intended results.

Diageo s ability to fund its long term strategies may be adversely affected if there is an extended period of constraint in the capital markets, particularly the debt markets, at the same time that cash flows from Diageo s business are under pressure. Such developments may adversely affect shareholder returns or share price. Additionally, continued volatility in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo s reported results. Changes in the trustees valuations of the assets and liabilities of Diageo s pension plans may also increase pension funding requirements.

Risks related to the global economy

Diageo s business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates

Diageo may be adversely affected by political, economic or social developments in any of the countries where it has distribution networks, production facilities or marketing companies. Diageo s business is dependent on general economic conditions in the United States, countries that form the European Union and other important markets.

If the economy in any of these markets does not recover as forecast, or if there is a significant deterioration in the economic conditions in any of Diageo s important markets, including any resulting social unrest, reduction in consumer confidence and spending levels, customer destocking, the failure of customer, supplier or financial counterparties or a reduction in the availability of, or an increase in the cost of financing to, Diageo, it could have a material adverse effect on Diageo s business and performance. Any such economic developments may lead to reduced economic growth and, in turn, reduced demand for Diageo s products, in Europe and other markets in which Diageo operates. This could have a material adverse effect on Diageo s business.

Diageo is headquartered in the United Kingdom and has significant production and investment in Scotland. As such, the outcome of the referendum on Scottish independence, and any subsequent period of regulatory or political uncertainty may adversely affect Diageo s business. In addition, Diageo s operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Political and/or social unrest, potential health issues, natural disasters and terrorist threats and/or acts may also occur in various places around the world, which will have an impact on trade, tourism and travel. Many of these risks are heightened, or occur more frequently, in emerging markets. These disruptions can affect Diageo s ability to import or export products and to repatriate funds, as well as affecting the levels of consumer demand (for example, in duty free outlets at airports or in on trade premises in affected regions) and therefore Diageo s levels of sales or profitability. A substantial portion of Diageo s operations, representing approximately 39% of Diageo s net sales for the year ended 30 June 2014, are carried out in emerging markets. Emerging markets are also generally exposed to relatively higher risk of liquidity constraints, inflation, devaluation, price volatility, currency convertibility and sovereign default. Due to Diageo s specific exposures, any or all of the aforementioned factors may affect Diageo disproportionately or in a different manner as compared to its competitors.

Part of Diageo s growth strategy includes expanding its business in certain countries where consumer spending in general, and spending on Diageo s products in particular, has not historically been as great but where there are strong prospects for growth. There is no guarantee that this strategy will be successful and some of these markets represent a higher risk in terms of their changing regulatory environments and higher degree of uncertainty over levels of consumer spending.

Risks related to the industry

Demand for Diageo s products may be adversely affected by many factors, including changes in consumer preferences and tastes and adverse impacts of a declining economy

Diageo s collection of brands includes some of the world s leading beverage alcohol brands as well as brands of local prominence. Maintaining Diageo s competitive position depends on its continued ability to offer products that have a strong appeal to consumers. Consumer preferences may shift due to a variety of factors including changes in demographic and social trends, public health regulations, changes in travel, vacation or leisure activity patterns, weather effects and a downturn in economic conditions, which may reduce consumers willingness to purchase premium branded products. Continued economic pressures could also lead to consumers selecting products at lower price points, whether Diageo s or those of its competitors, which may have an adverse effect on Diageo s profitability. The competitive position of Diageo s brands could also be affected adversely by any failure to achieve consistent, reliable quality in the product or in service levels to customers.

Business description (continued)

In addition, the social acceptability of Diageo s products may decline due to public concerns about alcohol consumption. These concerns could also result in regulatory action, litigation or customer complaints against companies in the industry and may have an adverse effect on Diageo s profitability.

Growth in Diageo s business has benefited from both the launch of new products and the creation of brand extensions and product innovation remains a significant element of Diageo s growth plans. The launch and ongoing success of new products is inherently uncertain, especially as to their appeal to consumers. The failure to launch successfully a new product can give rise to inventory write-offs and other costs and can affect consumer perception and growth of an existing brand. There can be no assurance of Diageo s continuing ability to develop and launch successful new products or variants of existing products or of the profitable lifespan of newly or recently developed products.

Diageo is subject to litigation directed at the beverage alcohol industry and other litigation

Companies in the beverage alcohol industry are, from time to time, exposed to class action or other litigation relating to alcohol advertising, product liability, alcohol abuse problems or health consequences from the misuse of alcohol. Diageo may also be subject to litigation arising from legacy and discontinued activities, as well as other litigation in the ordinary course of its operations. Diageo is further subject to the risk of litigation by tax, customs and other regulatory authorities, including with respect to the methodology for assessing importation value, transfer pricing or compliance matters. Changes in the political and economic climate have resulted in an increased focus on tax collection in recent years and tax authorities are showing an increased appetite to challenge the methodology used by multinational enterprises, even where it is compliant with international best practice guidelines. Any such litigation may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and as a result, Diageo s business could be materially adversely affected. For additional information with respect to legal proceedings, see Additional information for shareholders Legal proceedings and note 19 to the consolidated financial statements.

Climate change, or legal, regulatory or market measures to address climate change, may negatively affect Diageo s business or operations, and water scarcity or poor water quality could negatively impact Diageo s production costs and capacity

There is a growing concern that carbon dioxide and other so-called greenhouse gases in the atmosphere may have an adverse impact on global temperatures, weather patterns and the frequency and severity of extreme weather and natural disasters. In the event that such climate change has a negative effect on agricultural productivity, Diageo may be subject to decreased availability or increased pricing for certain raw materials that are necessary for Diageo s products, such as sugar, cereals, hops, agave and grapes. Water is the main ingredient in substantially all of Diageo s products and it is also a limited resource in many parts of the world. As demand for water continues to increase, and as water becomes scarcer and the quality of available water deteriorates, Diageo may be affected by increasing production costs or capacity constraints, which could adversely affect Diageo s operations and profitability.

An increase in the cost of raw materials or energy could affect Diageo s profitability

The components that Diageo uses for the production of its beverage products are largely commodities that are subject to price volatility caused by changes in global supply and demand, weather conditions, agricultural uncertainty and/or governmental controls. Commodity price changes may result in unexpected increases in the cost of raw materials, glass bottles, flavours and other packaging materials and Diageo s beverage products. Diageo may also be adversely affected by shortages of such materials or by increases in energy costs resulting in higher transportation, freight and other operating costs. Diageo may not be able to increase its prices to offset these increased costs without suffering reduced volume, sales and operating profit.

Risks related to regulation

Regulatory decisions and changes in the legal and regulatory environment could increase Diageo s costs and liabilities or limit its business activities

Diageo s operations are subject to extensive regulatory requirements relating to production, distribution, importation, marketing, advertising, promotion, sales, pricing, labelling, packaging, product liability, labour, pensions, antitrust, compliance and control systems, and environmental issues. Changes in laws, regulations or governmental or regulatory policies and/or practices could cause Diageo to incur material additional costs or liabilities that could adversely affect its business. In particular, governmental bodies in countries where Diageo operates may impose new labelling, product or production requirements, limitations on the marketing, advertising and/or promotion activities used to market beverage alcohol, restrictions on retail outlets, restrictions on importation and distribution or other restrictions on the locations or occasions where beverage alcohol is sold which directly or indirectly limit the sales of Diageo products.

Regulatory authorities under whose laws Diageo operates may also have enforcement power that can subject the group to actions such as product recall, seizure of products or other sanctions which could have an adverse effect on Diageo sales or damage its reputation. Any changes to the regulatory environment in which Diageo operates could cause Diageo to incur material additional costs or liabilities, which could adversely affect Diageo s performance.

Business description (continued)

Beverage alcohol products are also subject to national excise, import duty and other duties in most countries around the world. An increase in any such duties could have a significant adverse effect on Diageo s sales revenue or margin, both through reducing overall consumption and by encouraging consumers to switch to lower-taxed categories of beverage alcohol.

Diageo s reported after tax income is calculated based on extensive tax and accounting requirements in each of its relevant jurisdictions of operation. Changes in tax law (including tax rates), accounting policies and accounting standards could materially reduce Diageo s reported after tax income.

Diageo is subject to increasing costs of monitoring and maintaining compliance with anti-corruption laws; and a breach of such laws or of Diageo s related internal policies may have a material adverse effect on its business

Certain countries in which Diageo operates are reported to have high levels of corruption. There is increasing scrutiny and enforcement by regulators in many jurisdictions of anti-bribery laws including the US Foreign Corrupt Practices Act and the UK Bribery Act. This oversight has been enhanced by applicable regulations in the United States, which offer substantial financial rewards to whistleblowers for reporting information that leads to monetary fines.

While Diageo has implemented and maintains internal practices, procedures and controls designed to ensure compliance with anti-bribery legislation and routinely conducts investigations, either at its own initiative or in response to requests from regulators in connection with compliance with such internal controls, there is no guarantee that such procedures will be effective in preventing compliance failures at Diageo.

Any investigations and lawsuits, regardless of the ultimate outcome of the proceeding, are time consuming and expensive and can divert the time and effort of our personnel, including senior management, from our business. Adverse publicity, governmental scrutiny and legal and enforcement proceedings can also have a negative impact on our reputation and on the morale and performance of our employees. To the extent that violations of Diageo s policies and procedures are found, possible regulatory sanctions and fines and other consequences may also be material.

Risks related to Diageo s business

The value of Diageo s brands and its net sales may be negatively affected by its failure to maintain its brand image and corporate reputation

The value of Diageo s brands and its profitability depends heavily on its ability to maintain its brand image and corporate reputation. Adverse publicity, whether or not justified, may tarnish Diageo s reputation and cause consumers to choose products offered by its competitors. Such adverse publicity could arise as a result of a perceived failure by Diageo to make adequate positive social contributions, including in relation to the level of taxes paid by Diageo, or by the failures of internal controls or compliance breaches leading to a breach of Diageo s Code of Business Conduct, its other key policies or of the laws or regulations in the jurisdictions in which it operates.

Diageo also maintains an online presence as part of its business operations. Diageo s reputation may suffer if it is perceived to fail to appropriately restrict access to its online content or if it breaches any marketing regulation, code or policy. In addition, the proliferation of new methods of mass communication facilitated by the internet makes it easier for false or unfounded allegations to adversely affect Diageo s brand image and reputation, which may in turn affect Diageo s profitability.

Diageo faces competition that may reduce its market share and margins

Diageo faces substantial competition from several international companies as well as local and regional companies in the countries in which it operates and competes with drinks companies across a wide range of consumer drinking occasions. Within a number of categories, industry consolidation or realignment is still possible. Consolidation is also taking place among Diageo s customers in many countries and increased competition by competitors or customers could lead to downward pressure on prices and/or a decline in Diageo s market share in any of these categories, adversely affecting Diageo s results and growth potential.

Diageo may not be able to derive the expected benefits from its strategy to focus on premium drinks or from its acquisitions or cost saving and restructuring programmes designed to enhance earnings

Diageo s strategy is to focus on premium drinks and to grow its business through organic sales, operating profit growth and the acquisition of premium drinks brands that add value for shareholders.

There can be no assurance that Diageo s strategic focus on premium drinks will result in opportunities for growth and improved margins.

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further business combinations, acquisitions, disposals, joint ventures and/or partnerships (including any associated financing or the assumption of actual or potential liabilities, depending on the transaction contemplated). There can be no assurance that any transaction will be completed or that any such transaction would deliver the anticipated benefits, cost savings or synergies. The success of any transaction will depend in part on Diageo s ability to successfully integrate new businesses with Diageo s existing operations and realise the anticipated benefitsSimilarly, there can be no assurance that the cost saving or restructuring programmes implemented by Diageo in order to improve efficiencies and deliver cost savings will deliver the expected benefits. Diageo continues to undertake change programmes designed to improve the effectiveness and efficiency of end-to-end operations, including changes to organisational structures, business processes and business systems. There may also be disruption caused to business processes as a result of such change which could impact Diageo operations and lead to adverse customer or consumer reaction.

Business description (continued)

Contamination, counterfeiting or other events could harm the integrity of customer support for Diageo s brands and adversely affect the sales of those brands

The success of Diageo s brands depends upon the positive image that consumers have of those brands, and contamination, whether arising accidentally, or through deliberate third party action, or other events that harm the integrity of or consumer support for those brands, could adversely affect their sales. Diageo purchases most of the raw materials for the production and packaging of its products from third party producers or on the open market. Diageo may be subject to liability if contaminants in those raw materials or defects in the distillation, fermentation or bottling process lead to low beverage quality or illness among, or injury to, Diageo s consumers. Diageo may recall products in the event of contamination or damage. A significant product liability judgement or a widespread product recall may negatively impact sales and profitability of the affected brand or all Diageo brands for a period of time depending on product availability, competitive reaction and consumer attitudes. Even if a product liability claim is unsuccessful or is not fully pursued, any resulting negative publicity could adversely affect Diageo s reputation with existing and potential customers and its corporate and brand image.

Additionally, third parties may sell products which are either counterfeit versions of Diageo brands or inferior brands that look like Diageo brands, and consumers of Diageo brands could confuse Diageo products with them. A bad consumer experience with such a product could cause them to refrain from purchasing Diageo brands in the future and in turn could impair brand equity, adversely affecting Diageo s business.

Diageo s operating results may be adversely affected by increased costs or shortages of talent

Diageo s operating results could be adversely affected by labour or skill shortages or increased labour costs due to increased competition for employees, higher employee turnover or increased employee benefit costs. Diageo s success is dependent on the capability of its employees. There is no guarantee that Diageo will continue to be able to recruit, retain and develop the capabilities that it requires to deliver its strategy, for example in relation to sales, marketing and innovation capability within markets or in its senior management. The loss of senior management or other key personnel or the inability to identify, attract and retain qualified personnel in the future could make it difficult to manage the business and could adversely affect Diageo s operations and financial results.

Diageo s operating results may be adversely affected by disruption to production facilities, business service centres or information systems

Diageo would be affected if there was a catastrophic failure of its major production facilities or business service centres. Diageo operates production facilities around the world. If there was a technical failure in Diageo production facilities, or fire or explosion at one of Diageo s production facilities, it could result in damage to the facilities, plant or equipment, their surroundings and/or the local environment. Such an event could lead to a loss in production capacity, or could result in regulatory action, legal liability or damage to Diageo s reputation.

Diageo has a substantial inventory of aged product categories, principally Scotch whisky and Canadian whisky, which may mature over periods of up to 30 years or more. The maturing inventory is stored primarily in Scotland, and the loss through contamination, fire or other natural disaster of all or a portion of the stock of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, Diageo would not be able to meet consumer demand for those products as it arises. There can be no assurance that insurance proceeds would cover the replacement value of Diageo s maturing inventory or other assets, were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third parties. In addition, there is an inherent risk of forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption. A forecasting error could lead to Diageo being unable to meet future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks. Any failure of information systems or Diageo s data infrastructure could adversely impact Diageo s ability to operate. As with all large systems, Diageo s information systems could be penetrated by outside parties intent on extracting information, corrupting information or disrupting business processes. Such unauthorised access could disrupt Diageo s business and/or lead to loss of assets or to outside parties having access to confidential information, including privileged data or strategic information of Diageo and its employees, customers and consumers, or to making such information public in a manner that harms Diageo s reputation. The concentration of processes in business service centres also means that any sustained disruption to the facility or issue impacting the reliability of the information systems used could impact a large portion of Diageo s business operations and in some circumstances, could result in property damage, breaches of regulations, litigation, legal liabilities and reparation costs.

Diageo s operations and financial results may be adversely affected by movements in the value of its pension funds, fluctuations in exchange rates and fluctuations in interest rates

Diageo has significant pension funds. These funds may be affected by, among other things, the performance of assets owned by these plans, the underlying actuarial assumptions used to calculate the surplus or deficit in the plans, in particular the discount rate and long term inflation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. If there are significant declines in financial markets and/or deterioration in the value of fund assets or changes in discount rates or inflation rates, Diageo may need to make significant contributions to the pension funds in the future.

Business description (continued)

Furthermore, if the market values of the assets held by Diageo s pension funds decline, or if the valuations of those assets by the pension trustees decline, pension expenses may increase which, as a result, could materially adversely affect Diageo s financial position. There is no assurance that interest rates or inflation rates will remain constant or that pension fund assets can earn the assumed rate of return annually; Diageo s actual experience may be significantly more negative than the assumptions used.

Diageo may be adversely affected by fluctuations in exchange rates. In particular, any redenomination of the euro or its constituent parts could materially adversely affect Diageo. The results of operations of Diageo are accounted for in pounds sterling. Approximately 31% of Diageo s net sales in the year ended 30 June 2014 were in US dollars, approximately 12% were in euros and approximately 18% were in sterling. Movements in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo s reported results of operations from year to year. Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense.

Diageo s operations may be adversely affected by failure to maintain or renegotiate distribution, supply, manufacturing or licence agreements on favourable terms

Diageo s business has a number of distribution, supply, manufacturing or licence agreements for brands owned by it or by other companies. These agreements vary depending on the particular brand, but tend to be for a fixed number of years. There can be no assurance that Diageo will be able to renegotiate its rights on favourable terms when these agreements expire or that they will not be terminated. Failure to renew these agreements on favourable terms could have an adverse impact on Diageo s sales and operating profit. In addition, Diageo s sales and operating profit may be adversely affected by any disputes with distributors of its products or with suppliers of raw materials.

Diageo may not be able to protect its intellectual property rights

Given the importance of brand recognition to its business, Diageo has invested considerable effort in protecting its intellectual property rights, including trademark registration and domain names. Diageo s patents cover some of its process technology, including some aspects of its bottle marking technology. Diageo also uses security measures and agreements to protect its confidential information and trade secrets. However, Diageo cannot be certain that the steps it has taken will be sufficient or that third parties will not infringe on or misappropriate its intellectual property rights in its brands or products. Moreover, some of the countries in which Diageo operates offer less intellectual property protection than Europe or North America. Given the attractiveness of Diageo s brands to consumers, it is not uncommon for counterfeit products to be manufactured and traded. Diageo cannot be certain that the steps it takes to assist the authorities to prevent, detect and eliminate counterfeit products will be effective in preventing material loss of profits or erosion of brand equity resulting from lower quality or even dangerous counterfeit product reaching the market. If Diageo is unable to protect its intellectual property rights against infringement or misappropriation, this could materially harm its future financial results and ability to develop its business.

Risks related to Diageo s securities

It may be difficult to effect service of US process and enforce US legal process against the directors of Diageo

Diageo is a public limited company incorporated under the laws of England and Wales. The majority of Diageo s directors and officers, and some of the experts named in this document, reside outside of the United States, principally in the United Kingdom. A substantial portion of Diageo s assets, and the assets of such persons, are located outside of the United States. Therefore, it may not be possible to effect service of process within the United States upon Diageo or these persons in order to enforce judgements of US courts against Diageo or these persons based on the civil liability provisions of the US federal securities laws. There is doubt as to the enforceability in England and Wales, in original actions or in actions for enforcement of judgements of US courts, of civil liabilities solely based on the US federal securities laws.

Business description (continued)

Cautionary statement concerning forward-looking statements

This document contains forward-looking statements. These statements can be identified by the fact that they do not relate only to historical or current facts. In particular, forward-looking statements include all statements that express forecasts, expectations, plans, outlook and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of changes in interest or exchange rates, the availability or cost of financing to Diageo, anticipated cost savings or synergies, expected investments, the completion of Diageo s strategic transactions and restructuring programmes, anticipated tax rates, expected cash payments, outcomes of litigation, anticipated deficit reductions in relation to pension schemes and general economic conditions. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo s control.

These factors include, but are not limited to:

- changes in political or economic conditions in countries and markets in which Diageo operates, including changes in levels of consumer spending, failure of customer, supplier and financial counterparties or imposition of import, investment or currency restrictions;

- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues, or contamination, counterfeiting or other circumstances which could harm the integrity or sales of Diageo s brands;

- developments in any litigation or other similar proceedings (including with tax, customs and other regulatory authorities) directed at the drinks and spirits industry generally or at Diageo in particular, or the impact of a product recall or product liability claim on Diageo s profitability or reputation;

- the effects of climate change and regulations and other measures to address climate change including any resulting impact on the cost and supply of water;

- changes in the cost or supply of raw materials, labour and/or energy;

- legal and regulatory developments, including changes in regulations regarding production, product liability, distribution, importation, labelling, packaging, consumption or advertising; changes in tax law, rates or requirements (including with respect to the impact of excise tax increases) or accounting standards; and changes in environmental laws, health regulations and the laws governing labour and pensions;

- the costs associated with monitoring and maintaining compliance with anti-corruption and other laws and regulations, and the costs associated with investigating alleged breaches of internal policies, laws or regulations, whether initiated internally or by external regulators, and any penalties or fines imposed as a result of any breaches;

- ability to maintain Diageo s brand image and corporate reputation, and exposure to adverse publicity, whether or not justified, and any resulting impacts on Diageo s reputation and the likelihood that consumers choose products offered by Diageo s competitors;

- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo s market share, increase expenses and hinder growth potential;

- the effects of Diageo s strategic focus on premium drinks, the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergies and/or costs savings;

- Diageo s ability to complete existing or future business combinations, restructuring programmes, acquisitions and disposals;

- contamination, counterfeiting or other events that could adversely affect the perception of Diageo s brands;

- increased costs or shortages of talent;

- disruption to production facilities or business service centres, and systems change programmes, existing or future, and the ability to derive expected benefits from such programmes;

- changes in financial and equity markets, including significant interest rate and foreign currency exchange rate fluctuations and changes in the cost of capital, which may reduce or eliminate Diageo s access to or increase the cost of financing or which may affect Diageo s financial results and movements to the value of Diageo s pension funds;

- renewal of supply, distribution, manufacturing or licence agreements (or related rights) and licences on favourable terms when they expire;

- technological developments that may affect the distribution of products or impede Diageo s ability to protect its intellectual property rights.

All oral and written forward-looking statements made on or after the date of this document and attributable to Diageo are expressly qualified in their entirety by the above factors and by the principal risks set out in the Risk factors section above. Any forward-looking statements made by or on behalf of Diageo speak only as of the date they are made. Diageo does not undertake to update forward-looking statements to reflect any changes in Diageo s expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that Diageo may make in any documents which it publishes and/or files with the US Securities and Exchange Commission (SEC). All readers, wherever located, should take note of these disclosures.

Business description (continued)

The information in this document does not constitute an offer to sell or an invitation to buy shares in Diageo plc or an invitation or inducement to engage in any other investment activities.

This document includes information about Diageo s target debt rating. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating organisation. Each rating should be evaluated independently of any other rating.

Past performance cannot be relied upon as a guide to future performance.

Business review

MARKET DYNAMICS

1. Commercial context

The global beverage alcohol market is large and diverse, comprising an estimated six billion equivalent units* of alcohol and £300 billion of revenue. Across the world there are significant variations in the type of beverage alcohol consumed depending on local incomes, cultures and attitudes.

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* An equivalent unit is equal to one-nine-litre case of spirits; 45 litres of wine; 90 litres of beer.

On average, per capita consumption is higher in developed markets at 2.4 equivalent units of alcohol per year versus 1.1 in emerging markets, which is driven, in part, by differences in the average level of disposable income. The shape of the beverage alcohol market also varies significantly across geographies; some regions, such as Asia, consume more spirits, others such as Africa are more focused on beer.

Our business is increasingly balanced across developed and emerging markets and we are able to capture share across a wide variety of consumer occasions given the geographic breadth of our participation, our leading portfolio of brands across categories and price points, the depth of our consumer insights and innovation capabilities, combined with the strength of our route to consumer. Both developed and emerging markets are important beverage alcohol value pools, with different dynamics. Developed markets are large and profitable, but with lower growth rates. Emerging markets, also large, are less profitable, with faster growth rates. Given lower levels of disposable income in emerging markets they are more volatile in response to fluctuations in local economies, as we have seen this year.

Overall, the global beverage alcohol market is supported by the strong consumer fundamentals of a growing legal drinking age (LDA) population and increasing wealth, driving both consumer penetration and premiumisiation.

Developed markets

Consumers in developed markets are very conscious of what their brand choices say about them. Our strong portfolio of brands across categories and price points, coupled with our innovation capability, allows us to evolve our offering to provide what consumers are looking for, while the strength of our distribution networks enables us to get our products to the consumer, allowing us to benefit from these trends. Given the higher levels of disposable income and the importance of branding, these are markets where consumers are often prepared to pay more for high quality brands with heritage and provenance. There is also sustained growth in the number of consumers who are able to enjoy our reserve (luxury) portfolio of brands.

Emerging markets

In emerging markets we are seeing significant growth in the LDA population groups classified as emerging middle class and above. These consumers represent a significant opportunity, particularly for our premium core brands, as consumption per capita is currently far lower than in developed markets. Each country is different and growth occurs at different price points depending on wealth, and in categories and occasions which reflect local culture. Accessing this growth requires an understanding of local consumers and the categories, brands and price points they are seeking. A broader distribution platform which makes these brands accessible to this set of consumers is a critical enabler. There are also a significant, and growing, number of globally affluent consumers in the emerging markets for whom our reserve (luxury) portfolio holds particular appeal.

Business review (continued)

2. Regulatory and broader stakeholder context

Alcohol is one of the most regulated products in the world, and beverage alcohol companies rightly operate in the context of a range of stakeholder expectations and demands.

At the same time beverage alcohol companies, like the rest of the private sector, are increasingly expected to be transparent and demonstrate progress on the wider social and environmental agenda. Using voluntary frameworks (such as the Global Reporting Initiative Guidelines, launched in 2000 and updated this year, the United Nations Global Compact principles, established in 2006, and the International Integrated Reporting Framework, published this year) is becoming a standard expectation for companies to follow. Moreover, reporting on these issues is becoming mandatory in more parts of the world. For example, the UK Companies Act, the US California Transparency in Supply Chains Act and the US Dodd Frank Act, require public disclosure of human rights and environmental issues. This year, the European Council and the European Commission reached an agreement to require publicly-traded companies with more than 500 employees to report performance against a number of social and environmental metrics. This high and growing level of regulation and scrutiny can be an advantage to companies with good corporate governance and the right approach to sustainability and responsibility.

Alcohol policy

While the approaches taken by governments to address alcohol misuse vary, Diageo believes that the most effective alcohol policies are evidence-based, account for drinking patterns, target at-risk groups, treat all forms of alcohol equally, and involve all stakeholders. These include mandating a minimum legal purchasing age of not less than 18; a maximum blood alcohol concentration (BAC) level for drivers of no more than 0.08mg; and lower BACs for novice and commercial drivers. Also effective are high-visibility enforcement campaigns of drink-driving laws and alcohol interlocks(1) for convicted drink drivers. Diageo advocates these policies while opposing measures that are not based on evidence, and are likely to have unintended consequences. For example the use of high taxes to control consumption can in some cases push consumers to unregulated alcohol markets.

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(1). Interlocks are breathalysers that stop a car from starting if the driver s blood alcohol level is above a certain limit.

Industry collaboration

Beverage alcohol companies have recognised, and stakeholders are expecting, that issues such as reducing the harmful use of alcohol should be addressed through concerted industry initiatives in collaboration with stakeholders. Diageo is one of 13 global producers of beer, wine and spirits to launch a new set of commitments in support of the WHO s Global strategy to reduce the harmful use of alcohol. The industry s commitments include a focus on reducing underage drinking, strengthening and expanding marketing codes of practice, providing consumer information and responsible product innovation, reducing drink driving, and enlisting the support of retailers to reduce harmful drinking.

Unrecorded alcohol

The WHO estimates that 25% of alcohol consumed is unrecorded, which means it is outside the usual systems of governmental control: regulation and taxation. Because it is not regulated, little is known about its production, consumption, and related outcomes. What little we do know, suggests that some may be contaminated, some toxic, and a risk to public health. Therefore working with governments and other stakeholders to improve data collection in this area is helpful to all consumers.

Business review (continued)

Climate change and water security

A variety of environmental issues associated with climate change, such as extreme weather events, water scarcity and biodiversity loss, will increasingly affect businesses and how they operate. For the alcohol industry, water scarcity is an issue that demands particular attention given that water is a main ingredient in all its products. The World Bank expects water scarcity to affect 2.8 billion people directly by 2025. In some countries that have always faced hydrologic variability, climate change could increase water scarcity. The map below shows the specific Diageo sites operating in water-stressed locations where measures to address supply chain risks, contribute to community infrastructure, and work with governments and other partners on water stewardship are particularly important.

Value chain partnerships

Alcohol beverage companies contribute to the economic development of their communities in a variety of ways, whether through direct employment, taxes or community investment efforts. However, companies can further contribute by leveraging the economic impact of their entire value chain in the way they work with suppliers and customers and doing so is an increasing expectation of the private sector by government and international development institutions. One powerful trend in the food and beverage industry is a focus on local sourcing in markets with an agricultural economy or potential for one. Not only does this help build trust with government and other stakeholders, but with the use of long term contracts, it can help secure supply. At the other end of the value chain, strategic partnerships and investment to train and support individuals interested in working in hospitality can build trust while strengthening the industry itself.

Business review (continued)

Operating results 2014 compared with 2013

In the year ended 30 June 2014, Diageo has reviewed its approach to the narrative discussion of its operating results. As a result of this review, Diageo has determined to focus on the key financial performance indicators on pages 28 to 29 which management uses to measure the financial performance of the group. In order to provide comparability to the prior year s narrative discussion of operating results, the following section provides a reference for the narrative discussion of specific line items.

As at 1 July 2013 the group adopted a number of new standards and amendments and the application of *IFRS11 - Joint arrangements* and the amendment to *IAS19 - Employee benefits* resulted in a restatement of comparative figures. The impact on the group s consolidated statement of comprehensive income and net cash flow for the years ended 30 June 2013 and 30 June 2012, and net assets as at 30 June 2013 and 30 June 2012 is provided in note 18 to the consolidated financial statements on pages 202 and 203.

1. INCOME STATEMENT

Sales and net sales

For the impact of exchange rate movements and acquisitions and disposals see pages 46-47. See Group Financial Review Key Performance Indicators Organic net sales growth on page 43 in respect of organic movements.

Operating costs before exceptional items and operating profit

Operating costs before exceptional items comprise cost of sales, marketing and other operating expenses. For the impact of exchange rate movements and acquisitions and disposals see pages 46-47. See Group Financial Review Key Performance Indicators Organic operating margin improvement on page 43 in respect of organic movements.

Net finance charges, taxation and associates and joint ventures

See Group Financial Review Key Performance Indicators Earnings per share before exceptional items on page 44.

Post employment plans

See Group Financial Review Key Performance Indicators Free cash flow on page 45.

Exceptional items, exchange and dividend

Exceptional items comprise exceptional operating items, non-operating items and discontinued operations. See Group Financial Review Additional Financial Information Exceptional items on page 47.

2. ANALYSIS BY REPORTING SEGMENTS

North America see page 50

Western Europe see page 53

Africa, Eastern Europe and Turkey see page 56

Latin America and Caribbean see page 59

Asia Pacific see page 62

Corporate see Group Financial Review Organic growth by region page 43

3. CATEGORY REVIEW PAGES 65 TO 67

Business review (continued)

GROUP FINANCIAL REVIEW

This year was tougher than anticipated with mixed regional performance as North America delivered top-line growth and significant margin expansion; Western Europe was stable and performance in emerging markets reflected economic weakness and market specific challenges. Despite this tougher environment we have gained share in a number of markets, invested for the future, expanded margins and simplified the organisation.

Deirdre Mahlan,

Chief Financial Officer

HIGHLIGHTS OF THE YEAR

- Net sales, up 0.4%, reflecting mixed performance; growth in North America, stability in Western Europe and weakness in emerging market economies.
- Fourth quarter net sales up 0.8%.
- Positive consumer trends in higher priced categories, Diageo s reserve brands net sales were up 14% and targeted price increases drove 3ppt of positive price/mix.
- Operating margin improved 0.8ppt.
- Procurement driven savings, worth 4% of total marketing spend, more than offset the cost of increased activity, contributing 0.2ppt of the total margin improvement.
- Eps before exceptionals was down 7.6p to 95.5 pence per share as foreign exchange movements reduced eps by 10 pence per share.
- Free cash flow was £1,235 million.
- Recommended final dividend of 32.0 pence per share, up 9%.

Key performance indicators		**2014**	**2013 (restated)***
Organic net sales growth	%		5
Organic operating margin improvement	basis points	**77**	78
Earnings per share before exceptional items	pence	**95.5**	103.1
Free cash flow	£ million	**1,235**	1,452
Return on average invested capital	%	**13.7**	16.0

Other financial information		**2014**	**2013 (restated)***
Volume	EUm	**156.1**	164.2
Net sales	£ million	**10,258**	11,303
Marketing spend	£ million	**1,620**	1,769
Operating profit before exceptional items	£ million	**3,134**	3,479
Operating profit	£ million	**2,707**	3,380
Reported tax rate	%	**16.5**	16.6
Reported tax rate before exceptional items	%	**18.2**	17.4
Profit attributable to parent company s shareholders	£ million	**2,248**	2,452
Basic earnings per share	pence	**89.7**	98.0
Recommended full year dividend	pence	**51.70**	47.40

Business review (continued)

Organic growth by region	Volume %	Net sales %	Marketing spend %	Operating profit** %
North America	(1)	3	2	8
Western Europe				
Africa, Eastern Europe and Turkey	(5)	1	1	
Latin America and Caribbean	(1)	2	1	3
Asia Pacific	(5)	(7)	(7)	(13)
Diageo * **	**(2)**		**(1)**	**3**

* Restated following the adoption of IFRS 11 and the amendment to IAS 19.

** Before exceptional items

*** Includes Corporate. In the year ended 30 June 2014 Corporate reported net sales and net operating charges of £79 million (2013 £76 million) and £130 million (2013 £151 million) respectively. The reduction in net operating charges primarily comprised lower costs in respect of global functions. For the reconciliation of reported to organic results, see pages 103-104.

KEY PERFORMANCE INDICATORS

1. Organic net sales growth (£ million)

Reported net sales were adversely impacted by foreign exchange, while sustained performance in North America offset emerging market weakness

(a) See notes on pages 46-47.

Organic volume growth in reserve brands was largely offset by decline in beer and in scotch in emerging markets. The strong performance of reserve brands and selective price increases drove positive price/mix.

2. Organic operating margin improvement

Focus on costs and driving efficiencies delivered 77bps of margin improvement

Significant supply chain savings and positive price/mix from growth of reserve brands was offset by cost inflation and under recovery of fixed costs in Africa due to weaker beer volume. The organic increase in operating margin was primarily driven by an increased focus on costs and efficiencies across the business and by procurement savings on marketing spend.

Business review (continued)

3. Earnings per share before exceptional items (pence)

Eps before exceptionals impacted by adverse foreign exchange

(a) The group s after tax share of the results of associates and joint ventures was £252 million for the year ended 30 June 2014 (2013 £217 million), of which, Diageo s 34% equity interest in Moët Hennessy contributed £246 million (2013 £230 million).

Reduction in eps due to lower operating profit was largely as a result of adverse foreign exchange movements. Increased income from associates and joint ventures and lower net finance charges partly mitigated the impact of reduced operating profit. The reduction in non-controlling interests is largely driven by the operating loss that has been reported by Shuijingfang.

Basic eps was 89.7 pence (2013 98.0 pence), with exceptionals reducing eps by 5.8 pence (2013 5.1 pence).

For movements in net finance charges see below:

Movement in net finance charges	**£ million**
2013 Reported (restated)	457
Net interest charge	(51)
Post employment charges	(26)
Venezuela hyperinflation adjustment	9
Other finance charges	(1)
2014 Reported	388

	2014 Reported	2013 Reported (restated)
Average monthly net borrowings (£ million)	**9,174**	8,267
Effective interest rate (%)	**3.8**	4.9

For the calculation of the effective interest rate, the net interest charge excludes fair value adjustments to derivative financial instruments and borrowings. Average monthly net borrowings include the impact of interest rate swaps that are no longer in a hedge relationship but excludes the market value adjustment for cross currency interest rate swaps.

The increase in average net borrowings was principally a result of the acquisition of shares in USL, completed on 4 July 2013, and the one off pension contribution to the UK pension plan in the year ended 30 June 2013 and a 100 million (£85 million) contribution to the Irish pension plans in the year ended 30 June 2014. Despite the increase in debt, the interest charge decreased in the year driven by lower interest rates on new debt issues and proportionally higher commercial paper balances.

On 2 July 2014 Diageo acquired an additional 37.8 million shares in USL for £1,118 million. This will increase average net borrowings in the year ending 30 June 2015.

The positive impact on post employment charges is mainly driven by the reduction of the pension deficit as a result of the one off contributions mentioned above.

Business review (continued)

4. Free cash flow (£ million)

Lower pension contributions and capex partly offset the impact of reduced operating profit on cash flow

(a) Operating profit adjusted for non cash items including depreciation and amortisation and excluding the thalidomide charge.

(b) Other movements includes dividends received from associates and joint ventures, movements in loans receivable and other investments, pension contributions excluding one off contributions and the payment of £53 million in respect of the settlement of Thalidomide litigation in Australia and New Zealand in the year.

The decrease in free cash flow was primarily driven by lower operating profit due to the adverse impact of exchange rate movements and restructuring exceptional charges during the year. The reduction attributable to the termination of the distribution agreement with Jose Cuervo was largely offset by organic growth. The negative working capital movement arose in respect of lower creditors driven by reductions in overhead spend, bonus accruals and phasing of marketing spend. One off contributions to pension plans in the year ended 30 June 2014 were lower than last year, resulting in a favourable cash movement.

5. Return on average invested capital (ROIC) (a)

Adverse foreign exchange movements and investment in USL led to a reduction in ROIC

(a) ROIC calculation excludes exceptional items

Lower operating profit reduced ROIC by 1.5ppt primarily due to adverse exchange movements. Average invested capital increased as a result of our acquisition of shares in USL. The negative movement in working capital is partly accounted for by increased maturing inventory.

Business review (continued)

ADDITIONAL FINANCIAL INFORMATION

Income statement

	2013 (restated)	Exchange (a)	Acquisitions and disposals (b)	Organic movement	2014
	£ million	£ million	£million	£ million	£ million
Sales	15,276	**(1,082)**	**(368)**	**154**	**13,980**
Excise duties	(3,973)	**285**	**78**	**(112)**	**(3,722)**
Net sales	11,303	**(797)**	**(290)**	**42**	**10,258**
Cost of sales*	(4,389)	**243**	**167**	**(27)**	**(4,006)**
Gross profit	6,914	**(554)**	**(123)**	**15**	**6,252**
Marketing	(1,769)	**108**	**31**	**10**	**(1,620)**
Other operating expenses*	(1,666)	**110**	**(8)**	**66**	**(1,498)**
Operating profit before exceptional items	3,479	**(336)**	**(100)**	**91**	**3,134**
Exceptional operating items (c)	(99)				**(427)**
Operating profit	3,380				**2,707**
Non-operating items (c)	(83)				**140**
Net finance charges	(457)				**(388)**
Share of after tax results of associates and joint ventures	217				**252**
Profit before taxation	3,057				**2,711**
Taxation	(507)				**(447)**
Profit from continuing operations	2,550				**2,264**
Discontinued operations (c)					**(83)**
Profit for the year	2,550				**2,181**

* Before exceptional operating items

(a) Exchange

The impact of exchange rates movements on reported figures is principally in respect of the Venezuelan bolivar, the US dollar, the Turkish lira and the South African rand.

In March 2014, the Central Bank of Venezuela opened the Second Ancillary Foreign Currency Administration System (Sicad II) that allows private and public companies to trade foreign currency at a higher exchange rate than the official exchange rate. As a result, the group has applied a consolidation rate of $1 = VEF49.98 (£1 = VEF85.47) for its Venezuelan operations for the year ended 30 June 2014. For the year ended 30 June 2013 a rate of $1 = VEF9 (£1 = VEF13.68) was used. The change in the exchange rate for the year ended 30 June 2014 reduced net sales by £358 million, operating profit by £229 million, cash and cash equivalents by £329 million and net assets by £378 million.

The estimated effect of exchange rate and other movements on profit before exceptional items and taxation for the year ended 30 June 2014 is set out in the table below.

	Gains/ (losses) £ million
Translation impact	**(182)**
Transaction impact	**(154)**
Operating profit before exceptional items	**(336)**
Net finance charges translation impact	**12**
Mark to market impact of IAS 39 on interest expense	**(6)**
Impact of IAS 21 and IAS 39 on net other finance charges	**(2)**
Interest and other finance charges	**4**
Associates translation impact	**8**
Profit before exceptional items and taxation	**(324)**

	2014	**2013**
Exchange rates		
Translation £1 =	$1.63	$1.57
Transaction £1 =	$1.59	$1.57
Translation £1 =	1.20	1.21
Transaction £1 =	1.26	1.18

Business review (continued)

(b) Acquisitions and disposals

The impact of acquisitions and disposals on the reported figures was primarily attributable to the termination of the distribution agreement with Jose Cuervo. See page 105 for further details.

(c) Exceptional items

Exceptional operating charges of £427 million (2013 £99 million) in the year ended 30 June 2014 comprise:

- £98 million (2013 £nil) in respect of the Global efficiency programme announced in January 2014;
- £35 million (2013 £25 million) in respect of the Supply excellence restructuring programme;
- £30 million (2013 £44 million) for the restructuring of the group s supply operations; and
- a brand and tangible asset impairment charge of £264 million in respect of Shui Jing Fang (2013 £50 million in respect of the Cacique brand) as a result of the downturn in the baijiu category in China driven by the anti extravagance measures by the Chinese government. The related deferred tax liability of £65 million has been written back to taxation in the income statement and therefore the net charge is £199 million. As the group has a 39.7% controlling interest in Sichuan Shuijingfang Co., Ltd (Shuijingfang), the impact of this impairment on the group s basic earnings per share is a reduction of 3.2 pence.

In the year ended 30 June 2013 exceptional operating items also included a gain of £20 million in respect of changes to future pension increases for the Diageo Guinness Ireland Group Pension Scheme.

Non-operating items in the year ended 30 June 2014 comprise a gain of £140 million following the acquisition of additional investment in United Spirits Limited (USL) which increased the group s investment in USL from 10.04% to 25.02% on 4 July 2013 and triggered a change in accounting from available-for-sale investments to associates. As a result, the difference between the original cost of the investment and its fair value has been included in the income statement. In the year ended 30 June 2013 exceptional non-operating items comprised a loss of £83 million in respect of the Nuvo disposal.

Discontinued operations in the year ended 30 June 2014 represent a charge after taxation of £83 million (2013 £nil) in respect of the settlement of thalidomide litigation in Australia and New Zealand and anticipated future payments to thalidomide organisations.

Cash payments in the year ended 30 June 2014 in respect of exceptional restructuring items and thalidomide were £104 million (2013 £61 million) and £59 million (2013 £23 million), respectively. An exceptional operating charge of approximately £130 million is expected to be incurred in the year ending 30 June 2015 primarily in respect of the Global efficiency and Supply excellence programmes, while total cash expenditure is expected to be approximately £200 million.

(d) Dividend

The directors recommend a final dividend of 32.0 pence per share, an increase of 9% from the year ended 30 June 2013. The full dividend will therefore be 51.7 pence per share, an increase of 9% from the year ended 30 June 2013. Subject to approval by shareholders, the final dividend will be paid on 2 October 2014 to shareholders on the register on 15 August 2014. The New York Stock Exchange has announced that Diageo ADSs will carry due bills from 13 August 2014 through 19 September 2014 pending approval of the dividend at the AGM. Payment to US ADR holders will be made on 7 October 2014. A dividend reinvestment plan is available to holders of ordinary shares in respect of the final dividend and the plan notice date is 10 September 2014.

Business review (continued)

Balance sheet

Movement in net borrowings

	2014 £ million	2013 (restated) £ million
Net borrowings at the beginning of the year	**(8,403)**	(7,573)
Free cash flow (a)	**1,235**	1,452
Acquisition and sale of businesses (b)	**(534)**	(660)
Proceeds from issue of share capital	**1**	
Net purchase of own shares for share schemes (c)	**(113)**	(11)
Dividends paid to non-controlling interests	**(88)**	(100)
Purchase of shares of non-controlling interests (d)	**(37)**	(200)
Net (decrease)/increase in bonds (e)	**(93)**	1,231
Net movements on other borrowings	**(64)**	7
Equity dividends paid	**(1,228)**	(1,125)
Net (decrease)/increase in cash and cash equivalents	**(921)**	594
Net decrease/(increase) in bonds and other borrowings	**157**	(1,238)
Exchange differences (f)	**349**	(116)
Other non-cash items	**(32)**	(70)
Net borrowings at the end of the year	**(8,850)**	(8,403)

(a) See page 45 for the analysis of free cash flow.

(b) Primarily includes cash payments of £474 million in respect of the acquisition of an additional 18.74% investment in USL. On 2 July 2014 the group acquired an additional 26% investment in USL for INR 114.5 billion (£1,118 million) taking its aggregate investment to 54.78% (excluding 2.38% of the shares owned by the USL Benefit Trust on behalf of USL). From 2 July 2014 the group accounts for USL as a subsidiary with a 43.9% non-controlling interest.

In the year ended 30 June 2013 cash payments principally included £284 million in respect of 100% equity stake in Ypióca Bebidas S.A. (Ypióca) and £274 million in respect of a 10.04% investment in USL.

(c) Net purchase of own shares comprised purchase of treasury shares for the future settlement of obligations under the employee share option schemes of £208 million (2013 £143 million) less receipts from employees on the exercise of share options of £95 million (2013 £132 million).

(d) Primarily comprises the purchase of the remaining 7% (2013 purchase of 40%) equity stake in Sichuan Chengdu Shuijingfang Group Co., Ltd.

(e) In the year ended 30 June 2014 the group issued bonds of 1,700 million (£1,378 million) and repaid bonds of 1,150 million (£983 million) and $804 million (£488 million). In the prior year, the group issued bonds of $3,250 million (£2,100 million) and repaid bonds of $1,350 million (£869 million).

(f) Primarily arose on US dollar and euro denominated borrowings offset by adverse exchange rate movement on cash and cash equivalents held in Venezuela.

Business review (continued)

Movement in equity

	£ million
Equity at 30 June 2013 (restated)	**8,088**
Profit for the year	**2,181**
Exchange adjustments (a)	**(1,133)**
Net remeasurement of post employment plans (b)	**(167)**
Fair value movements on available-for-sale investments (c)	**(85)**
Dividends to non-controlling interests	**(88)**
Purchase of shares of non-controlling interests	**(37)**
Dividends paid	**(1,228)**
Other reserve movements	**59**
Equity at 30 June 2014	**7,590**

(a) Primarily arose on the US dollar, the euro, the Turkish lira and the Venezuelan bolivar denominated intangible assets, investments and borrowings.

(b) Mainly driven by the decrease in discount rate assumptions used to calculate the net post employment liabilities partly offset by the actual return on the plan assets being higher than the discount rate.

(c) Comprises the net recycling of the cumulative fair market value adjustment on the group s investment in USL due to the change in accounting from available-for-sale investment to associate.

Post employment deficit

The deficit in respect of post employment plans before taxation decreased by £66 million from £541 million at 30 June 2013 to £475 million at 30 June 2014. The decrease was primarily due to the cash contributions of £288 million (2013 £591 million) made into the post employment plans, which included a one off 100 million (£85 million) payment into the Irish pension plans, partially offset by the net remeasurement of post employment plans. Total cash contributions to the group s post employment plans for the year ending 30 June 2015 are expected to be approximately £185 million.

Business review (continued)

SEGMENT REVIEW

NORTH AMERICA

North America accounts for about a third of our net sales and around 45% of operating profit and is the largest market for premium drinks in the world. Due to our continued leadership in innovation, strong route to consumer, positive consumer trends, and increased marketing investment in key brands, we continue to be well positioned.

Key financials	2013 Reported (restated)* £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2014 Reported £million	Reported movement %
Net sales	3,723	(156)	(231)	108	3,444	(7)
Marketing spend	581	(27)	(24)	10	540	(7)
Operating profit before exceptional items	1,478	(54)	(71)	107	1,460	(1)
Exceptional items					(35)	
Operating profit	1,478				1,425	(4)

*Restated following the adoption of IFRS 11 and the amendment to IAS 19.

Our markets

Our North America business comprises US Spirits and Wines, Diageo Guinness USA (DGUSA), Canada.

Route to market

Route to market in the United States (US) is through the three-tier system and we distribute our products through more than 100 spirits and wines distributors and brokers, and more than 400 beer distributors nationally. We have a unique route to market for our spirits and wine business in the US, with more than 3,000 dedicated distributor sales personnel focused only on Diageo and Moët Hennessy spirits and wine brands. To date, Diageo has consolidated its US Spirits and Wines business into a single state-wide distributor or broker in 41 states and the District of Columbia, representing more than 80% of the company s US Spirits and Wines volume. We continue to focus on building capabilities within our distributor dedicated sales forces and creating a more efficient and effective value chain.

Diageo North America s US Spirits and Wines business operates through five divisions in Open States where we sell to distributors who then sell to retailers, and through two divisions in Control States where in most cases, we sell to the state, which in turn sells to state or agency stores and on premise retailers. US Spirits and Wines sells the vast majority of the Californian and imported wines we own and represent, with the remaining small portion of sales coming from winery visitor centres and online sales.

DGUSA sells and markets brands including Guinness, Smirnoff Ice and Red Stripe. Beer distribution generally follows the three-tier open state regulations across the United States.

Diageo Canada distributes our collection of spirits, beer and wine brands across all Canadian provinces, which generally operate through a provincial control system. In 2014, we announced that we are moving to a broker model effective 1 July 2014, appointing a single broker for Canada with a dedicated sales force handling our brands in the country.

National brand strategy, strategic accounts marketing as well as corporate functions are managed at North American level. In North America, we market a total beverage alcohol portfolio. Diageo North America s strong innovation pipeline and reserve business help fuel growth.

Supply operations

We have 11 bottling, distilling, blending and maturation sites including operations in Plainfield, Illinois; Amherstburg, Ontario; Valleyfield, Quebec; Relay, Maryland; Gimli, Manitoba; Tullahoma, Tennessee; and seven wineries, and wine bottling operations, in California.

Business review (continued)

Sustainability & Responsibility

As part of our commitment to tackling alcohol misuse, Diageo North America dedicates 20% broadcast advertisment towards responsible drinking messages. Operations continue to progress against all environmental targets; Diageo s Gimli, Manitoba plant, where the Company distills Crown Royal, is 99% carbon neutral. Our employee-focused culture won the company the best place to work accolade from the Human Rights Campaign again this year, and Diageo was listed as one of Working Mother magazine s top 100 companies this year.

Performance

North America, our biggest and most profitable region given our brand and market strength and its consistent strong performance, again delivered top line growth, driven by 5% growth in US Spirits and Wines, and margin expansion of 183bps as a result of gross margin expansion and cost reduction. Economic recovery in the US is uneven and this is reflected in the consumer trends seen in US spirits with overall spirits category growth slowing and premium and above price points driving category growth. Our growth reflects this with scotch, North American whiskey and tequila leading the growth. Our strength in innovation has continued. Launches of super and ultra premium variants have accelerated growth of our reserve brands, which grew 14%, and innovations against our premium core brands have driven brand relevance and recruited new consumers. However, performance in vodka was weak as Smirnoff volume has been impacted as its price premium has been maintained for another year. In Canada the spirits market is softer than the US and net sales grew 1%. Our DGUSA business declined 7% mainly reflecting reduced focus on the pouches segment.

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
North America	(1)	3	(7)
US Spirits and Wines	(1)	5	(7)
DGUSA	(5)	(7)	(11)
Canada	(2)	1	(17)
Spirits **	(1)	4	(7)
Beer	(7)	(5)	(9)
Wine	(1)	6	2
Ready to drink	(5)	(9)	(24)
Global and local leaders **:			
Johnnie Walker		6	2
Crown Royal	(4)		(4)
Buchanan s	22	24	19
Bulleit	69	69	63
Smirnoff	(4)	(2)	(6)
Ketel One vodka	1	4	
Cîroc	(3)	(3)	(7)
Captain Morgan	2	5	

Baileys	(1)	2	(3)
Tanqueray	(1)	1	(3)
Don Julio	26	26	22
Guinness	(6)	(3)	(8)

* Organic equals reported movement for volume except for North America (8)%, US Spirits and Wines (9)%, Canada (4)%, spirits (8)% and ready to drink (7)%, reflecting the disposal of Nuvo and the termination of the Jose Cuervo distribution agreement.

** Spirits brands excluding ready to drink.

Key highlights

- **US Spirits and Wines**. Diageo continues to lead the industry on price and mix but the volume performance was weaker, especially in the increasingly price sensitive standard vodka segment where the decline of Smirnoff was the main driver of overall volume down 1%. Price increases, which drove around 120bps of net sales growth, and the strong performance of reserve brands were the primary drivers of 6ppt of positive price/mix. Reserve brands grew double digit fuelled by almost 50% growth of Johnnie Walker super and ultra premium variants following the successful launches of Johnnie Walker Platinum and Gold Reserve, as well as the introduction of limited edition variants and packs targeted at the gifting occasion. Strong growth of Don Julio and scotch malts, especially Lagavulin, Talisker and Oban, contributed to the performance of reserve brands as did Bulleit which grew net sales 69%. Innovation delivered incremental net sales, with flavour extensions in vodka, as well as the launch of Captain Morgan White in February, which has expanded the brand s presence across the rum category and driven growth of the brand. Cîroc Amaretto performed strongly in the year, however, price pressure on the base variant resulted in an overall net sales decline of 3%. Buchanan s, the fastest growing scotch brand in the United States, continued to grow double digit through its continued focus on the growing Hispanic consumer segment. Crown Royal net sales grew 1%, lapping growth of 18% last year fuelled by the launch of Crown Royal Maple.

Business review (continued)

- **DGUSA** net sales declined 7%, primarily driven by continued decline of pouches, as the segment was defocused, and weakness in beer, while Smirnoff Red Ice performance improved. Renovation of Smirnoff Red Ice with new packaging, new flavor innovations and a new marketing campaign Cheers to Us targeted at Hispanic and African American consumers, halted the brand s decline with net sales broadly flat for the year and improved brand equity scores amongst all major consumer groups. Guinness performance reflects weak performance of Guinness Black Lager and slower growth in the on trade, particularly in the second half, with increased competition from the craft beer segment.

- In **Canada,** net sales grew 1% impacted by slowdown in the category. Reserve brands grew by over 40%, with Cîroc and scotch malts being the biggest contributors. Guinness grew net sales, largely driven by the launch of Guinness Black Lager with some growth also from the base variants.

- Last year, **marketing spend** increased 10% with upweighted investment behind global and local leading brands. This year spend was up and benefited from 3ppt of procurement efficiencies. Investment in the year was focused on supporting new launches, in particular Cîroc Amaretto and Captain Morgan White Rum, the re-invigoration of Guinness and the growth of Johnnie Walker focused on the Keep Walking campaign as well as supporting growth of super and ultra premium variants. Guinness investment increased significantly in the year to support the Basketball advertising as part of the global Made of More platform and the digital and television campaign saluting US sport heroes leading up to the Winter Olympics.

Business review (continued)

WESTERN EUROPE

Diageo is the largest premium drinks business in Western Europe. Consumer marketing programmes are developed at a market level to drive consistency, efficiency and scale across all countries.

Key financials	2013 Reported (restated)* £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2014 Reported £ million	Reported movement %
Net sales	2,203	9	(38)	(5)	2,169	(2)
Marketing spend	328		(4)	(1)	323	(2)
Operating profit before exceptional items	650	(5)	(8)	2	639	(2)
Exceptional items	(31)				(20)	
Operating profit	619				619	

*Restated following the adoption of IFRS 11 and the amendment to IAS 19.

Countries within Western Europe

Western Europe is managed as a single market with country teams focusing on sales and customer marketing execution. This market comprises Great Britain, Ireland, Iberia, France, Germany, Benelux, Italy, Nordics, Greece, Switzerland, Austria, Diageo Guinness Continental Europe beer business and European wines.

Route to market

In Great Britain we sell and market our products through three business units: Diageo GB (spirits, beer and ready-to-drink); Percy Fox & Co (wines); and Justerini & Brooks Retail (private client wines). Products are distributed both through independent wholesalers and directly to retailers. In the on trade, products are sold through major brewers, multiple retail groups and smaller regional independent brewers and wholesalers.

In both the Republic of Ireland and Northern Ireland, Diageo sells and distributes directly to both the on trade and the off trade through a telesales operation, sales calls to outlets and third-party logistics providers.

Across the remainder of Western Europe, we distribute our spirits brands primarily through our own distribution companies, except for France where products are sold through a joint venture arrangement with Moët Hennessy. In Norway and Sweden, off trade sales are controlled by state monopolies, with alcohol tax rates among the highest in the world.

Diageo Guinness Continental Europe, a specialist unit, distributes our beer brands in mainland Europe, focusing particularly in Germany, Russia and France, which for us are the largest mainland European beer markets by net sales.

Supply operations

The International Supply Centre (ISC) comprises the supply operations in the United Kingdom, Ireland and Italy and distils, brews, matures and packages product for other Diageo companies throughout the world. The group owns 29 whisky distilleries in Scotland, an Irish whiskey distillery and a Dublin based beer brewery. The ISC ships whisk(e)y, vodka, gin, rum, beer, wine and other spirit-based drinks in a combination of bottles, cans, kegs and pouches to over 180 countries. In 2012, we announced a £1billion investment in Scotch whisky production and inventory.

To date we have focused on expanding malt distillation capacity across Scotland at existing sites and developed a major new warehousing site to mature our inventory investment. The investment program has generated additional employment and benefited local communities. We are also planning to build a new malt whisky distillery in Scotland. A brewing rationalisation programme will be completed in 2015.

Business review (continued)

Sustainability & Responsibility

In Western Europe we focus on promoting responsible drinking in every country through partnerships with government agencies, non-governmental organisations (NGOs), independent charities and large retail customers. Such partnerships include Teach about Alcohol in Sweden, a schools-based programme that helps young people to resist social pressure, peer pressure and learn to say no to alcohol. Also the Avenue programme in Greece is tackling a culture of drink driving with support from the European Commission and European Transport Safety Council. We also expanded our Learning for Life community investment programme to Scotland as part of a five-year effort aiming to provide valuable life skills, technical training and work experience to young people across various sectors. We also launched Learning for Life Programmes in Germany and Ireland.

Performance

Western Europe still has weak economies and fragile consumer confidence but there has been steady improvement and our business has stabilised year on year, gaining share of spirits. There was modest growth in Great Britain, Benelux, France and the Nordics which counter-balanced the slowing declines in Southern Europe and Ireland. Germany was weaker due to higher trade investment and an increasingly price competitive off trade. Marketing was targeted more effectively, and we kept our investment as a percentage of net sales flat while prioritising higher growth and margin brands. We have focused on fewer, bigger pan-regional innovation launches with Baileys Chocolat Luxe, Smirnoff Gold, frozen pouches and premix, and our reserve business was strong with net sales up 15% driven by the scotch malts, Cîroc, Zacapa and Johnnie Walker. Operating margin expansion of nearly 20bps was driven by product optimisation and reductions in warehousing and logistic costs. Our route to consumer programme focused on efficiency, effectiveness and expansion, increasing the focus of our sales people, improving their capabilities and putting more feet on the street, which has given us a strong platform as we move into next year.

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key categories:			
Western Europe			(2)
Spirits **	1	(1)	(2)
Beer	(5)	(3)	(3)
Wine	(2)	(2)	(10)
Ready to drink	1	5	5
Global and local leaders **:			
Johnnie Walker	1	(1)	(1)
J B	(9)	(11)	(10)
Smirnoff	1	(6)	(6)
Captain Morgan	15	6	6
Baileys	(4)	(2)	(2)
Guinness	(4)	(3)	(2)

* Organic equals reported movement for volume except for Western Europe (2)%, spirits (1)% and wine (9)%, reflecting the termination of some agency brand distribution agreements including Jose Cuervo.

** Spirits brands excluding ready to drink.

Key highlights

- In **Great Britain,** in a relatively flat beverage alcohol market, net sales were up 2%. Baileys delivered a strong performance with top line growth of 8% on the back of a new advertising campaign and the launch of Chocolat Luxe which was one of the top five spirits sold on Amazon over the week of Christmas. Captain Morgan and Cîroc also performed well. Bell s was weaker as it faced increasingly intense price pressure. Smirnoff net sales declined 3% given the weak vodka category but it gained volume share supported by the Great Drinks Made Easy with Smirnoff campaign and the launch of Smirnoff Gold. Ready to drink was up double digit led by the success of premix, providing popular brands, such as Diageo s Gordon s and Pimm s in more convenient formats.

- Following a significant increase in excise duties in the first half of the year, the market in **Ireland** remained challenging and net sales declined 4%. Spirits were impacted and net sales were down double digit. Roughly half of the decline was driven by weakness in agency beer brands. Guinness net sales declined 3%, but brand equity improved with the launch on television and YouTube of the Basketball campaign, and the launch of an on trade footfall driver, the GUINNESS Plus app which provides consumers with in outlet experiences and discounts.

Business review (continued)

- In **Southern Europe,** which now represents 16% of Western Europe, net sales declined 3%. Greece and Italy net sales were down 7% and 5% respectively, as economic weakness continued to weigh on scotch and Smirnoff performance in both countries, and on Baileys performance in Italy. In Iberia the net sales decline moderated to 1%. Scotch net sales declined 8% as J B was impacted by an increasingly price competitive off trade environment but the brand gained share in the second half of the year. This was partly offset by the performance of Tanqueray which was up 14% on the back of a double digit increase in media spend and Baileys, which was up 2%. Increased investment in the Spanish route to consumer was partially offset by cost saving initiatives.

- In **France,** in an environment of intensified price competition amongst major off trade retailers, net sales grew 1%. The strong performance of scotch malts, which were up 7% led by The Singleton, Cardhu and Talisker, and of Captain Morgan where net sales more than doubled, offset weakness in J B.

- In **Germany,** following a number of years of double digit growth which has built Captain Morgan to be Diageo s second biggest brand, performance was weaker this year as Baileys and Smirnoff continued to decline.

- Net sales in **wine** declined 2%, with innovations on Blossom Hill and strong growth of [yellow tail] partially offsetting soft Bordeaux En Primeur performance and the decision to exit unprofitable sales channels and distribution agreements.

- **Marketing spend** as a percentage of net sales was held at 15%. Spend in premium core, innovation and reserve were prioritised over lower margin local brands. Efficiencies in procurement and promotional activities were used to fund a 15% increase in media spend.

Business review (continued)

AFRICA, EASTERN EUROPE AND TURKEY

In Africa our strategy is to grow Diageo s leadership across beer and spirits by providing brand choice across a broad range of consumer motivations, profiles, and occasions. We are focused on growing beer faster than the market and accelerating the growth of spirits through continued investment in infrastructure and brands. In Russia & Eastern Europe we are driving our premium core and reserve portfolio, whilst in Turkey, Diageo continues to focus its mainstream route to consumer presence to drive accelerated growth in international premium spirits.

	2013 Reported (restated)*	Exchange	Acquisitions and disposals	Organic movement	2014 Reported	Reported movement
Key financials	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**	**%**
Net sales	2,276	(210)	(6)	15	2,075	(9)
Marketing spend	265	(24)	(1)	2	242	(9)
Operating profit before exceptional items	653	(95)	(2)	(2)	554	(15)
Exceptional items	(5)				(23)	
Operating profit	648				531	(18)

*Restated following the adoption of IFRS 11 and the amendment to IAS 19.

Our markets

The region comprises Nigeria, East Africa (Kenya, Tanzania, Uganda, Burundi, Rwanda and South Sudan), Africa Regional Markets (including Ghana, Cameroon, Ethiopia, Angola and Mozambique), South Africa, Russia and Eastern Europe, Turkey.

Route to market

In Africa our largest businesses are in Nigeria, where we own 54.3% of a listed company whose principal brands are Guinness, Harp and Malta, and in East Africa, where we own 50.03% of East African Breweries Limited (EABL). EABL produces and distributes beer and spirits brands to a range of consumers in Kenya and Uganda, and has a 51% equity interest in Serengeti Breweries Limited, Tanzania. Within Africa Regional Markets, we have wholly-owned subsidiaries in Cameroon, Ethiopia, Mozambique and Reunion and majority-owned subsidiaries in Ghana and the Seychelles. Angola is supplied via a third-party distributor. In South Africa we sell spirits through a wholly-owned subsidiary and our beer, cider and ready-to-drink products through our 42.25% stake in DHN Ltd, a joint venture with Heineken and Namibia Breweries Ltd. In addition, we own a 50% equity stake in United National Breweries, a sorghum beer business. Diageo has brewing arrangements with the Castel Group to license, brew and distribute Guinness in the Democratic Republic of Congo, Gambia, Gabon, Ivory Coast, Togo, Benin, Burkina Faso, Chad, Mali and Guinea. Diageo sells spirits through distributors in most other sub-Saharan countries.

Russia and Eastern Europe comprises the principal markets of Russia and Poland, where there are wholly-owned subsidiaries and distributor agreements.

In Turkey, we sell our products via the distribution network of our wholly-owned subsidiary, Mey İçki. Mey İçki distributes both local brands (raki, other spirits and wine), which are produced in its distilleries and wineries, and Diageo s global spirits brands.

Business review (continued)

Supply operations

We have 14 breweries in Africa, including our 25% stake in Sedibeng in South Africa.

In addition, our beer and spirits brands are produced by third-parties under licence in 20 other African countries. We also own six manufacturing facilities including glass, blending, malting and cider plants.

Raki and vodka is produced in Turkey at a number of sites, and we produce Smirnov vodka in Russia.

Sustainability & Responsibility

In Africa we create wealth both directly through our operations and indirectly through our broader value chains where we support development and growth in partnership with businesses and communities. We source over 60% of agricultural and packaging materials locally, and we work with more than 45,000 local farmers for our agricultural inputs. Thirteen of our production sites in Africa are in water-stressed areas, so much of our focus is on managing water use in our operations effectively and reducing water poverty in surrounding communities through our pan-African Water of Life programme. Since its launch, we have brought safe drinking water to around 10 million people. In Russia we have launched some highly innovative responsible drinking programmes.

Performance

In a tough year and despite facing significant challenges, net sales grew 1% as the region responded to the specific market challenges that it faced. In Nigeria, where beer performance was weak, we adjusted prices and increased our presence in the growing value segment. Innovation was a key enabler for responding to changing consumer trends through new formats and brands and the region delivered the highest growth rate for innovation through the success of brands such as Snapp in Nigeria, Jebel in Kenya, Smirnoff Black Ice in Cameroon and Ghana and super premium brands in Turkey. We have expanded our route to consumer, revitalised the Guinness brand across its key markets in Africa and reserve brands grew 26%. Under recovery of fixed costs in supply due to lower beer volumes and cost and salary inflation drove an overall reduction in organic operating margin, although significant procurement and supply chain savings partly mitigated this impact.

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
Africa, Eastern Europe and Turkey	(5)	1	(9)

Africa	(6)		(9)
Nigeria	(9)	(9)	(14)
East Africa	(12)	2	(2)
Africa Regional Markets	(3)	2	(8)
South Africa	4	12	(9)
Russia and Eastern Europe	(1)	2	(7)
Turkey	(3)	5	(12)
Spirits **	2	3	(10)
Beer	(16)	(5)	(11)
Ready to drink	44	34	21
Global and local leaders **:			
Johnnie Walker			(8)
J B	(1)	(2)	(12)
Smirnoff	(5)	(3)	(16)
Captain Morgan	16	17	3
Baileys	(8)	(7)	(13)
Guinness	(7)	1	(5)

* Organic equals reported movement for volume except for South Africa 3%, Russia and Eastern Europe (2)% and spirits 1%, reflecting the termination of the Jose Cuervo distribution agreement.

** Spirits brands excluding ready to drink.

Key highlights

- **Nigeria** net sales declined 9% for the full year driven by beer, while spirits and ready to drink grew double digit. The beer market has become more price competitive, significantly impacting Harp, which lost share and some distribution. Although pricing was adjusted in the third quarter this was not fully passed through to consumers. Malta performance was similarly impacted by increased competition and pricing pressure. Despite these challenges, performance slightly improved in the second half, driven by growth of Guinness following reinvigoration of the brand, including a new pack, media campaign and trade promotion and the launch of Orijin, a new local spirit and ready to drink brand, which sold over 100k cases of the spirit format in the year.

Business review (continued)

- **East Africa s** net sales grew and price increases taken across the beer portfolio led to strong price/mix. For the market s two largest beer brands, Guinness and Tusker, double digit growth was driven by price increases, supported by increased investment behind strong marketing campaigns. Innovations such as Jebel and Senator Dark Extra, targeted at providing value for money offering to consumers, have driven growth. Balozi lager, launched last year and priced just below mainstream beer, has also contributed to growth. This strong performance was partly offset by Senator keg in Kenya where the brand declined around 80% post the duty change.

- In **Africa Regional Markets,** net sales grew 2% with growth of beer partly offset by the decline in spirits largely as a result of distributor changes in Angola. Growth was led by Malta both in its existing markets, aided by a new pack, as well as its launch in Ethiopia, the growth of Meta in Ethiopia and the launch of Harp Premium and the recovery of Guinness in Cameroon. Following the changes in Angola, while spirits shipments declined overall, depletions and share continued to grow and performance improved in the second half.

- **South Africa**. Despite softness in the economy, share gains and price increases resulted in spirits net sales growth of 2%. Johnnie Walker grew double digit with growth across price segments supported by the King of Flavours campaign and trade activation. This growth was partly offset by the decline of Smirnoff 1818 due to reduced inventory levels, although depletions and share of spirits grew and performance improved in the second half. South Africa s strong net sales performance includes the sale of Smirnoff Ice Double Black & Guarana at cost to Diageo Heineken Namibia Drinks (DHN Drinks) to cover demand in excess of supply capacity following the strong performance of the brand. This capacity shortage has now been resolved.

- Net sales growth in **Russia and Eastern Europe** slowed this year to 2%. In Russia net sales grew 4%. While performance was impacted by reduced consumer confidence and higher excise taxes, Diageo grew share in whisk(e)y with growth of White Horse and double digit growth of Bushmills and Bell s and in rum with strong growth of Captain Morgan. The impact of the crisis in Ukraine offset high single digit growth in the rest of Diageo s distributor markets in Eastern Europe. In Poland we retained leadership of the scotch category in softer than expected market conditions.

- Following a much improved performance in the second half, net sales for **Turkey** grew 5%. Following two years of decline, the raki category volume is stabilising and through price increases and premiumisation, the business s raki net sales grew low single digit and contributed significantly to the markets positive price/mix. The scotch market has continued to show solid growth and scotch net sales grew double digit led by Johnnie Walker on the back of increased distribution and visibility in the off trade. Vodka net sales grew in the second half and recovered to flat for the full year with festivals and the new Apple Bite serve driving share gains and growth of Smirnoff.

- **Marketing spend** increased 1%, benefiting from 6ppt of procurement efficiencies. In Russia and Eastern Europe and in Turkey, in response to marketing restrictions, investment was increasingly focused on commercial activations, driving improved visibility across trade channels, supporting new serves and bartender programmes to build brands.

Business review (continued)

LATIN AMERICA AND CARIBBEAN

In Latin America and Caribbean the strategic priority is continued leadership in scotch, while broadening the category range to include vodka, rum, liqueurs and local spirits. We are continuing to invest in routes to market and in the range and depth of our portfolio of leading brands. We are also enhancing our supply structure to enable the business to provide the emerging middle class and an increasing number of wealthy consumers with the premium brands they aspire to.

	2013 Reported (restated)*	Exchange	Acquisitions and disposals	Organic movement	2014 Reported	Reported movement
Key financials	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**	**%**
Net sales	1,453	(328)	(8)	27	1,144	(21)
Marketing spend	233	(30)	(2)	2	203	(13)
Operating profit before exceptional items	468	(151)	2	9	328	(30)
Exceptional items					(14)	
Operating profit	468				314	(33)

*Restated following the adoption of IFRS 11 and the amendment to IAS 19.

Our markets

Our Latin America and Caribbean (LAC) business comprises Paraguay, Uruguay and Brazil (PUB), Venezuela, Colombia, Mexico, WestLAC (Central America and Caribbean, Argentina, Chile, Peru, Ecuador and Bolivia).

Route to market

We sell our products through a combination of our own companies and third-party distributors. In Brazil, sales are primarily made directly to international retailers and distributors. In addition to Diageo Brazil, Diageo owns 100% of Ypióca, a leading cachaça producer and distributor. In Uruguay, Diageo manages distribution directly and through distributors.

All products in Venezuela are sold through dedicated third-party distributors. In Colombia we sell directly to major grocers, serving all other accounts and channels through distributors.

In Mexico, distribution of Smirnoff is managed by Casa Cuervo SA, while all other brands are sold directly by Diageo, either through direct sales to international accounts or through wholesalers and distributors.

In selected markets in West LAC, we manage sales ourselves, while in key markets, such as Costa Rica and the Dominican Republic, we use exclusive distributors. In Jamaica, we own a 58% controlling interest in Desnoes & Geddes Limited, the Jamaican brewer of Red Stripe lager.

In Argentina, we sell directly to major grocers, and other businesses are managed through a combination of wholesalers and distributors outside of major grocers, to whom we sell directly.

Supply operations

The majority of brands sold in the region are manufactured in our International Supply Centre in Europe. However, we have been expanding our local footprint. Our largest owned asset base in the region is Ypióca in Brazil. We also have a controlling interest in a company in Guatemala (Anejos de Altura) producing Zacapa. The region has a brewery in Jamaica (Red Stripe), and the Navarro Correas winery in Mendoza, Argentina. In addition, we partner with more than 12 brewers and over 20 co-pack partners to manufacture brands and package products under strict quality assurance protocols.

Business review (continued)

Sustainability & Responsibility

Our strategy in the Latin America and Caribbean region focuses on Diageo being the partner of choice with all our key stakeholders in the diverse countries in which we operate. We seek to demonstrate informed leadership in public policy, and positively impact our communities. For example, customer programmes with Walmart in Mexico and Puerto Rico are aimed at combating alcohol misuse issues, such as underage drinking. In Brazil we have created a glass-recycling programme, which also serves to create jobs through the development of recycling co-operatives with local authorities. This work is underpinned by Diageo s flagship community re-investment programme, Learning for Life. Since 2008, Learning for Life has provided life skills and vocational training to more than 100,000 disadvantaged individuals in more than 30 countries across the region.

Performance

Our Latin America and Caribbean business has delivered a good set of results despite mixed performance in individual countries. In West LAC, our biggest market, net sales were down 8% following a destocking in the border zones. Both Brazil and Colombia delivered solid performance, benefiting from changes in the route to consumer and, in Brazil, from synergy with Ypióca. In a challenging operating environment Venezuela net sales grew 78%, with slower growth in the second half as high inflation and currency devaluation has affected demand and the affordability of imported products. Mexico was weak as tax reforms and a general economic slowdown impacted consumers discretionary spend. While scotch remains the largest category in the region, growth came from the investment we made to widen participation to categories such as vodka, cachaça, liqueurs and to capture the growing affluent and emerging middle class. Despite the negative country mix from weakness in West LAC and Mexico, total operating margin for the region improved 18bps driven by strong price/mix, and a focus on overhead cost reductions.

	Organic volume movement* %	**Organic net sales movement %**	**Reported net sales movement %**
Key markets and categories:			
Latin America and Caribbean	(1)	2	(21)
PUB	9	10	(4)
Venezuela	(17)	78	(71)
Colombia	5	8	(7)
Mexico	(1)	(4)	(10)
West LAC	(9)	(8)	(15)
Spirits **	(1)	1	(23)
Beer	5	10	(3)
Wine	(19)	2	(24)
Ready to drink	6	16	(11)
Global and local leaders **:			
Johnnie Walker	(7)	(4)	(15)
Buchanan s	(20)	1	(32)
Smirnoff	12	18	(1)
Baileys		9	(6)

* Organic equals reported movement for volume except for Venezuela (19)%, Colombia (3)%, Mexico (2)% and West LAC (10)% and spirits (2)%, reflecting the disposal of Nuvo and the termination of the distribution agreement with Jose Cuervo.

** Spirits brands excluding ready to drink.

Key highlights

- **Paraguay, Uruguay and Brazil** (**PUB**) reflected the strong performance of Brazil where improvements in route to consumer, synergy with Ypióca and a favourable comparison versus last year contributed to net sales growth in every category. Strong growth from Old Parr, White Horse and Black & White, and 5% net sales growth in Johnnie Walker, with half of the growth coming from super and ultra premium segments, drove 13% net sales increase in scotch and Diageo Brazil gained share in scotch. Ypióca again grew strongly with net sales up 21% on the back of the Vamos Brazilizar campaign and the launch of new packaging to upgrade the brand perception. Vodka was back in growth with net sales increasing 15% driven by Smirnoff which gained share in the standard vodka segment. In the growing luxury segment, Cîroc and Ketel One vodka continued to perform strongly with net sales growing 41% and 25% respectively. The duty free zones of Paraguay and Uruguay were affected by currency weakness and net sales declined 13%.

- Diageo **Venezuela** net sales grew 78% with volume down 17%. High inflation and currency devaluation impacted consumer demand for scotch with volume declining 47%. Net sales in locally produced rum such as Pampero and Cacique grew 84% as consumers traded down from scotch to rum. Diageo Venezuela continued to gain share in scotch and rum, however it lost share in ready to drink due to supply constraints.

Business review (continued)

- In **Colombia**, net sales grew high single digit with changes in the route to consumer and a review of commercial terms driving a stronger performance in the second half. Old Parr and Buchanan s contributed to over 60% of net sales growth supported by new marketing campaigns such as The more you give, the more you have . Ready to drink net sales grew 24% as it benefited from distribution gains driven by changes in the route to consumer.

- Diageo **Mexico** net sales declined 4% as tax reforms and a weaker economy affected consumer confidence. Buchanan s net sales were down 11% as the brand was impacted by competition from the growing value segment and Johnnie Walker net sales were down 7% but gained share across all brand s segments. In the fast growing value segment, Black & White nearly doubled in size, albeit from a small base, and grew share. Old Parr net sales were up 30% supported by the launch of Old Parr Silver, a non age declared variant of the main brand driving share gains. Baileys extended its lead in the liqueur category, supported by the successful Mother s Day Hija de mi Madre campaign.

- Net sales in **West LAC** were down 8%. Performance was largely driven by the destocking in the border zones where net sales declined 66%. Net sales in other countries which make up the market grew 8%, driven by double digit growth in Argentina, as local production of Smirnoff started in the first half and import restrictions on Johnnie Walker eased, and Jamaica which benefited from a new distribution joint venture.

- **Marketing spend** increased 1%, less than net sales, as Diageo Brazil reallocated some marketing spend into trade spend to secure in store visibility and benefit from the FIFA World Cup and expansion into new outlets. Increased investment behind reserve brands, mainly Cîroc, and non scotch categories such as rum, particularly in Mexico with the successful Captain Morgan s Morgan Fest campaign, Baileys and cachaça in Brazil was in line with the strategy to expand beyond scotch and capture the affluent and growing emerging middle class.

Business review (continued)

ASIA PACIFIC

Our strategy in Asia Pacific, which encompasses both developed and emerging markets, is to operate across categories with participation in international spirits, local spirits and beer. Our strategy focuses on the highest growth categories and consumer opportunities, driving continued development of super and ultra premium scotch, and leveraging the emerging middle class opportunity through a combination of organic growth and selective acquisitions.

Key financials	2013 Reported (restated)* £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2014 Reported £ million	Reported movement %
Net sales	1,572	(112)	(7)	(106)	1,347	(14)
Marketing spend	356	(27)		(24)	305	(14)
Operating profit before exceptional items	381	(35)	(19)	(44)	283	(26)
Exceptional items	(1)				(276)	
Operating profit	380				7	(98)

*Restated following the adoption of IFRS 11 and the amendment to IAS 19.

Our markets

Asia Pacific comprises South East Asia (Vietnam, Thailand, Philippines, Indonesia, Malaysia, Singapore, Cambodia, Laos, Myanmar and Sri Lanka), Greater China (China, Taiwan, Hong Kong and Macau), India, Global Travel Asia and Middle East, Australia and North Asia (Korea and Japan).

Route to market

In South East Asia, spirits and beer are sold through a combination of Diageo companies, joint venture arrangements, and third-party distributors. Diageo manages a Singapore based key accounts business. In Thailand, Malaysia and Singapore, joint venture arrangements are in place with Moët Hennessy, where administrative and distribution costs are shared. Diageo has wholly-owned subsidiaries in the Philippines and Vietnam. In Vietnam we also have a 45.56% equity stake in Hanoi Liquor Joint Stock Company. In Malaysia, Diageo s own and third-party beers are brewed and distributed by a listed company, Guinness Anchor Berhad, in which we have an effective 25.5% equity interest. In Indonesia, Guinness is brewed by, and distributed through, third-party arrangements.

In Greater China, a significant part of our spirits business is conducted through a joint venture arrangement with Moët Hennessy. We are also the sole distributor of Shui Jing Fang, a super premium Chinese white spirit, through our controlling 39.71% equity stake in a listed company.

In India, we have our own distribution company for our international spirits brands and in 2014 we expanded our route to market through a sales promotion agreement with United Spirits Limited (USL), the leading spirits company in India. Diageo is now the largest shareholder in USL with a 54.78% equity interest. 26% of this equity interest was acquired on 2 July 2014. Diageo will fully consolidated the results of USL from 2 July 2014.

In Australia, Diageo owns production, distillation and distribution companies and in New Zealand we operate through third-party distributors.

In North Asia, we have our own distribution company in Korea, whilst in Japan, the majority of sales are through joint venture agreements with Moët Hennessy and Kirin.

Airport shops and airline customers are serviced through a dedicated Diageo sales and marketing organisation. In the Middle East, we sell our products through third-party distributors.

Business review (continued)

Johnnie Walker houses in Shanghai, Beijing and Seoul have been driving ultra premium scotch sales.

Supply operations

We have distilleries in Chengdu in China that produce Chinese white spirit and in Bundaberg, Australia for the production of rum.

Sustainability & Responsibility

Promoting responsible drinking is a particular focus for us as it is in many parts of the world. We run a number of programmes to address drink driving, to train bartenders and promotional staff on how to serve alcohol responsibly, and to raise awareness of alcohol and its effects. We also focus on empowering women through our Plan W programme, which aims to reach two million women by 2017. In Australia, which is home to our largest blending and packaging site in the region, we have developed some of our most innovative and award-winning sustainable manufacturing initiatives.

Performance

Performance in Asia Pacific was impacted by a weaker trading environment in China and South East Asia and this top line weakness and negative country mix impacted operating margin, which, despite a reduction in overheads, decreased 136bps. In China the effects of the government s anti extravagance campaign severely impacted the on trade channel, and continued to affect performance of both our Chinese white spirits and scotch businesses, while South East Asia was impacted by tax increases and social unrest in Thailand and destocking in other markets and channels. Despite the challenging trading environment we gained share in scotch in both Thailand and China. Elsewhere, Korea, Japan, GTME, Taiwan and India delivered good growth and we gained share in scotch across the countries. Strong growth of scotch malts in Taiwan and successful innovation launches in super and ultra premium scotch segments contributed to another year of double digit growth of the reserve brands.

	Organic volume movement* %	**Organic net sales movement %**	**Reported net sales movement %**
Key markets and categories:			
Asia Pacific	(5)	(7)	(14)
South East Asia	(25)	(19)	(25)
Greater China	(20)	(31)	(33)
India	22	42	8
Global Travel Asia and Middle East	18	19	15
Australia hub	(2)	(3)	(17)

North Asia	2	4	(2)
Spirits **	(5)	(11)	(15)
Beer	(1)	2	(9)
Ready to drink	1	(1)	(14)
Global and local leaders **:			
Johnnie Walker	(13)	(11)	(14)
Windsor	(5)	1	1
Smirnoff	4	(3)	(13)
Baileys	12	11	3
Guinness	(1)	3	(9)

* Organic equals reported movement for volume except for Greater China (21)% and Australia (3)% reflecting the termination of the distribution agreement with Jose Cuervo.

** Spirits brands excluding ready to drink.

Key highlights

- In **South East Asia** performance was largely driven by Thailand and destocking in other markets and channels as trade confidence was affected by pricing pressure, currency devaluation and economic uncertainty in the region. In Thailand tax increases and political unrest contributed to a weak consumer environment with net sales down 24%. In a declining scotch category Diageo gained 5.8ppt volume share. In Indonesia net sales were up double digit driven by 7% growth of Guinness and strong performance in ready to drink.

- **Greater China** performance continued to be affected by the government s anti extravagance measures. Shui Jing Fang net sales declined 78% as the brand suffered from pricing pressure from other leading brands. Net sales of Diageo s international brands in China declined 14%, largely driven by weakness in scotch, down 20%, as Johnnie Walker Black Label net sales declined 28%. However, Johnnie Walker Black Label grew share 1.2ppt as activation was increased into tier 2 and 3 cities. Reserve brands net sales grew 9%, driven by a strong growth in scotch malts. Baileys net sales grew double digit, as the brand continued to capture the trend of increasingly empowered female consumers with the support of the Sisterhood Campaign . In Taiwan, net sales grew 9% driven by strong growth from The Singleton, the fastest growing scotch malt in the market, and it gained 2ppt of share.

Business review (continued)

- Diageo **India** continued to deliver strong double digit net sales growth as it benefited from having its brands sold through the sales agency agreement with USL. Strong performance by Johnnie Walker Black Label, VAT 69 and Black & White drove most of the growth in scotch, and share in scotch increased 1.9ppt. Smirnoff net sales grew high single digit benefiting from its partnership with several music festivals.

- In **Global Travel Asia and Middle East** (**GTME**) net sales were up 19% driven by the Middle East where despite political turmoil in the region, it delivered strong growth boosted by an increase in tourism, expansion in the region s airports as well as improvements in Diageo s route to consumer. Global Travel Asia returned to growth with net sales up 9% mainly driven by an increased focus on Johnnie Walker Blue Label which showcased the Dunhill partnership, including a limited edition pack, in many airports in the region.

- In **Australia** net sales declined 3%, largely driven by the decline in ready to drink, where net sales were down 5% as tax increases continued to impact pricing and demand in the category. Spirits net sales declined 1%, as Baileys, which benefited from the launch of Baileys Chocolat Luxe, and Captain Morgan grew, but not enough to offset a decline in Smirnoff and Bundaberg, which suffered from growth in spiced rum. Reserve brands net sales grew 30% mainly driven by the launch of Bundaberg 125th anniversary bottle and Ketel One vodka which almost doubled in size.

- In **North Asia,** net sales increased 4% driven by Windsor in Korea and strong growth from Smirnoff Ice in Japan. In Korea s declining scotch category, Windsor volume was broadly flat and gained 1.7ppt of volume share driven by strong performance of Windsor 12 and the launch of Windsor Black. The business increased its participation into other categories with Smirnoff net sales up 13%, as it benefited from sponsoring music festivals, and Guinness net sales increased 5%, supported by new in venue vending machines. In Japan, ready to drink net sales increased 20% driven by Smirnoff Ice and the launch as a permanent SKU of Smirnoff Ice Green Apple after a successful limited edition offer last year.

- **Marketing spend** decreased 7% in line with net sales, as a result of lower spend in international spirits in China and South East Asia. Investment behind innovation increased and new launches across the region included Johnnie Walker Gold Label Reserve limited edition in the Middle East, to celebrate the Dubai duty free 30th anniversary, the Bundaberg 125th anniversary bottle in Australia and the Johnnie Walker Blue Label and Dunhill partnership. Shui Jing Fang marketing spend was maintained and focused on new launches which target more attractive price points in the baijiu segment.

Business review (continued)

CATEGORY REVIEW

Key markets and categories:	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Spirits **	**(1)**		**(10)**
Whisk(e)y	**(4)**		**(8)**
Johnnie Walker	(6)	(4)	(9)
Crown Royal	(4)	1	(3)
J B	(7)	(8)	(11)
Buchanan s	(13)	6	(24)
Windsor	(5)	1	1
Bushmills	8	7	4
Bulleit	66	69	62
Vodka	**(1)**		**(5)**
Smirnoff	(1)	(2)	(7)
Ketel One vodka	3	6	2
Cîroc	2	2	(2)
Rum	**9**	**7**	**(4)**
Captain Morgan	6	6	1
Liqueurs	**(2)**		**(7)**
Baileys	(2)	1	(3)
Tequila	**43**	**34**	**(71)**
Don Julio	27	27	22
Gin	**3**	**3**	**(1)**
Tanqueray	4	6	3
Beer	**(11)**	**(3)**	**(8)**
Guinness	(5)	(1)	(5)
Wine	**(4)**	**1**	**(6)**
Ready to drink	**8**	**4**	**(11)**
Total	**(2)**		**(9)**

* Organic equals reported movement for volume except for total (5)%, spirits (4)%, wine (8)%, ready to drink 5%, liqueurs (4)%, and tequila (86)%, largely reflecting the disposal of Nuvo and the termination of agency brand distribution agreements, including Jose Cuervo.

** Spirits brands excluding ready to drink.

Business review (continued)

Spirits net sales were broadly flat, with growth in the United States offset by weakness in emerging markets, particularly Asia Pacific. Reserve brands delivered the strongest growth up 14%, with 5ppt of positive price/mix.

Whisk(e)y, our largest spirits category, performed broadly in line with overall spirits, and again strong performance in North America offset weak performance in emerging markets. Consequently scotch net sales declined 1%, largely Johnnie Walker, given its strong presence in emerging markets.

- **Johnnie Walker s** net sales decline was driven by Johnnie Walker Red and Black Label which were adversely impacted by market weakness in a number of emerging markets, particularly in South East Asia, West LAC and PUB. Reserve brands grew strongly, with 7ppt of price mix, driven by successful innovation launches in the United States and pricing in Venezuela.

- **Crown Royal** in the United States grew, driven by the launch of Crown Royal XO and Crown Royal 75th Anniversary, which drove positive price/mix. Its growth was partly offset by the negative impact of lapping last year s launch of Crown Royal Maple Finished and competition from flavoured whiskey brands. Marketing investment focused on the Reign On campaign.

- **J B** net sales declined 8%, primarily driven by increased price competition in the Spanish scotch market, and a weaker market in Mexico. This was partly offset by growth in South Africa, the brand s third largest market, and in Korea. J B Urban Honey, an innovation in the rapidly growing favoured whisk(e)y segment, was launched.

- **Buchanan s** grew net sales 6% on strong price/mix. Volume in Latin America and Caribbean, its biggest region was significantly impacted by; destocking in West LAC; softer consumer demand in Mexico; and weak volume growth in Venezuela. Net sales growth was driven by Venezuela and the United States where the brand continued to target Latin American consumers. In the United States Buchanan s is now the #3 blended scotch brand, with 375k cases, driven by increased marketing behind the A lo Grande campaign, sponsorships and trade activation.

- **Windsor s** performance improved with net sales up 1%. In Korea, the brand s primary market, net sales grew 3%, in a declining market. Windsor s volume share gains were driven by the strong performance of Windsor 12 and the launch of a new super premium variant, Windsor Black, to drive incremental growth in the on trade.

- **Bushmills** net sales growth of 7% was driven by the music based Bushmills Live platform and the honey flavour innovation, with Russia and Eastern Europe, Germany and GTME the strongest markets.

- **Bulleit** continued its strong trajectory, net sales grew 69% as the brand grew strongly in the United States and expanded in to new markets.

- **Scotch Malts** performed very strongly with net sales up 18% driven by the recently launched Talisker Storm and the Talisker Whisky Atlantic Challenge, and strong growth of The Singleton and Lagavulin, up 17% and 23% respectively.

Vodka net sales were broadly flat, with strong growth in reserve offsetting the decline in standard and value segments. In the United States volume declined in the value and standard price segments due to a challenging price environment and lapping of prior year innovations. Growth in Latin America was strong, driven by Brazil and Argentina.

- **Smirnoff** net sales declined, driven by increasing price pressure in its largest markets. In the United States the brand held price in an increasingly price competitive segment, losing share. In Western Europe net sales also declined driven by poor performance in Germany, where the brand was impacted by pricing pressure from wholesalers, in Great Britain where we gained share in an increasingly price competitive market, and in Ireland where duty increases drove up retail prices. In contrast in Latin America, Smirnoff delivered strong growth in both Brazil and Argentina. There was also positive momentum from innovations, with strong performance from the Smirnoff Confectionary line in the United States, and the launch of the new signature serve Smirnoff Apple Bite and Smirnoff Gold in Western Europe.

- **Ketel One vodka** grew both net sales and volume, with 3ppt of positive price/mix. In the United States, its largest market, net sales growth was driven by the launch of the Vodka of Substance campaign and by brand ambassador and mentoring programmes supporting Ketel One s strong on premise positioning. Outside of the United States, net sales grew over 40%, led by net sales in Australia almost doubling and strong performance in GTME and Western Europe.

- Over 85% of **Cîroc s** net sales are from the United States, where strong performance and share gains driven by the launch of Cîroc Amaretto were not enough to offset a decline in the core brand which faced tough price competition. The brand was supported with increased investment to support the launch Cîroc Amaretto as well as the Luck be a Lady campaign and the new NBA partnership. Outside of the United States Cîroc sustained its growth trajectory, with strong net sales growth in Western Europe, Brazil, GTME and launches into new markets.

Rum net sales grew 7% driven by Captain Morgan, Zacapa and Cacique.

- **Captain Morgan** performed strongly with net sales growing 6% driven by continued growth in the United States, its largest market, Great Britain, Russia and Eastern Europe and Australia. This was driven through the success of the Keys to Adventure experiential events and the new Live like the Captain campaign. Growth in the United States was driven by the successful launch of Captain Morgan White in February which was supported by increased investment.

Business review (continued)

• **Zacapa** net sales grew 22%, driven by 37% growth in its largest region, Western Europe, with strong growth in Russia and Eastern Europe and North America. Investment focused on mentoring, trade activation and sampling, with a continuation in the roll out of the successful Zacapa Rooms, a luxury temporary lounge dedicated to tasting events for key influencers, media and consumers across Western Europe.

• **Cacique** net sales increased 16% driven by both volume growth and price increases in Venezuela as consumers switched to more affordable local spirits.

Liqueurs performance was driven by Baileys, which represents over 85% of the category.

• **Baileys** grew 1% and performance was broadly mixed across markets. In China the brand grew double digit as the Sisterhood Campaign resonated strongly with female consumers. In Australia the brand benefited from the growth of Chocolat Luxe. In Latin America and Caribbean the roll out of the global campaign, and activation in Mexico focused on the Baileys and coffee serve, drove 9% net sales growth. In the United States the brand continued to grow net sales driven by the success of the launch of Baileys Vanilla Cinnamon and the Stylish Shot campaign. In Western Europe however, net sales declined, with performance impacted by price increases in Germany and Benelux. This decline was partly offset by the successful launch of Baileys Chocolat Luxe, which drove share gains in Great Britain.

Tequila net sales grew 34% driven by strong performance of **Don Julio**, with strong growth and share gains in the United States, its primary market. This was driven by a significant increase in marketing spend to support new brand positioning and commercial activation around the summer programme, Elevate your Summer and Your Margarita Crafted . Don Julio continued to perform strongly outside of the United States, growing net sales 34%, with particularly strong growth in Western Europe and Australia.

Gin net sales grew 3%, with strong growth in Western Europe, Africa, and Latin America partly offset by a decline in Asia Pacific.

• **Tanqueray** net sales grew 6% with growth in all regions supported by the extension of the Tonight we Tanqueray campaign. There was strong performance across Western Europe, in particular Great Britain, Germany and Iberia where net sales grew and the brand gained share and also Latin America, driven by Brazil, Mexico and Colombia. In the United States, depletions performed well and Diageo grew share but shipments were impacted by higher stock levels at the start of the financial year.

Beer net sales declined 3%. In Nigeria consumers traded down to value beer resulting in share losses, duty changes had a negative impact on Senator keg in Kenya, and there were continued challenges in Ireland and Great Britain.

• **Guinness** net sales declined 1%, delivering 4ppt of positive price/mix from price increases. The brand declined in Nigeria due to challenging market conditions, however performance improved in the second half driven by a number of activities including new packaging, a new media campaign and increased trade promotions. Guinness was down 5% in the United States, lapping the launch of Guinness Black Lager and down 3% in Western Europe where the on trade remains challenging. Guinness performed strongly in East Africa where price increases drove net sales growth of 19%, supported by an increase in marketing spend. Growth was also strong in Indonesia.

- Performance of local African beers was negatively impacted by the decline of Harp which was impacted by pricing pressure in Nigeria, and Senator keg which declined driven by October s excise duty increase in Kenya. These challenges were in part offset by the growth of other local beer brands including Tusker which grew double digit driven by price increases and strong football related marketing programmes, and value beer brands such as Dubic and Satzenbrau in Nigeria and Balozi lager in Kenya which are benefiting from growth in the value segment.

Wine grew net sales 1% with growth largely driven by the United States, as a result of price increases and innovation.

Ready to drink grew 4% driven by South Africa, Great Britain, Venezuela, and Japan, partly offset by a decline in the United States and Australia. In South Africa, strong performance reflects the production and sale to DHN Drinks of Smirnoff Ice Double Black and Guarana to resolve short term capacity issues. In Japan, net sales grew 20% with Smirnoff Ice, the leading bottled ready to drink, extending its leadership position with strong performance by core variants and innovation. Net sales declined in the United States driven by the continued decline of pouches and in Australia where our performance continued to be impacted by the market contraction.

Business review (continued)

Operating results 2013 compared with 2012

As at 1 July 2013 the group adopted a number of new standards and amendments and the application of *IFRS11 - Joint arrangements* and the amendment to *IAS19 - Employee benefits* resulted in a restatement of comparative figures. The impact on the group s consolidated statement of comprehensive income and net cash flow for the years ended 30 June 2013 and 30 June 2012, and net assets as at 30 June 2013 and 30 June 2012 is provided in note 18 to the consolidated financial statements on pages 202 and 203.

1. INCOME STATEMENT

Summary consolidated income statement

	Year ended 30 June 2013 (restated) £ million	Year ended 30 June 2012 (restated) £ million
Sales	**15,276**	14,392
Excise duties	**(3,973)**	(3,753)
Net sales	**11,303**	10,639
Operating costs before exceptional items	**(7,824)**	(7,491)
Operating profit before exceptional items	**3,479**	3,148
Exceptional operating items	**(99)**	(40)
Operating profit	**3,380**	3,108
Non-operating items	**(83)**	147
Net finance charges	**(457)**	(441)
Share of after tax results of associates and joint ventures	**217**	229
Profit before taxation	**3,057**	3,043
Taxation	**(507)**	(1,011)
Profit from continuing operations	**2,550**	2,032
Discontinued operations		(11)
Profit for the year	**2,550**	2,021
Attributable to:		
Equity shareholders of the parent company	**2,452**	1,901
Non-controlling interests	**98**	120
	2,550	2,021

Sales and net sales

On a reported basis, sales increased by £884 million from £14,392 million in the year ended 30 June 2012 to £15,276 million in the year ended 30 June 2013 and net sales increased by £664 million from £10,639 million in the year ended 30 June 2012 to £11,303 million in the year ended 30 June 2013. Exchange rate movements decreased reported sales by £82 million and reported net sales by £60 million. Acquisitions increased reported sales by £317 million and reported net sales by £233 million and disposals decreased both reported sales and net sales by £19 million.

Operating costs before exceptional items

On a reported basis, operating costs before exceptional items increased by £333 million from £7,491 million in the year ended 30 June 2012 to £7,824 million in the year ended 30 June 2013 due to an increase in cost of sales of £212 million from £4,177 million to £4,389 million, an increase in marketing spend of £98 million from £1,671 million to £1,769 million, and an increase in other operating expenses before exceptional costs of £23 million, from £1,643 million to £1,666 million. Exchange rate movements benefited total operating costs before exceptional items by £56 million.

Cost of sales excluding exceptional items was £4,389 million in the year ended 30 June 2013 compared with £4,177 million in the year ended 30 June 2012. The 1% volume increase together with some favourable mix impact added £37 million to cost of sales. Acquisitions and disposals added £96 million, with Ypióca and Shuijingfang being the main contributors, and positive exchange movements reduced cost of sales by £23 million. As expected cost increases on materials, utilities and logistics amounted to around 4% of cost of sales. This was partially mitigated by cost reductions through packaging sourcing initiatives, asset rationalisation, procurement benefits and operational efficiencies arising from restructuring programmes implemented in recent years.

Business review (continued)

Exceptional operating items

Net exceptional operating charges of £99 million in the year ended 30 June 2013 comprised:

- £25 million (2012 £nil) for the Supply excellence restructuring programme,
- a charge of £44 million (2012 £27 million) for the restructuring of the group s Global Supply operations in Ireland, Scotland and in the United States,
- a gain of £20 million in respect of changes to future pension increases for the Diageo Guinness Ireland Group Pension Scheme (2012 £115 million in respect of the group s principal UK and Irish pension schemes), and
- a brand impairment charge of £50 million (2012 £59 million) in respect of the Cacique brand.

In the year ended 30 June 2012 exceptional operating items also included a charge of £69 million for the operating model review announced in 2011.

In the year ended 30 June 2013 total restructuring cash expenditure was £61 million (2012 £158 million).

Post employment plans

The deficit in respect of post employment plans before taxation decreased by £535 million from £1,076 million at 30 June 2012 to £541 million at 30 June 2013 primarily as a result of the one off cash contribution of £400 million into the Diageo UK Pension Scheme. In addition, an increase in the market value of plan assets was partially offset by a decrease in the discount rates used to calculate the liabilities of the Irish plans and an increase in the inflation assumptions in the United Kingdom. Cash contributions to the group s UK and Irish post employment plans in the year ended 30 June 2013 were £529 million (2012 £131 million).

Operating profit

Reported operating profit for the year ended 30 June 2013 increased by £272 million to £3,380 million from £3,108 million in the prior year. Before exceptional operating items, operating profit for the year ended 30 June 2013 increased by £331 million to £3,479 million from £3,148 million in the prior year. Exchange rate movements decreased both operating profit and operating profit before exceptional items for the year ended 30 June 2013 by £4 million. Acquisitions increased reported operating profit by £98 million and disposals decreased reported operating profit by £3 million.

Exceptional non-operating items

In the year ended 30 June 2013 a loss of £83 million arose in respect of the Nuvo disposal. In the year ended 30 June 2012 the gain on sale of businesses of £147 million included a step up gain of £124 million on the revaluation of the group s equity holdings in Sichuan Chengdu Shuijingfang Group Co., Ltd. (SJF Holdco) (formerly Sichuan Chengdu Quanxing Group Company Ltd.) and Sichuan Shuijingfang Co., Ltd (Shuijingfang) to fair value as the associates became subsidiaries during the year. In addition, exceptional non-operating items included a gain of £23 million on the sale of the group s investment in Tanzania Breweries.

Net finance charges

Net finance charges amounted £457 million in the year ended 30 June 2013 (2012 £441 million).

Net interest charge increased by £17 million from £382 million in the prior year to £399 million in the year ended 30 June 2013. The effective interest rate was 4.9% (2012 4.6%) in the year ended 30 June 2013 and average net borrowings decreased by £39 million compared to the prior year. For the calculation of effective interest rate, the net interest charge excludes fair value adjustments to derivative financial instruments and borrowings and average monthly net borrowings include the impact of interest rate swaps that are no longer in a hedge relationship but exclude the market value adjustment for cross currency interest rate swaps.

Net other finance charges for the year ended 30 June 2013 were £58 million (2012 £59 million). There was an increase of £1 million in finance charges in respect of post employment plans from an charge of £37 million in the year ended 30 June 2012 to a charge of £38 million in the year ended 30 June 2013. Other finance charges also included £16 million (2012 £17 million) in respect of the unwinding of discounts on liabilities and a hyperinflation adjustment of £4 million (2012 £3 million) in respect of the group s Venezuela operations.

Associates and joint ventures

The group s share of after tax results of associates and joint ventures was £217 million for the year ended 30 June 2013 compared to £229 million in the prior year. Diageo s 34% equity interest in Moët Hennessy contributed £230 million (2012 £205 million). The share of loss after tax of £13 million (2012 £24 million profit) from other associates and joint ventures contains a deferred tax write off of £23 million (2012 £nil).

Profit before taxation

Profit before taxation increased by £14 million from £3,043 million in the prior year to £3,057 million in the year ended 30 June 2013.

Taxation

The reported tax rate decreased from 33.2% in the year ended 30 June 2012 to 16.6% in the year ended 30 June 2013. During the year ended 30 June 2012 tax authority negotiations were concluded resulting in a favourable change to the taxation basis of certain overseas profit and intangible assets which reduced the ongoing tax rate but resulted in the loss of future tax amortisation deductions giving rise to an exceptional write off of the related deferred tax assets of £524 million. The tax rate before exceptional items for the year ended 30 June 2013 increased to 17.4% from 17.2% for the year ended 30 June 2012.

Business review (continued)

Discontinued operations

Discontinued operations in the year ended 30 June 2012 represented a charge after taxation of £11 million in respect of anticipated future payments to additional thalidomide claimants.

Exchange

Exchange rate movements are calculated by retranslating the prior year results as if they had been generated at the current year exchange rates. The difference is excluded from organic growth. The estimated effect of exchange rate and other movements on profit before exceptional items and taxation for the year ended 30 June 2013 is set out in the table below.

	Gains/ (losses) £ million
Translation impact	(7)
Transaction impact	3
Operating profit before exceptional items	(4)
Net finance charges translation impact	(3)
Impact of IAS 21 and IAS 39 on other finance charges	2
Interest and other finance charges	(1)
Associates translation impact	(3)
Total effect on profit before exceptional items and taxation	(8)

	Year ended 30 June 2013	**Year ended 30 June 2012**
Exchange rates		
Translation £1 =	$1.57	$1.58
Transaction £1 =	$1.57	$1.57
Translation £1 =	1.21	1.18
Transaction £1 =	1.18	1.19

Business review (continued)

2. SEGMENT REVIEW

The organic movements for volume, net sales, marketing spend and operating profit before exceptional items by reporting segment for the year ended 30 June 2013 were as follows:

Organic growth by region	Volume %	Net sales %	Marketing spend %	Operating profit* %
North America	1	5	10	9
Western Europe	(3)	(4)	(6)	(7)
Africa, Eastern Europe and Turkey	4	10	16	10
Latin America and Caribbean	4	15	11	26
Asia Pacific	(1)	3	(1)	6
Diageo**	1	5	5	8

* Operating profit excluding exceptional items

** Including Corporate. Corporate net sales were £76 million in the year ended 30 June 2013, up £6 million compared to last year. Corporate net operating charges were £151 million in the year ended 30 June 2013 having been £167 million in the year ended 30 June 2012. The reduction comprised, a £10 million decrease in corporate costs, primarily due to a reduction in acquisition costs and a £6 million favourable exchange rate movement.

NORTH AMERICA

Key highlights

- **US spirits** net sales grew 8% driven by a strong performance in North American whiskey, scotch, and vodka. Crown Royal and Bulleit Bourbon contributed more than 45% of the net sales growth following successful innovations such as Crown Royal Maple Finished and Bulleit 10 year old which were launched this year. Smirnoff delivered a strong performance and grew net sales 6% with the expansion of the confectionery line and the launch of Smirnoff Kissed Caramel, Iced Cake and Root Beer Float. Johnnie Walker increased net sales 14% driven by the strong performance of both Johnnie Walker Black Label and Blue Label. 5ppts of positive price/ mix arose from price increases put through across categories and positive mix from premiumisation as net sales of the reserve brands grew 9%. Net sales growth in the fourth quarter benefited from the shipment of a new Cîroc flavour which was launched in July.

- **Canada** net sales growth of 8% was driven by price increases across categories, successful innovation launches in whiskey, rum, and liqueurs, and the impact of increased marketing investment behind Johnnie Walker, Crown Royal and Baileys as well as bulk whiskey sales.

- Net sales in beer declined 1%. Guinness lost share in the United States as we lapped the introduction of Guinness Black Lager and Red Stripe was affected by supply disruptions.

- Ready to drink net sales declined 10% as Smirnoff Ice faced increased competition from established beer brands.

- Marketing investment was up 10% driven by an increased investment behind strategic brands. Increased spend of 24% on Johnnie Walker was focused on the My Label is Black campaign which was designed to celebrate the Hispanic community. Successful campaigns included the Reign On campaign for Crown Royal, the continuation of the Master of the Mix programme, featuring a DJ competition on cable TV, sponsored by Smirnoff, and the Luck Be a Lady campaign for Cîroc featuring Sean Combs. Increased investment behind Bulleit Bourbon was focused on raising consumer awareness of the brand.

- Price increases implemented across the portfolio and positive mix from the double digit net sales growth of our super and ultra premium brands drove 128bpts of organic operating margin improvement.

Business review (continued)

Performance

Key financials	2012 Reported £ million	Exchange £ million	Acquisitions and disposals* £ million	Organic movement £ million	2013 Reported £ million	Reported movement %
Net sales	3,547	22	(24)	178	3,723	5
Marketing spend	543	6	(18)	50	581	7
Operating profit before exceptional items	1,352	14	(3)	115	1,478	9
Exceptional items	(11)					
Operating profit	1,341				1,478	10

* Diageo reported net sales of £267 million (2012 £266 million) from Jose Cuervo in North America. Acquisitions and disposals are in respect of the year on year movement for Jose Cuervo, as a result of the termination of the distribution agreement, and for disposals made in the years ended 30 June 2013 and 30 June 2012. The variance is primarily driven by the sales decline of Nuvo.

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
North America	1	5	5
US Spirits	3	8	7
DGUSA	(7)	(6)	(6)
Diageo Chateau & Estate Wines	1	3	4
Canada		8	7
Spirits**	2	8	8
Beer	(2)	(1)	(3)
Wine	1	4	4
Ready to drink	(10)	(10)	(11)
Global and local leaders:**			
Johnnie Walker	5	12	13
Crown Royal	14	17	17
Buchanan s	13	19	19
Smirnoff	2	5	6
Ketel One vodka	5	8	8
Cîroc	1	4	5
Captain Morgan		4	4
Baileys	4	7	8
Tanqueray	7	11	12
Guinness	(2)	(1)	

Restated following the adoption of IFRS 11 and the amendment to IAS 19.

* Organic equals reported movement for volume except for Canada (1)%, beer (3)% ready to drink (12)%, and wine 0%, reflecting the North American wine and other disposals and the termination of the Jose Cuervo distribution agreement.

** Spirits brands excluding ready to drink.

Business review (continued)

WESTERN EUROPE

Key highlights

- In the stronger economies of **Germany, Austria, and Benelux** double digit net sales growth was delivered. Germany and Austria maintained strong momentum on the back of increased marketing investment and expansion of the sales force in the off trade. Captain Morgan and Smirnoff both grew volume and share while net sales of Mey İçki s brands in Germany, the largest export market for raki, grew following increased marketing.

- In **Great Britain**, innovation and growth of reserve brands offset the impact of a weaker beer market. Innovations included Pimm s Blackberry & Elderflower and a further range extension of pre-mix cans. Growth in reserve was driven by the introduction of Cîroc. Guinness net sales declined 3%, however in the last quarter Guinness gained share as a result of increased marketing investment.

- In **Ireland,** the beer market contracted across all channels due to the weak economy, and Guinness declined 5%. However, as a result of increased investment, the brand has gained share in the last quarter.

- Net sales in **France** declined 8% in a weak trading environment and J B lost share as promotional activity by competitors increased.

- **Iberia, Greece** and **Italy** now represent 3% of Diageo s net sales after a number of years of tough trading. In these Southern European markets, volume declined 13% and net sales declined 16% as deeper austerity measures affected overall consumption and sales mix. J B and Baileys were impacted the most, declining 30% and 18%, respectively.

- Captain Morgan was the best performing brand in Western Europe with 15% net sales growth primarily in Great Britain and Germany driven by higher marketing investment. Reserve continues to show significant growth across Western Europe, with strong growth from the Malts portfolio, while Tanqueray performed well in Great Britain, Benelux, and Germany and gained share in the key gin market of Spain.

- In Western Europe, innovation plays an increasingly important role. Innovation is focused on both sustaining prior year launches, such as Captain Morgan in Germany, and The Singleton in Northern Europe, and on ensuring successful new launches in this year, such as Pimm s Limited Editions, Johnnie Walker Gold Label Reserve, and Johnnie Walker Platinum Label.

- Net sales in **Diageo Wines Europe** declined 10% in the financial year, mainly due to the lapping of very strong En Primeur sales in the previous year, and the decision to exit from some low value wines.

Business review (continued)

Performance

Key financials	2012 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2013 Reported £ million	Reported movement %
Net sales	2,331	(36)	1	(93)	2,203	(5)
Marketing spend	355	(8)	1	(20)	328	(8)
Operating profit before exceptional items	712	(12)	(1)	(49)	650	(9)
Exceptional items	43				(31)	
Operating profit	755				619	(18)

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key categories:			
Western Europe	(3)	(4)	(5)
Spirits**	(2)	(3)	(4)
Beer	(6)	(5)	(7)
Wine	(13)	(7)	(7)
Ready to drink	(13)	(8)	(9)
Global and local leaders:**			
Johnnie Walker	(2)	(1)	(3)
J B	(18)	(24)	(26)
Smirnoff	2	(1)	(2)
Captain Morgan	17	15	13
Baileys	(4)	(6)	(7)
Guinness	(5)	(3)	(4)

Restated following the adoption of IFRS 11 and the amendment to IAS 19.

* Organic equals reported movement for volume except for spirits (1)% and ready to drink (14)%

** Spirits brands excluding ready to drink

Business review (continued)

AFRICA, EASTERN EUROPE AND TURKEY

Key highlights

- **Africa, Eastern Europe and Turkey** delivered 10% net sales growth, with spirits net sales up 13% and beer net sales up 5% and therefore spirits have driven 60% of the region s net sales growth. Volume in the region was up 4% despite a challenging Africa beer market. Ready to drink net sales grew 32%, driven by Africa.

- **Nigeria** proved to be a challenging market as consumer confidence was negatively impacted by low government spending and the beer market continued to decline. Volume decreased 1%, however, net sales grew 5% as a result of 52% net sales growth in spirits and price/mix in beer. Beer volume decreased 4%, largely due to Harp and Guinness, however Diageo s beer business delivered net sales growth of 1% as the beer route to market was reinforced through investment in Guinness distribution network, and an increased sales force. Malta Guinness delivered 15% net sales growth following the introduction of Malta Guinness Low Sugar last year, price increases, and marketing investment. In spirits, Johnnie Walker net sales grew 63% and Baileys net sales were up 30%, as a result of increased distribution and marketing investment. Johnnie Walker spend was focused behind outdoor advertising, the Keep Walking campaign, and event sponsorship while Baileys increased visibility and promotions, coupled with a new bottle launch. Snapp, an apple flavoured ready to drink, targeting the female audience, performed well, benefiting from marketing support, strong distribution and launch events.

- **East Africa** delivered 10% net sales growth from 3% volume growth. Beer net sales increased by 9%, driven by beer brands in Kenya. Guinness delivered 19% net sales driven by the Made of More advertising campaign, and the Guinness Football Challenge promotion and grew margin as a result of price increases. Tusker net sales were up 13% largely because of favourable price/mix, and volume also grew due to strong marketing support through soccer sponsorships and the It s Our Time campaign. Senator beer net sales grew 9% driven by growth of Senator Keg in Kenya, and the introduction of Senator in Tanzania. There was some weakness in local spirits, however, international spirits performed particularly well with Johnnie Walker and Smirnoff delivering 22% and 24% incremental net sales, respectively. Johnnie Walker s performance was delivered through a mix of growth drivers, including building bar staff capability in premium spirits, educational whisky events for consumers, and on trade activations to promote smaller sized bottles. Key drivers of Smirnoff growth were price increase and geographic mix. Ready to drink net sales were up 48% as Smirnoff Ice and Snapp continued to grow.

- In **Africa Regional Markets** spirits growth was driven by Johnnie Walker which delivered double digit increases in net sales across all key markets. Beer net sales were driven by price increases in Ghana, Cameroon, and Seychelles. In Ghana, beer benefited from the government s tax concessions on products containing a majority of local raw materials. This helped to offset supply constraints, such as water shortages and increased energy costs. In Cameroon, growing competition from lagers and beer price increases impacted volume. Strong performance of Meta in Ethiopia contributed to total beer net sales growth. Marketing investment was focused behind Johnnie Walker in spirits as well as Ruut Extra in Ghana, Malta Guinness in Cameroon, and Meta beer.

- **South Africa** delivered a strong performance in spirits driving net sales growth of 17%. Scotch was the largest contributor following national roll out of VAT 69 and J B promotion campaigns. The expansion of the Johnnie Walker Red Label Step Up campaign and the launch of the Keep Walking campaign targeted at emerging middle class consumers drove premiumisation. As a result, Johnnie Walker net sales grew

31% and share increased. In vodka, Smirnoff maintained last year s performance trajectory and grew net sales 19%. As pricing and value are key to growth of spirits against local beer and brandy, 500ml PET packaging was launched, following the successful introduction of the 200ml PET pack last year. Smirnoff introduced new flavours, Smirnoff Iced Cake and Smirnoff Kissed Caramel.

- **Russia and Eastern Europe** delivered 16% net sales growth. Scotch contributed over half of this growth. Johnnie Walker maintained its leadership, posting its biggest share gains in Poland, Bulgaria, and Ukraine. In the standard segment, Bell s and Black&White drove volume growth recruiting emerging middle class consumers into the whisky category. Increased marketing investment was focused behind the strategic brands and innovation, which is one of the key growth drivers in the market. Captain Morgan performed strongly with net sales growth of over 30%, as did Bushmills.

- **Turkey** net sales were up 8% while volume declined 4% driven by raki category, which was impacted by excise duty increases. Yenı Raki, which remains the most recognised raki brand in Turkey, grew net sales 7% as a result of price increases and better mix. Johnnie Walker and Smirnoff grew net sales double digit and gained share. Johnnie Walker Double Black, Johnnie Walker Gold Label Reserve, Smirnoff Gold, and Cîroc were introduced to widen the range of international brands. Captain Morgan Spiced Gold was introduced to meet the opportunity in cocktail consumption occasions. Marketing investment grew 12% and supported new brand introductions, as well as Johnnie Walker and Smirnoff.

Business review (continued)

• Marketing investment in the region was up 16%, mainly driven by significant increases on spirits brands, which were up 25% in Africa, 25% in Russia and Eastern Europe, and 12% in Turkey. In Africa marketing investment in beer grew 8%.

Performance

Key financials	2012 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2013 Reported £ million	Reported movement %
Net sales	2,048	(28)	59	197	2,276	11
Marketing spend	232	(6)	3	36	265	14
Operating profit before exceptional items	574	(12)	31	60	653	14
Exceptional items	(7)				(5)	
Operating profit	567				648	14

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
Africa, Eastern Europe and Turkey	4	10	11
Africa	3	9	8
Nigeria	(1)	5	6
East Africa	3	10	13
Africa Regional Markets	(1)	9	7
South Africa	14	17	4
Russia and Eastern Europe	14	16	14
Turkey	(4)	8	22
Spirits**	8	13	14
Beer	(1)	5	6
Ready to drink	27	32	28
Global and local leaders:**			
Johnnie Walker	22	22	19
J B	5	4	
Smirnoff	8	19	11
Captain Morgan	17	19	12
Baileys	13	13	11
Guinness	(2)	2	1

Restated following the adoption of IFRS 11 and the amendment to IAS 19.

* Organic equals reported movement for volume except for: Africa, Eastern Europe and Turkey 7%, Africa 5%, Africa Regional Markets 5%, Turkey 9%, spirits 11%, beer 1%, reflecting the acquisition of Meta Abo and Mey İçki.

** Spirits brands excluding ready to drink.

Business review (continued)

LATIN AMERICA AND CARIBBEAN

Key highlights

- Performance in **Paraguay, Uruguay** and **Brazil** (PUB) has been impacted by a slowdown in beverage alcohol in Brazil and declines in duty free in Paraguay and Uruguay. In Brazil, the government has made changes which have long term social benefits, including the elimination of some tax incentives and increased enforcement of inter-state taxes which led to destocking in the wholesale channel, stricter enforcement of drink driving laws, and the closure of outlets due to the introduction of nightclub safety guidelines which impacted the on trade. In addition, Diageo has begun to implement a dedicated distributor model, which will reduce stock levels held by the distributors. The realignment of distributors will continue into the next financial year which will also negatively impact sales. The distributor realignment led to improved distribution with an increase in the size of the sales teams now focused on Diageo s brands. As a result, Diageo s scotch brands outperformed the category gaining 3.5ppts of share. In standard scotch, White Horse performed strongly and in the premium segment, Old Parr grew over 20%. In vodka, Diageo lost share to local competitors, however Smirnoff remains the category leader in Brazil.

- Performance in the **Andean** market was driven primarily by Venezuela where net sales increased 54% despite the political and economic instability which impacted the availability of local brands, due to production delays, and the restricted availability of imported products. Scotch delivered over 75% of Venezuela s growth mainly in the premium segment while double digit net sales growth in rum, vodka, and gin also contributed. Three brands, Old Parr, Buchanan s and Cacique delivered over two thirds of the net sales increase, growing 55%, 60%, and 49%, respectively. Gordon s Flavours, the first locally-produced gin flavour, performed well. The price of imported brands increased by 80% to reflect the devaluation and high inflation. Local products increased 20%. Despite these price increases, Diageo maintained its leading position in Venezuela, with a 57% share in scotch, 50% in rum, and 26% in imported vodka.

- Diageo again delivered a strong performance in **Mexico** with volume up 14% and net sales up 18%. Diageo s strategy in Mexico is to grow the scotch category where Diageo is the clear leader, drive premiumisation, and widen the reach to middle class consumers by expanding the portfolio through innovation and through increasing use of on trade platforms and customer partnerships. Diageo s scotch brands grew 18% as Johnnie Walker Red Label grew share in standard scotch and Johnnie Walker Black Label gained share in premium scotch following the successful Keep Walking Mexico campaign. Innovations were a key contributor to the strong performance. Buchanan s Master was focused on enhancing leadership in premium scotch. Captain Morgan expanded the reach to middle class consumers and Zacapa built Diageo s position in rum. Implementation of an in-store execution programme has increased share of shelf and display and the launch of a successful strategic partnership programme with key wholesalers improved sales capabilities and contributed to the strong growth.

- **WestLAC** is Diageo s biggest market in the region and growth was driven by the strong performance of scotch with a 17% net sales increase. Premium scotch, particularly Old Parr and Johnnie Walker Black Label, led the trend with 35% and 25% increases in net sales, respectively. The new Morning Keep Walking campaign was launched with strong television communications throughout the region. Additionally, the House of Walker Mentor programme was introduced and together with scotch festival activations drove the Johnnie Walker brand performance. In **Argentina**, government restriction on imports resulted in low single digit top line growth during the year.

Performance

Key financials	2012 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2013 Reported £ million	Reported movement %
Net sales	1,236	(26)	62	181	1,453	18
Marketing spend	208	(5)	8	22	233	12
Operating profit before exceptional items	368	(4)	9	95	468	27
Exceptional items	(2)					
Operating profit	366				468	28

Business review (continued)

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
Latin America and Caribbean	4	15	18
PUB	1	1	10
Andean	7	39	41
Mexico	14	18	21
WestLAC	2	12	10
Spirits**	4	17	21
Beer	1	5	2
Wine	(5)	4	(5)
Ready to drink	(6)		(4)
Global and local leaders:**			
Johnnie Walker	6	11	9
Buchanan s	10	26	27
Smirnoff	(3)	3	(6)
Baileys	(8)	(1)	(1)

Restated following the adoption of IFRS 11 and the amendment to IAS 19.

* Organic equals reported movement for volume except for: Latin America and Caribbean 35%, PUB 95%, spirits 39% reflecting the acquisition of Ypióca; Andean 9%, beer 4%, and ready to drink 0% reflecting the restatements in the year.

** Spirits brands excluding ready to drink

ASIA PACIFIC

Key highlights

- **South East Asia** continued to deliver strong double digit net sales growth with 6% volume growth and 11ppts of positive price/mix. Johnnie Walker delivered a strong performance across all markets contributing more than 60% of the top line growth. Performance was particularly strong in Thailand from both Johnnie Walker Red Label and Johnnie Walker Black Label and grew net sales 17%, gaining a further 1ppt of share. Guinness grew volume 12% and net sales 25%. Growth was particularly strong in Indonesia with 19% net sales growth on the back of successful marketing activities such as Guinness Live Music , where consumers were offered the opportunity to vote for the best local band to represent Indonesia in the global Guinness Arthur s Day celebration in Dublin.

- **Greater China** delivered a solid performance, with volume up 1% and net sales up 8% despite a difficult trading environment, and continued share gains across all markets. Diageo s China hub, which includes China, Hong Kong and Macau, grew net sales 7% with 8ppts of positive price/mix largely due to a successful premiumisation strategy. Despite a slowdown in China in the second half, as a result of the anti-extravagance campaign launched by the government in China, net sales in the super and ultra premium segments grew 44% driven by Johnnie Walker and Windsor and share increased by 5ppts in China. Baileys net sales grew 30% and the Baileys Sisterhood campaign was launched in Shanghai, leveraging an existing local Sisterhood Day festival to create an off peak gifting occasion. In **Taiwan** net sales grew 10% with 5ppts of positive price/mix. The strong momentum of The Singleton continued and with 37% net sales increase was the fastest growing single malt brand in the category, gaining 2ppts of share. In the super premium segment Johnnie Walker Premier grew net sales 17% while Johnnie Walker XR 21 drove the 41% net sales growth in ultra premium.

- **India** s net sales declined 2% and volume 5% as stock in trade was reduced in the first quarter. Diageo s scotch brands grew net sales 3% helped by an increased investment behind VAT 69 and Black&White which delivered strong net sales and volume growth and led to a 4ppts increase in the total Diageo scotch share. In a declining vodka category, Smirnoff gained 0.5ppt of share and grew net sales 1% with a volume decline of 6%. The high stock in trade in the first quarter was the main driver for the 5% decline of Johnnie Walker s net sales. Despite these uncertainties depletions growth for Johnnie Walker Black Label and Johnnie Walker Red Label was robust in the second half of the year.

- **Global Travel Asia & Middle East** net sales declined 2%, mainly driven by the Asia duty free business where net sales declined 15% with destocking among key customers. Political tension between North and South Korea negatively impacted passenger trends in South Korea, the largest Johnnie Walker Blue Label market in travel retail and contributed to net sales declining 14% for the variant. A strong performance from Cîroc and Ketel One vodka was unable to offset a decline in Smirnoff which resulted in a decline of the vodka category of 1%. Austerity measures implemented by the Chinese government led to a 33% net sales decline of Shui Jing Fang in duty free. Middle East grew net sales 10%. The scotch category delivered 15% net sales growth as Johnnie Walker Black Label and the expanded distribution of Johnnie Walker Double Black helped to deliver a combined net sales growth of 18% in the important premium segment. Successful launches of Johnnie Walker XR 21, John Walker & Sons Odyssey and the Johnnie Walker Explorers Club Collection contributed to strengthen Diageo position in the ultra premium segment which grew net sales 28%.

Business review (continued)

- **Australia** grew net sales 3% despite a volume decline of 4% mainly due to price increases across the core brands and a focus on premiumisation. The ultra premium segment grew 22% overall with Cîroc and Ketel One vodka growing net sales 91% and 22%, respectively. Net sales growth of 8% was delivered in scotch, mainly driven by Dimple and Johnnie Walker Blue Label. Despite a volume decrease of 12% Smirnoff grew net sales 7% on the back of price increases. Increased marketing investment behind Gordon s and Tanqueray delivered solid growth in the gin category contributing 22% to the overall growth. Innovation launches of Bundaberg Select VAT and Master Distillers Collection continued to play a key role in premiumising the Bundaberg brand and contributing to 1% net sales growth. Within the rum category Captain Morgan delivered excellent results growing net sales 85% by capitalising on the increasing popularity of spiced rums. Ready to drink volume and net sales decreased 7% and 1% respectively due to price increases taken during the year. The higher duty compared to beer and cider continued to hinder the category and the launch of new variants with lower ABV helped to soften the decline. Diageo Australia remains the category leader in scotch gaining a further 1.9ppts share during the year.

- **North Asia** performance was impacted by the contraction of the traditional on trade channel in Korea resulting in an overall 11% net sales decline. While performance improved in the second half, net sales in Korea decreased 17% with Windsor losing 3ppts of share due to price increases that were not immediately followed in the market. J B, Guinness and Smirnoff grew net sales 30%. Japan grew net sales 5% boosted by Johnnie Walker, which grew 34% helped by the introduction of new variants such as Johnnie Walker Platinum Label, Johnnie Walker Gold Label Reserve, and Smirnoff Ice, which led the strong performance of the growing category of ready to drink.

- Marketing investment in the region decreased 1% mostly driven by a reduction in spend in Korea. Marketing on reserve brands increased 35% to drive premiumisation and it now accounts for nearly 30% of the marketing investment in the region. In China marketing activities such as Johnnie Walker s Blue Label 360 Tiger aimed at highlighting brand rarity and the John Walker & Sons Odyssey launch on the Voyager yacht contributed to the net sales increase in the ultra premium segment. In the faster growing markets such as Southeast Asia, investment behind Johnnie Walker grew 18% led by successful experiential marketing campaigns such as Blacklist and REDrevolution in Thailand, which saw Johnnie Walker Red Label sponsor the biggest music event in the country.

Performance

Key financials	2012 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2013 Reported £ million	Reported movement %
Net sales	1,407	4	116	45	1,572	12
Marketing spend	327	5	27	(3)	356	9
Operating profit before exceptional items	309	11	40	21	381	23
Exceptional items	(10)				(1)	
Operating profit	299				380	27

Business review (continued)

	Organic volume movement* %	Organic net sales movement %	Reported net sales movement %
Key markets and categories:			
Asia Pacific	(1)	3	12
South East Asia	6	18	17
Greater China	1	8	75
India	(5)	(2)	(7)
Global Travel Asia and Middle East	(1)	(2)	(2)
Australia hub	(4)	3	4
North Asia	(9)	(11)	(11)
Spirits**	(1)	3	14
Beer	8	16	12
Ready to drink	(4)	2	2
Global and local leaders:**			
Johnnie Walker	4	8	8
Windsor	(20)	(21)	(19)
Smirnoff	(8)	4	3
Baileys	3	8	9
Guinness	8	17	13

Restated following the adoption of IFRS 11 and the amendment to IAS 19.

* Organic equals reported movement for volume except for Asia Pacific 2%, Greater China 30% and spirits 1% due to the Shuijingfang acquisition and Australia (3)% due to the termination of the distribution contract for Jose Cuervo.

** Spirits brands excluding ready to drink

Business review (continued)

3. CATEGORY REVIEW

Key markets and categories:	Organic volume* movement %	Organic net sales movement %	Reported net sales movement %
Spirits **	2	7	9
Whisk(e)y	5	10	9
Johnnie Walker	7	10	10
Crown Royal	14	17	17
J B	(12)	(15)	(17)
Buchanan s	11	25	26
Windsor	(20)	(21)	(19)
Bushmills	11	12	12
Vodka		5	5
Smirnoff	1	4	3
Ketel One vodka	5	8	8
Cîroc	5	8	8
Rum	1	5	5
Captain Morgan	5	7	7
Liqueurs	(1)	2	
Baileys		2	1
Tequila	11	13	7
Gin	3	8	7
Tanqueray	8	12	12
Beer	(2)	2	1
Guinness	(2)	1	
Wine	(9)		
Ready to drink	(3)		(3)
Total	1	5	6

* Organic equals reported movement for volume except for total 5%, spirits 7%, beer (1)%, wine (8)%, ready to drink (4)%, vodka 1%, tequila 6%, reflecting the Mey İçki, Meta Abo, Ypióca and Shuijingfang acquisitions and the Jose Cuervo and North American wine disposal

** Spirits brands excluding ready to drink

Spirits represent 68% of Diageo s net sales, and generated 98% of the total net sales growth in the year.

Whisk(e)y represents 37% of Diageo s total net sales and was up 10%, contributing 69% of total net sales growth. Emerging markets contributed over half of total whiskey net sales. Scotch led whiskey growth, with net sales up 9% and volume up 4% driven by premium and super premium brands in faster growing markets.

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Business review (continued)

- **Johnnie Walker** is now a 20 million 9 litre case brand, growing over 1 million cases this year. The emerging markets accounted for 80% of the total net sales growth. In developed markets, Johnnie Walker grew net sales by 14% in the United States, while the economic challenges in Southern Europe continued to impact the brand s commercial performance in Western Europe. From a variant perspective, the brand s performance is driven by premium and super premium variants, namely Johnnie Walker Black Label, the roll out of Johnnie Walker Platinum Label and Johnnie Walker Gold Label Reserve. Innovation continues to be a key driver of growth. Johnnie Walker Double Black is now sold in over 100 markets. The launches of John Walker & Sons Odyssey and the Johnnie Walker Explorers Club Collection have received a strong positive response from customers and consumers. Johnnie Walker Red Label had strong momentum with 8% net sales growth, as Africa continued to deliver strong performance for the brand on the back of investment and expanded distribution.

- **Crown Royal** net sales grew 17% driven by strong performance in its primary market, North America. Crown Royal Deluxe, Crown Royal Black, and Crown Royal Maple Finished, which was launched in the first half, all grew strongly. Increased marketing investment of 8% was directed to the new Reign On consumer recruitment campaign, with significant media support across North America. In Canada, Crown Royal is growing share as it outpaces the Canadian whiskey category.

- **J B** net sales declined 15% due to J B s exposure to Southern Europe and the excise duty increases in France. J B delivered 13% net sales growth in South Africa, the brand s third biggest market, with a strong on trade promotional programme.

- **Buchanan s** again delivered very strong growth, with volume up 11% and net sales up 25% led by the Latin American markets. In North America it also delivered a strong performance, with volume up 13% targeting Latin American consumers. In Latin America and Caribbean Buchanan s delivered 26% net sales growth; Venezuela and Mexico drove this performance through the new Share Yourself campaign. Another growth driver was Buchanan s Master, which became the second largest scotch in Venezuela and Mexico. Buchanan s Special Reserve led the super premium segment in these key markets.

- **Windsor** declined double digit both by volume and net sales due to the downturn in the traditional on trade channel in Korea. This was driven by a change in business entertainment activities, growing consumer concerns over health and wellbeing, and stronger local regulation of the whisky industry. Windsor has recovered share from the first half decline and remains the leading scotch whisky in Korea.

- **Bushmills** grew volume 11% and net sales 12%. The brand grew in all regions with a particularly strong performance in Russia and Eastern Europe, growing 36%. The growth was driven by global and local Bushmills Live marketing events and expanded distribution. Western Europe continues to deliver single digit growth in a tough economic environment.

- **Malts** performed strongly, delivering 17% of net sales growth. Talisker and The Singleton grew net sales 30% and 36%, respectively with the launch of Talisker Storm and marketing investment in the impactful Singleton Sensorium campaign.

Vodka delivered net sales growth of 5% and constitutes 13% of total Diageo net sales. North America, Diageo s largest vodka market, remained flat by volume with net sales up 5%. Category performance was again driven by super and ultra premium variants, with Cîroc and Ketel One vodka leading the growth.

- **Smirnoff** net sales grew 4% building on last year s strength. In North America, Smirnoff net sales were up 5%, driven by the United States, the largest Smirnoff market, which delivered 6% net sales growth. Strong innovation launches including Smirnoff Confectionery and Smirnoff Sorbet Light flavours added to the Smirnoff brand performance, which was sustained by marketing investment. In Western Europe, performance was mixed by market. In Great Britain, Smirnoff benefited from Smirnoff s World s Best Drinks programme. However, this was offset by destocking. Ireland remains tough due to the economic environment, and in Germany, Smirnoff gained share. In emerging markets, Smirnoff led the establishment of the vodka category with strong double digit net sales growth in South Africa, Kenya and Ghana. In Latin America and Caribbean, the brand was affected in Brazil by the economic slowdown, however, this was offset by strong performance in other Latin American countries. In Asia Pacific, the brand also performed well in new vodka markets, particularly in Korea, Thailand, Indonesia and Japan.

- **Ketel One vodka** had another good year, growing both net sales and volume on the back of continued strong performance in North America driven by pricing. The brand delivered double digit growth outside the United States as distribution was expanded to over 70 markets across the world.

- **Cîroc** sells over 2 million 9 litre cases. In the United States growth was driven by Cîroc s base variant and the continued success of Cîroc Peach, the largest revenue generating innovation in the United States. Cîroc marketing investment increased double digit. Outside of the Unites States, Cîroc grew strongly especially in Western Europe, Brazil, and in Global Travel Retail.

Business review (continued)

Rum grew 5%, with strong performances from Captain Morgan and Zacapa, and constitutes 6% of total Diageo net sales.

- **Captain Morgan** grew net sales 7% with sales volume reaching 10 million cases this year. The To Life, Love and Loot campaign in the United States continued with new creative executions, featuring the legendary Captain Henry Morgan. The brand also grew strongly in its newer markets of Western Europe, Eastern Europe, and Mexico, where the proven Keys to Adventure experiential events and Captain Morgan Starts the Party campaign, have continued to be key growth drivers.

- **Zacapa** delivered net sales growth in North America and Western Europe. In emerging markets, the brand grew net sales double digit, driving the super premium and the ultra premium segments of the rum category. Key growth drivers for the brand were sampling, PR and consumer experiences along with bartender programmes such as Diageo Reserve World Class.

Liqueurs, which represent 5% of Diageo net sales, grew 2% driven by growth in Baileys.

- **Baileys** delivered 2% net sales growth. This was driven by a global re-launch, supported by the new Cream with spirit campaign, and the new pack, and retail design. In the United States, which accounts for more than a quarter of the brand s net sales, Baileys performed strongly with 9% net sales growth driven by the new advertising campaign and the launch of Baileys Hazelnut. In Western Europe Baileys declined 6%, driven by Great Britain, and Southern Europe; Germany and Austria, and Ireland performed well and grew net sales 10% and 9%, respectively. Baileys continues its growth trajectory in emerging markets, with double digit net sales growth in Russia, Africa and China.

Tequila, **Don Julio**, grew net sales 13% and volume 11%. In its primary market, North America, the brand maintained favourable price/mix and grew share. The performance was driven by increased investment in mentorship programmes, experiential sampling in the on trade, public relations, and above the line advertising. Outside North America, Don Julio continued to deliver strong double digit net sales growth, especially in Asia Pacific, and Africa, Eastern Europe and Turkey. In these markets, the brand was driven by experiential consumer events. In Canada, Western Europe, and Latin America, the key growth drivers were improved visibility, mentorship and sampling programmes in the on trade, as well as strong execution of Don Julio in Diageo Reserve World Class.

Gin grew net sales 8% and constitutes 3% of Diageo total net sales.

- **Tanqueray** net sales increased 12%, with strong growth across all regions, driven by the performance in the United States and continued growth in Western Europe. In the Unites States, Tanqueray returned to growth as the advertising campaign Tonight We Tanqueray was amplified. Increased marketing investment, combined with commercial focus and execution drove strong brand awareness and sales. An educational experience for bartenders was activated in 30 markets this financial year. Outside the United States Tonight We Tanqueray campaign was rolled out supported by increased investment.

- **Gordon s** grew net sales 5% globally driven by growth in the emerging markets of Eastern Europe, Turkey, Latin America and Caribbean, and in South East Asia.

Beer represents 20% of Diageo net sales and delivered 2% net sales growth driven by emerging markets, which grew net sales 7%. Volume declined 2%, principally in Western Europe.

- **Guinness** net sales increased 1% while volume declined 2%. Africa, the largest Guinness market by volume, delivered net sales growth of 2%, despite tough economic conditions in a number of African countries. In Western Europe, net sales were down 3% driven by the beer market decline and economic uncertainty. In Asia Pacific, Guinness delivered double digit growth, primarily in Indonesia, due to a combination of marketing, pricing, and strong commercial activations. Marketing investment was focused behind the Made of More campaign in Western Europe and Africa, consumer participation programmes related to the Arthur s Day celebration in Dublin, rugby and football communication platforms, and the official broadcast partnership with the English Premier League in Africa.

Wine net sales represent 4% of Diageo s net sales and were flat following a decline of 7% of net sales in Western Europe and growth of 4% in North America.

Ready to drink represents 6% of Diageo net sales, and were flat. 10% net sales decline in North America was offset by strong net sales growth in Africa, which was driven by innovations: Smirnoff Black Ice in Cameroon, Smirnoff Double Black & Guarana in South Africa, and Snapp in Kenya and Nigeria.

Business review (continued)

Liquidity and capital resources

As at 1 July 2013 the group adopted a number of new standards and amendments and the application of *IFRS11 - Joint arrangements* and the amendment to *IAS19 - Employee benefits* resulted in a restatement of comparative figures. The impact on the group s consolidated statement of comprehensive income and net cash flow for the years ended 30 June 2013 and 30 June 2012, and net assets as at 30 June 2013 and 30 June 2012 is provided in note 18 to the consolidated financial statements on pages 202 and 203.

1. ANALYSIS OF CASH FLOW AND BALANCE SHEET

The primary source of the group s liquidity over the last three financial years has been cash generated from operations. These funds have generally been used to pay interest, taxes and dividends, and to fund capital expenditure and acquisitions.

a) 2014 compared with 2013

Movement in net borrowings see page 48

Movement in equity see page 49

Post employment deficit see page 49

b) 2013 compared with 2012

Movement in net borrowings

	2013 (restated) £ million	2012 (restated) £ million
Net borrowings at the beginning of the year	**(7,573)**	(6,480)

Free cash flow (a)	**1,452**	1,657
Sale of businesses	**(16)**	51
Acquisition of businesses (b)	**(644)**	(1,420)
Proceeds from issue of share capital		1
Net purchase of own shares for share schemes (c)	**(11)**	
Dividends paid to non-controlling interests	**(100)**	(101)
Proceeds from non-controlling interests		11
Purchase of shares of non-controlling interests (d)	**(200)**	(155)
Net increase in bonds (e)	**1,231**	377
Net movements on other borrowings	**7**	115
Equity dividends paid	**(1,125)**	(1,036)
Net increase/(decrease) in cash and cash equivalents	**594**	(500)
Net increase in bonds and other borrowings	**(1,238)**	(492)
Exchange differences	**(116)**	152
Borrowings acquired through purchase of businesses		(5)
Other non-cash items (f)	**(70)**	(248)
Net borrowings at the end of the year	**(8,403)**	(7,573)

(a) Free cash flow decreased from £1,657 million in the year ended 30 June 2012 to £1,452 million in the year ended 30 June 2013 principally as a result of a one off £400 million payment to the Diageo UK Pension Scheme, higher net interest and tax payments and increased net purchase of tangible fixed assets and computer software. This is partially offset by the higher operating profit and increased dividends received from Moët Hennessy. The increase in net interest paid is driven by the impact of the renegotiation of the terms of certain interest rate swaps in the prior year while higher tax payments are a result of increased profits and tax settlements paid during the year. The net purchase of tangible fixed assets and computer software increased from £438 million in the year ended 30 June 2012 to £597 million in the year ended 30 June 2013. The expenditure was incurred on a number of projects throughout the world with the largest investments made to increase capacity and to improve efficiencies in operations in Africa, Ireland, Scotland and North America.

Free cash flow is stated after exceptional restructuring costs of £61 million (2012 - £158 million).

(b) In the year ended 30 June 2013 the group incurred expenditure of £660 million on acquisitions and disposals including £284 million on purchasing 100% of the equity share capital of Ypióca and £274 million on acquiring 10% equity interest in United Spirits Limited. In the year ended 30 June 2012 the group spent £1,420 million in connection with business acquisitions. This included the acquisition of 100% of the equity share capital of Mey İçki (£1,260 million) and Meta Abo Brewery (£145 million) and a 50% controlling equity stake in Zacapa (£118 million). In May 2012 Diageo received back the deposit of $185 million relating to the acquisition of Shuijingfang from China s securities depositary and clearing agency.

Business review (continued)

(c) Net purchase of own shares for share schemes included £143 million (2012 £119 million) to purchase treasury shares for the future settlement of obligations under the employee share option schemes. These purchases were partially offset by consideration received from employees on the exercise of share options of £132 million (2012 £119 million).

(d) Purchase of a non-controlling interest of £200 million in respect of an additional 40% equity stake in SJF Holdco (2012 £155 million primarily in respect of Kenya Breweries).

(e) In the year ended 30 June 2013, the group repaid bonds of $750 million (£475 million) and $600 million (£394 million). The group borrowed $3,250 million (£2,100 million), consisting of $750 million (£485 million) of 0.625% bonds due April 2016, $650 million (£420 million) of 1.125% bonds due April 2018, $1,350 million (£872 million) of 2.625% bonds due April 2023 and $500 million (£323 million) of 3.875% bonds due April 2043. On 1 July 2013 the group repaid bonds of 1,150 million (£983 million) as scheduled.

In the year ended 30 June 2012, the group repaid bonds of $900 million (£566 million) and 750 million (£605 million). The group borrowed $2,500 million (£1,548 million), consisting of $1,000 million of 1.5% bonds due May 2017, $1,000 million of 2.875% bonds due May 2022, and $500 million of 4.25% bonds due May 2042.

(f) Adverse non-cash movements of £70 million (2012 £248 million) predominantly comprise new finance leases.

Movement in equity

At 30 June 2013 total equity was £8,088 million compared with £6,792 million at 30 June 2012. The increase was mainly due to the profit for the year of £2,550 million, partly offset by the dividend paid out of shareholders equity of £1,225 million.

Post employment deficit

The deficit in respect of post employment plans before taxation decreased by £535 million from £1,076 million at 30 June 2012 to £541 million at 30 June 2013 primarily as a result of the one off cash contribution of £400 million into the Diageo UK Pension Scheme. In addition, an increase in the market value of plan assets was partially offset by a decrease in the discount rates used to calculate the liabilities of the Irish plans and an increase in the inflation assumptions in the United Kingdom. Cash contributions to the group s UK and Irish post employment plans in the year ended 30 June 2013 were £529 million (2012 £131 million).

2. ANALYSIS OF BORROWINGS

a) Gross borrowings (excluding finance lease liabilities and fair value of derivative instruments) at 30 June 2014 are expected to mature as follows:

	2014 £ million	2013 (restated) £ million	2012 (restated) £ million
Within one year	**1,576**	1,852	1,219
Between one and three years	**1,894**	2,220	2,635
Between three and five years	**1,972**	2,509	1,516
Beyond five years	**3,772**	3,488	3,233
	9,214	10,069	8,603

b) During the year ended 30 June 2014 the following bonds were issued and repaid:

	2014 £ million	2013 £ million	2012 £ million
Issued			
denominated	**1,378**		
US$ denominated		2,100	1,548
Repaid			
denominated	**(983)**		(605)
US$ denominated	**(488)**	(869)	(566)
	(93)	1,231	377

Business review (continued)

c) The group had available undrawn committed bank facilities as follows:

	2014	2013
	£ million	£ million
Expiring within one year*	**1,535**	
Expiring between one and two years	**632**	411
Expiring after two years	**1,050**	1,891
	3,217	2,302

* Of the facilities at 30 June 2014 $2,000 million (£1,170 million) was not drawn down and was cancelled on 2 July 2014.

Other than the committed facility relating to the purchase of further investment in USL, these facilities can be used for general corporate purposes and, together with cash and cash equivalents, support the group s commercial paper programmes.

There are no financial covenants on the group s material short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges.

The committed bank facilities are subject to a single financial covenant, being minimum interest cover ratio of two times (defined as the ratio of operating profit before exceptional items, aggregated with share of after tax results of associates and joint ventures, to net interest). They are also subject to pari passu ranking and negative pledge covenants.

Any non-compliance with covenants underlying Diageo s financing arrangements could, if not waived, constitute an event of default with respect to any such arrangements, and any non-compliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain borrowings and the inability to access committed facilities. Diageo was in full compliance with its financial, pari passu ranking and negative pledge covenants throughout each of the years presented.

3. CAPITAL MANAGEMENT

The group s management is committed to enhancing shareholder value in the long term, both by investing in the businesses and brands so as to deliver continued improvement in the return from those investments and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels. This is achieved by targeting a net borrowing to EBITDA leverage of 2.5 3.0x, this range for Diageo being currently broadly consistent with an A band credit rating. Diageo would consider operating outside of this range in order to effect strategic initiatives within its stated goals, which could have an impact on its rating. If Diageo s leverage was to be negatively impacted by the financing of an acquisition, it would seek over time to return to the range of 2.5 3.0x. The group regularly assesses its debt and equity capital levels against its stated policy for capital structure. For this calculation net borrowings is adjusted by the pension deficit whilst EBITDA equals operating profit less exceptional operating items and depreciation, amortisation and impairment and includes share of after tax results of associates and joint ventures.

4. CAPITAL REPAYMENTS

Authorisation was given by shareholders on 19 September 2013 to purchase a maximum of 251,039,000 shares at a minimum price of 28101/108 pence and a maximum price of the higher of (a) 105% of the average of the middle market quotations for an ordinary share for the five preceding business days and (b) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange at the time the purchase is carried out. The programme expires at the conclusion of the next Annual General Meeting or on 18 December 2014, if earlier.

During the year ended 30 June 2014, the company purchased 14 million ordinary shares (including shares acquired through call option exercises), nominal value of £4 million (2013 8 million ordinary shares, nominal value of £2 million; 2012 9 million ordinary shares, nominal value of £3 million), representing approximately 0.5% (2013 0.3%; 2012 0.4%) of the issued ordinary share capital (excluding treasury shares).

Shares were either directly granted to employees as part of employee share schemes or held as treasury shares and used to hedge share scheme grants to employees during the course of the year.

Business review (continued)

The monthly breakdown of shares purchased and the average price paid per share (excluding expenses) for the year ended 30 June 2014 were as follows:

Calendar month	Number of shares purchased	Average price paid pence	Authorised purchases unutilised at month end
September 2013**	**3,809,995**	**1997**	**247,229,005**
October 2013	**2,511,772**	**1951**	**244,717,233**
January 2014	**416,298**	**1789**	**244,300,935**
February 2014	**414,358**	**1823**	**243,886,577**
March 2014	**538,301**	**1813**	**243,348,276**
Total*	**7,690,724**	**1949**	**243,348,276**

*In addition, the company exercised call options to acquire 6,797,642 shares at an average price of 953 pence during the course of the year.

**Including 621,767 shares purchased at an average price of 1998 pence for the purpose of satisfying share awards made under the company s share incentive plan.

Contractual obligations and other commitments

					Payments due by period
As at 30 June 2014	Less than 1 year £ million	1-3 years £ million	3-5 years £ million	More than 5 years £ million	Total £ million
Long term debt obligations	1,286	1,891	1,905	3,806	**8,888**
Interest obligations	349	482	345	1,522	**2,698**
Credit support obligations	59				**59**
Operating leases	102	139	93	223	**557**
Purchase obligations	954	931	671	357	**2,913**
Capital commitments	155	7			**162**
Finance leases	47	84	67	181	**379**
Deferred consideration payable	3	149			**152**
Post employment benefits*	48	95	95	305	**543**
Provisions and other non-current payables	172	167	42	135	**516**
	3,175	**3,945**	**3,218**	**6,529**	**16,867**

* For further information see note 13 (a) of the consolidated financial statements.

Long term debt obligations comprise the principal amount of borrowings (excluding foreign currency swaps) with an original maturity of greater than one year. Interest obligations comprise interest payable on these borrowings. Credit support obligations represent liabilities to counterparty banks in respect of cash received as collateral under credit support agreements. Purchase obligations include various long term purchase contracts entered into for the supply of certain raw materials, principally bulk whisky, grapes, cereals, cans and glass bottles. The contracts are used to guarantee supply of raw materials over the long term and to enable more accurate predictions of future costs. Provisions and other non-current payables exclude £4 million in respect of vacant properties.

Potential income tax exposures included within corporate tax payable of £197 million and deferred tax liabilities are not included in the table above, as the ultimate timing of settlement cannot be reasonably estimated.

Management believe that it has sufficient funding for its working capital requirements.

Post employment contractual obligations comprise the committed deficit contributions and exclude service cost contributions.

Post balance sheet events

On 2 July 2014, with the completion of the tender offer the group acquired an additional 26% investment in USL for INR 114.5 billion (£1,118 million) taking its investment to 54.78% (excluding 2.38% owned by the USL Benefit Trust) financed by debt. From 2 July 2014 the group will account for USL as a subsidiary with a 43.9% non-controlling interests. As a result of USL becoming a subsidiary of the group a gain of £103 million arose, being the difference between the book value of the associate balance prior to the transaction and the market value. This will be reported as a non-operating exceptional gain in the consolidated accounts in the year ending 30 June 2015.

Business review (continued)

Off-balance sheet arrangements

Neither Diageo plc nor any member of the Diageo group has any off-balance sheet financing arrangements that currently have or are reasonably likely to have a material future effect on the group s financial condition, changes in financial condition, results of operations, liquidity, capital expenditure or capital resources.

Risk management

The group s funding, liquidity and exposure to foreign currency, interest rate risks, financial credit risk and commodity price risk are conducted within a framework of board approved policies and guidelines. The group purchases insurance for commercial or, where required, for legal or contractual reasons. In addition, the group retains some insurable risk where external insurance is not considered to be an economic means of mitigating this risk. Loan, trade and other receivables exposures are managed locally in the operating units where they arise and credit limits are established as deemed appropriate for the customer.

For a detailed analysis of the group s exposure to foreign exchange, interest rate, commodity price, credit and liquidity risks see note 15 to the consolidated financial statements on pages 189-195.

Critical accounting policies

The consolidated financial statements are prepared in accordance with IFRS. Diageo s accounting policies are set out in the notes to the consolidated financial statements. In applying these policies, the directors are required to make estimates and subjective judgements that may affect the reported amounts of assets and liabilities at the balance sheet date and reported profit for the year. The directors base these on a combination of past experience and any other evidence that is relevant to the particular circumstance. The actual outcome could differ from those estimates. Of Diageo s accounting policies, the directors consider that policies in relation to the following areas are particularly subject to estimates and the exercise of judgement.

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgements, are set out in detail in the relevant notes:

- *Exceptional items page 164*
- *Taxation page 169*

- *Business combinations   page 173*
- *Brands, goodwill and other intangibles   page 175*
- *Post employment benefits   page 181*
- *Contingent liabilities and legal proceedings   page 203*

New accounting standards

A number of accounting standards, amendments and interpretations have recently been issued by the IASB or IFRIC. Those that are of relevance to the group are discussed in note 1 to the consolidated financial statements on pages 156 and 157.

SUSTAINABILITY & RESPONSIBILITY REVIEW

1. ALCOHOL IN SOCIETY

PERFORMANCE AGAINST 2015 TARGETS

Responsible drinking programmes

373* (vs 315 in 2013)

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* We are moving towards a new metric in future years that will demonstrate the impact of our programmes on awareness, attitudes or behaviour.

This year we made good progress in implementing the landmark Global Beer, Wine and Spirits Producers Commitments to Reduce Harmful Drinking, as well as our broader goals to support effective programmes that tackle alcohol misuse; communicate about alcohol responsibly; and advocate effective, evidence-based policy.

The Global Beer, Wine and Spirits Producers Commitments

The first annual report on progress against the Commitments was published in July 2014. The report concludes that signatory companies made good progress, but that more remains to be done. The first year was used to establish benchmarks, set key performance indicators and create resources for future work. These building blocks will inform, strengthen and accelerate future efforts. The following are highlights included in the report:

• Producers supported 135 education programmes aimed at preventing and reducing underage drinking which together reached nearly one million young people under the legal purchase age, and more than 500,000 parents, teachers, and community leaders

• An analysis in seven countries found more than 96% of producer advertising is compliant with the 70/30 rule under which advertising is placed in media where at least 70% of the audience is of legal drinking age

• Producers developed guiding principles for responsible digital marketing, which are now under public stakeholder review

The report, which was independently assured, can be found on www.producerscommitments.org. Information about Diageo s performance can be found on our website.

Tackling alcohol misuse

We will continue to work with others to implement programmes that tackle misuse in ways that go beyond these Commitments. The choice of programme in each market reflects local stakeholder concerns but our focus is always on initiatives that can be shown to shift awareness, attitudes and behaviour.

This year, Diageo supported 373 programmes, including Commitments programmes in 53 countries, many of which have been evaluated to show measurable effects on awareness, attitudes and behaviour. Our sponsorship of the McLaren Mercedes F1 team continues to give Diageo a stylish and impactful platform to speak credibly about the importance of staying in control while driving. Johnnie Walker s Join the Pact campaign has a goal to give one million kilometres of safe rides home to consumers across the globe who have pledged never to drink and drive. So far it has given about 423,025 rides, representing around 265,491 kilometres.

Complaints about advertising upheld by industry bodies that report publicly (2014)		**Industry complaints upheld**	**Complaints about Diageo brands**
Australia	Alcohol Beverage Code	3	
Ireland	Advertising Standards Authority for Ireland (ASAI)	3	
United Kingdom	The Portman Group	8	
	Advertising Standards Authority (ASA)	38	1
United States	Distilled Spirits Council of the United States (DISCUS)	3	

Communicating about alcohol responsibly

Five industry bodies publicly report breaches of their self-regulatory codes. The industry bodies that monitor these self-regulatory codes do not impose fines; nevertheless, removing the offending marketing can be a costly lesson for any company. Further consequences include reputational damage and, in some instances, additional controls, such as being subject to mandatory pre-clearance for future advertising. This year, Diageo was found to be in breach by the Advertising Standards Authority in the United Kingdom for a Captain Morgan television commercial on the grounds of linking alcohol with daring, tough and aggressive behaviour. The commercial was immediately withdrawn.

Further details in the S&R Performance Addendum 2014.

Further details at www.diageo.com.

2. WATER STEWARDSHIP

PERFORMANCE AGAINST 2015 TARGETS

Improve water efficiency by 30%	
2.4% (vs 2013)	21% (vs 2007)
Reduce water wasted in water-stressed sites by 50%	
12% (vs 2013)	25% (vs 2007)
Reduce polluting power of wastewater by 60%	
4% (vs 2013)	(13)% (vs 2007)

(1) 2007 baseline data and data for each of the six years in the period ended 30 June 2013 have been restated in accordance with Diageo s environmental reporting methodologies.

(2) In accordance with Diageo s environmental reporting methodologies, total water used excludes irrigation water for agricultural purposes on land under the operational control of the company.

Overall this year, Diageo has delivered improved performance across all water and other environmental target areas versus the prior year, and progressed towards meeting 2015 goals. We reduced absolute water use by 9% or 2,268,000 cubic metres while water efficiency improved by 2.4% compared to the prior year. In water-stressed locations, we have reduced water wasted by 12%, an important contribution towards our target of a 50% reduction versus the company s 2007 baseline.

While some savings are the result of major investments, most come from operational improvements related to equipment, processes, culture and behaviour. For example, our distillery at Valleyfield, Canada has reduced water used by 44% through investment in surface condensers. In Nairobi, where three of our sites are in water-stressed locations, brewing, malting and glass production facilities have reduced the absolute volume of water withdrawn by 23%, reflecting the impact of a sustained focus on water conservation.

Water used for irrigation purposes on land under Diageo s operational control extends to 7,512,000 cubic metres and is reported separately from direct operations water use efficiency performance. The significant majority of this irrigation water relates to sugar cane production at the Ypioca business in Brazil where Diageo is investing in improving irrigation techniques and broader water stewardship improvements. See page 100 for information about our Value chain partnerships.

We also aim to reduce the polluting power of wastewater, measured in biochemical oxygen demand (BOD) grams per litre of product packaged. Overall we reduced BOD by 4%, with a 56% improvement at sites in Africa as a result of better wastewater treatment facilities and operation.

A significant proportion of Diageo s BOD in wastewater comes from our Cameronbridge distillery in Scotland, where we have built a new bioenergy plant which generates renewable energy from co-products while also reducing BOD load. This facility, once fully commissioned, will significantly reduce BOD load to the environment in future years.

In addition to driving improvements in our operations, we also invest in infrastructure and sanitation through our Water of Life programme to provide access to clean water in local communities. Please see page 94 for more information.

Further details in the S&R Performance Addendum 2014.

Further details at www.diageo.com.

Water efficiency by region, by year (l/l) (1),(2)	**2007**	**2012**	**2013**	**2014**
North America	6.68	4.96	6.45	5.27
Western Europe	7.56	6.57	6.57	6.90
Africa, Eastern Europe and Turkey	9.94	7.21	6.64	6.23
Latin America and Caribbean	21.87	15.98	21.01	20.61
Asia Pacific	4.41	3.52	3.34	3.63
Diageo (total)	8.68	6.93	7.03	6.86

Wastewater polluting power by region,by year (BOD/kt)(1)	**2007**	**2012**	**2013**	**2014**
North America	248	13	11	13
Western Europe	21,802	28,437	33,689	35,990
Africa, Eastern Europe and Turkey	11,613	8,398	6,623	2,756
Latin America and Caribbean	565	35	11	10
Asia Pacific	22	8	6	0
Corporate	1	1	1	1
Diageo (total)	34,251	36,892	40,341	38,770
Total under direct control	33,426	36,646	40,088	38,541

(1) 2007 baseline data and data for each of the six years in the period ended 30 June 2013 have been restated in accordance with Diageo s environmental reporting methodologies.

(2) In accordance with Diageo s environmental reporting methodologies, total water used excludes irrigation water for agricultural purposes on land under the operational control of the company.

3. ENVIRONMENT

PERFORMANCE AGAINST 2015 TARGETS

Reduce carbon emissions equivalent by 50%	
5% (vs 2013)	30% (vs 2007)
Eliminate waste to landfill	
23% (vs 2013)	83% (vs 2007)
Reduce average packaging weight by 10%*	
0.8% (vs 2013)	6% (vs 2009)
Increase average recycled content across all packaging to 42%	
1% (vs 2013)	37% (vs 2009)
Make all packaging 100% recyclable/reusable	
0.01% (vs 2013)	98.6% (vs 2009)

* A 2009 baseline was established for packaging targets versus the 2007 baseline for other environmental metrics.

Alongside water stewardship, our environmental programme focuses on reducing greenhouse gases and waste sent to landfill as well as improving the sustainability of our packaging.

Carbon emissions

We use the World Resources Institute/World Business Council for Sustainable Development Greenhouse Gas Protocol as a basis for reporting our emissions, and we include all facilities over which we have operational control for the full fiscal year.

This year Diageo s net carbon emissions (CO_2e) were reduced by 5% in absolute terms or 35,000 tonnes, compared to the prior year. We achieved this reduction despite production volume going up in the most energy intensive area of our business, malt and grain whisky distilling. Cumulatively we have reduced absolute net tonnes of CO_2e by 30% since 2007.

Carbon emissions by weight by region (1,000 tonnes CO_2e)(1), (2)	**2007**	**2012**	**2013**	**2014**
North America	218	67	51	**56**
Western Europe	364	318	333	**337**
Africa, Eastern Europe and Turkey	294	295	275	**232**
Latin America and Caribbean	32	23	19	**19**
Asia Pacific	29	15	13	**14**
Corporate	23	17	16	**14**
Diageo (total)	**960**	**735**	**707**	**672**

(1) CO_2e figures are calculated using the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation or the International Energy Agency, as applicable.

(2) 2007 baseline data, and data for each of the six years in the period ended 30 June 2013, have been restated in accordance with the WRI/WBCSD Greenhouse Gas Reporting Protocol and Diageo s environmental reporting methodologies.

(1) CO_2e figures are calculated using the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation or the International Energy Agency, as applicable.

(2) 2007 baseline data, and data for each of the six years in the period ended 30 June 2013, have been restated in accordance with the WRI/WBCSD Greenhouse Gas Reporting Protocol and Diageo s environmental reporting methodologies.

These results represent the sum of many small improvements, increases in green energy sourcing and the application of new technology combined with larger capital projects such as a £4 million investment in a combined heat and power plant at the Red Stripe brewery in Jamaica, which will reduce the site s carbon emissions by 4,000 tonnes per year.

Diageo s gross carbon emissions for this year are 865,000Δ tonnes, with an intensity ratio of 255 grams per litre packaged. Our targets for absolute reduction of carbon emissions, set in 2007, are based on net emissions. This is the first year we are reporting both net and gross emissions.

This year, approximately 59% of electricity at our supply sites came from low-carbon sources such as wind, hydro and nuclear (2013: 52%). In the United Kingdom, 99% of our electricity came from low-carbon sources. This year marked our second year in the CDP (formerly the Carbon Disclosure Project) Supply Chain programme, a platform for engaging key suppliers on carbon emissions. Of the 146 suppliers we engaged, 83% responded to the CDP questionnaire.

This has provided important insights into the carbon impacts of our supply chain, and we will use the information to explore opportunities to reduce them.

Waste to landfill

Total waste to landfill by region (tonnes)(1)	**2007**	**2012**	**2013**	**2014**
North America	40,828	16,573	539	**246**
Western Europe	3,627	181	1,240	**705**
Africa, Eastern Europe and Turkey	52,536	30,753	19,596	**15,565**
Latin America and Caribbean	4,931	1,162	919	**870**
Asia Pacific	1,287	107	91	**66**
Corporate	1,140	852	843	**499**
Diageo (total)	**104,349**	**49,628**	**23,228**	**17,951**

(1) 2007 baseline data and data for each of the six years in the period ended 30 June 2013 have been restated in accordance with Diageo s environmental reporting methodologies.

Another focus of our environmental programme is to reduce the amount of waste we send to landfill. As well as having a positive impact on the environment, it saves money by reducing waste levies and fees, and saving on material inputs. In 2014, we reduced waste to landfill by 23% compared to the prior year. One of the key drivers was the progress made by our sites in Nigeria, where the business has accelerated an initiative started in 2012 to extensively reuse brewing by-products previously sent to landfill for animal feed and fertiliser applications.

Sustainable packaging

Complementing our focus on our own waste is our aim to use packaging that has a low environmental impact, an aspiration set out in our Sustainable Packaging Guidelines, published in 2011, which are used by all brands. Among the initiatives are light weighting, or reducing the weight of packaging; removing materials that cannot be recycled, or are difficult to recycle, including PVC, foil, mixed plastics, ceramics and some laminates; and, where viable alternatives exist, removing materials such as inks and heavy metals that may pose a risk to the environment. Among a number of projects, this year Ypioca in Brazil introduced an outercase for Smirnoff made from sugar cane by-products.

Further details in the S&R Performance Addendum 2014.

Further details at www.diageo.com.

4. COMMUNITY EMPOWERMENT

PERFORMANCE AGAINST TARGETS

Improve access to safe drinking water for one million people in Africa every year until 2015

1 million (vs 1 million in 2013)

Train 100,000 people through our Learning for Life programme by 2016

14,000 (vs 25,307 in 2013)

Empower two million women through our Plan W programme by 2016

40,545 (vs 16,750 in 2013)

* Category includes cause-related brand campaigns, local market giving and disaster relief.

** This is a sub-section of the total responsible drinking budget.

Like most businesses, we create wealth directly for our local stakeholders through our daily business operations, including providing jobs, sourcing locally, and paying local duties. However, creating wealth in a lasting way requires more: we must work with local people to address development challenges such as skills gaps or access to clean water, and advocate high standards of governance in the communities where we operate.

This year we invested £16.5 million or 0.6% of operating profits to charitable projects that help serve critical local need. This marks a decrease from the charitable giving reported last year, primarily because we have chosen not to include our legacy commitment of £10.3 milllion to the Thalidomide Trust and the Thalidomide Foundation Ltd and instead focus our community investment reporting on our long-term, actively managed flagship programmes.

Water of Life

Complementing our efforts to protect water resources, we work with local communities to provide access to safe drinking water through our Water of Life programme. Since June 2006, we have reached more than 10 million people through more than 200 projects in 18 countries. Our initiatives support boreholes, wells, rainwater harvesting and domestic filtration devices.

Learning for Life

Learning for Life was established with the belief that vocational and life-skills training can produce a ripple effect that will positively impact individuals, families, communities and societies while strengthening Diageo s value chain.

Last year we expanded our programme beyond Latin America, where it was founded, to North America and Scotland. In total this year Diageo ran 71 Learning for Life programmes in 30 countries, training 14,000 people. This brings the numbers of people trained since the launch of the programmes five years ago to more than 102,000, beating our target of 100,000 two years early.

Plan W

In Asia Pacific, we run a similar sustainable development programme to empower women to play a greater role in the economy by developing their hospitality and business enterprise skills. Since launching in December 2012, we have worked with 57,295 women in 16 countries in partnership with 13 organisations. We also believe that educating men on issues that concern women ultimately can help empower women, and thus far 19,501 men have gone through the programme.

Further details in the S&R Performance Addendum 2014.

Further details at www.diageo.com.

5. OUR PEOPLE

PERFORMANCE

Super-engagement score

38% (vs 41% in 2013)

Gender diversity in senior management

28% (vs 28% in 2013)

Reduction of lost-time accidents (LTAs)

47% (since 2013)

Our commitment to helping our people reach their full potential is at the heart of our success and at the core of our business strategy. We aim to create a working environment that is welcoming but also challenging, stimulating and inspiring.

We are proud to have been recognised in the Great Place to Work Institute s prestigious 25 Best Multinational Workplaces, achieving 8th place and reinforcing our position as a leading global employer. We have also been recognised as a great employer in Argentina, Belgium, Germany, Great Britain, Greece, Ireland, Mexico, Netherlands, Nigeria, Portugal and Spain. These are achievements which have only been possible through the commitment of thousands of talented and inspirational employees who together make Diageo a great place to work.

Employee engagement

Our Annual Values Survey is our primary means of measuring how connected our employees feel to the business and the extent to which they believe the company is living the Diageo values. This year, we made a number of changes to our survey to align it more closely to our Performance Ambition. We took a new approach to measuring engagement to focus on Diageo s five values and four Performance Ambition behaviours.

For the second year running, 92% of employees took part, with 84% of employees identified as being engaged. We received 24,000 comments from employees, many with constructive suggestions for how we can achieve our Performance Ambition. Diageo also measures super-engagement. This is a more stretching measure than engagement, which requires employees to assign the highest possible ranking to all six of the core engagement questions in the Values Survey. There have been no changes to the way we measure this metric from past years. We have largely maintained our strong results in a year when employees experienced change in the business. 38% of employees were identified as being super-engaged, compared to 41% in 2013. This year s survey confirmed that Diageo s core strength is employees pride and passion in our brands and it highlighted that employees are more positive about the quality of their line management, both of which we see as critical enablers of strong performance in a year when employees experienced change in the business.

Diversity

As a business which operates in countries all around the world with a variety of cultures and consumers, we believe diversity to be a key competitive advantage.

Diversity can be illustrated in many ways. Without seeking to set a specific goal for female representation on the Board, it remains our aspiration to maintain a high level of diversity, including gender diversity, within the Boardroom, appropriate to and reflecting the global nature of the company and the strategic imperatives the Board has agreed upon. Reflecting these values, we have four women on our Board, representing 44% of the directors. This year, Diageo along with Capita plc, received the Opportunity Now Female FTSE100 award, given to FTSE100 companies with the highest female representation on the Board.

Diageo s commitment to diversity at the senior management level is just as strong and we actively work to increase the number of women in leadership positions in the company. Currently, six of the 14 members of the Executive Committee are women, in comparison to five out of 15 members in 2013. Furthermore, 28% (2013 - 28%) of leadership positions across the business are filled by women.

We also embrace a business model which aims to promote local leaders: our 21 managing directors represent 13 different nationalities.

Average number of employees by region by gender(1)	**Men**	**Women**	**Total**
North America	2,023	1,386	3,409
Western Europe	5,182	3,065	8,247
Africa, Eastern Europe and Turkey	6,225	2,536	8,761
Latin America and Caribbean	2,096	1,276	3,372
Asia Pacific	2,217	1,349	3,566
Diageo (total)	**17,743**	**9,612**	**27,355**

Average number of employees by role by gender(2)	**Men**	**Women**	**Total**
Line manager	3,596	1,944	5,540
Supervised worker	13,291	7,262	20,553
Total	**16,887**	**9,206**	**26,093**

New hires by region by gender(2)	Men	Women	Total	% of total new hires
North America	267	176	443	15%
Western Europe	208	171	379	12%
Africa, Eastern Europe and Turkey	848	363	1,211	39%
Latin America and Caribbean	505	271	776	25%
Asia Pacific	139	137	276	9%
Diageo (total)	1,967	1,118	3,085	
Percentage of total new hires	64%	36%		

Leavers by region by gender(2)	Men	Women	Total	% of leavers
North America	467	342	809	17%
Western Europe	620	487	1,107	23%
Africa, Eastern Europe and Turkey	1,168	496	1,664	34%
Latin America and Caribbean	565	310	875	18%
Asia Pacific	215	179	394	8%
Diageo (total)	3,035	1,814	4,849	
Percentage of total leavers	63%	37%		

(1) Employees have been allocated to the region in which they reside. In note 3 to the consolidated financial statements, employees are allocated to the segment for which they provide the majority of service.

(2) Not all acquisitions collate full employee demographic data, hence the discrepancy in the total figures between this table and the Average number of employees by region by gender table. Where there is a lower total number, the figure excludes Shuijingfang.

Human rights

We have a responsibility to respect human rights, and that starts with the rights of our employees. Everyone has the right to expect their basic human identity and dignity to be fully respected in the workplace. We do not use forced or compulsory labour and we will not work with others who do. We will not employ children under the age of 16 and have a special responsibility to protect employees under 18, and ensure that their interests are promoted. Our commitment to pay wages and benefits for a standard working week that meet, at a minimum, national legal standards, is also an important element of our commitment to human rights. We aim to provide opportunities for a wide range of people including those with disabilities, fostering a culture that allows for a variety of lifestyles. Our training and education programme includes re-training, if needed, for people who have become disabled. Where possible, we encourage a flexible approach to working and emphasise the importance of treating individuals justly and in a non-discriminatory manner throughout the employment relationship, including recruitment, compensation, training, promotion and transfers.

We have outlined our approach in our policies and guidelines, including our Human Rights and Anti-Discrimination Policy, and have a robust controls, compliance and ethics programme to ensure we uphold our commitment. See the Governance and Ethics section for more information on page 98. We expect our suppliers to abide by the same principles; see page 100 for information on how we manage social risks in our supply chain.

Health and safety

The health and safety of our people is a critical measure of human rights. Diageo has a Severe and Fatal Incident Prevention (SFIP) programme, specifically designed to identify and effectively control severe and fatal risks in our operations. This year, the programme has helped avoid SFIP related fatalities across our operations, however, we are deeply saddened to report a fatality resulting from a security incident at our Tusker brewery in Kenya. In April, an armed criminal gang broke through a concrete perimeter wall at the rear of our site and fatally injured one of the guards patrolling the area. We have reviewed our security procedures and are working closely with local police to enhance our security.

This year we reduced LTAs by over 45% compared to 2013. Of particular note is our new business in Brazil delivering more than a 60% improvement in their first year of Zero Harm. We have also seen an increase to 86% in the number of supply locations with no LTAs. Despite this excellent performance trend and highly favourable comparison with peer performance, we remain focused on a number of business units that did not make the degree of progress we expect.

Our Zero Harm philosophy is aimed at eliminating workplace accidents, and we have a global target to deliver less than one lost-time accident per 1,000 people by 2015 as a milestone towards that ambition. Over the next 12 months we will focus on improving our safety culture and performance at our European office locations and will continue to deliver improvement in new acquisitions, behavioral safety interventions and our fatality prevention programme.

Our talent and organisation

During the year Diageo announced changes to the structure of its global operations across every function. This was part of an overall review to simplify the business and drive accountability for performance to our 21 markets, putting our resources and decision making closer to our customers and consumers. The reconfiguration included removing regional hubs as well as reducing the size of global teams so that their primary function is to support the markets and manage vital global activities that benefit us all.

During periods of change Diageo supports affected employees in line with our global people principles, which set out intentions of being transparent and fair, minimising uncertainty for individuals, and complying with all relevant legal obligations. Diageo makes great efforts to find new roles for those who wish to stay in the company, and where no alternative position exists within Diageo, employees receive full outplacement support and severance in line with local policy.

Lost-time accident frequency rate per 1,000 full-time employees(1)	2010	2011	2012	2013(2)	2014(2)
North America	9.98	5.06	4.15	1.64	**0.58**
Western Europe(3)	1.36	2.49	1.24	1.61	**2.29**
Africa, Eastern Europe and Turkey	3.13	1.37	1.63	2.0	**0.69**
Latin America and Caribbean	2.78	3.42	1.44	10.88	**4.7**
Asia Pacific	1.97	1.41		1.26	**1.62**
International Supply Centre	7.8	7.81	3.52	3.45	**2.31**
Diageo (total)	**4.96**	**3.73**	**2.14**	**2.97**	**1.58**

(1) Number of accidents per 1,000 employees and directly supervised contractors resulting in time lost from work of one calendar day or more.

(2) Includes results from recent acquisitions in Ethiopia, Turkey, Guatemala, China and Brazil. The 2013 numbers for Diageo (total) and Latin America and Caribbean from last year s report are restated for the inclusion of our new acquisition, Ypioca in Brazil. The original rate for Latin America and Caribbean was 0.90.

(3) Western Europe numbers 2010-2013 have been restated to split out the International Supply Centre.

Number of days lost to accidents per 1,000 full-time employees	2010	2011	2012	2013	2014
Diageo (total)	190.71	158.79	106.63	66.00	**49.67**

Fatalities	2010	2011	2012	2013	2014
Diageo (total)	2	4	1	4	**1**

Further details in the S&R Performance Addendum 2014.

Further details at www.diageo.com.

Business review (continued)

6. GOVERNANCE AND ETHICS

PERFORMANCE

Manager level and above employees completing Annual Certification of Compliance

100% (100% in 2013)

Employees leaving Diageo due to a breach of the Code of Business Conduct or other policies

146 (vs 116 in 2013)

We are committed to conducting our business responsibly and in accordance with all laws and regulations to which our business activities are subject. Our risk and compliance programme, overseen by the Audit and Risk Committee, focuses on effective risk management, compliance and ethics, and strong internal controls each of which has an annual plan to ensure we have a strong culture of integrity at Diageo. How the programme is implemented, however, is determined by each of our markets, based on their areas of greatest risk. We tailor the interventions and training to create what will work best for each market, in the context of local and international laws and regulation. Our over-riding aim is to encourage integrity in every part of Diageo: we want employees to act with exemplary conduct in all their business interactions and truly embody our value of being proud of what we do.

Standards and procedures

Our Code of Business Conduct (our Code) sets the standard for what is expected of everyone working at Diageo and our other policies and standards flow from its principles. Our manager level and above complete an Annual Certification of Compliance (ACC) to confirm their understanding of, and adherence to, our Code and any applicable policies, and to identify any areas of possible non-compliance. In 2014, the ACC was completed in 16 languages by all eligible managers 9,960 of our employees, or 36% of our people.

Due care in delegating authority

As our business expands, it is important to ensure that we embed our standards and procedures in all new business units. We plan ahead and move quickly to ensure our new acquisitions are operating to the same standards as our existing businesses, and we are consistent in our stance on non-compliance issues.

We are also committed to establishing good working relationships with our partners and ensuring that they adhere to our standards. For more information on how we manage social and ethics risks in our supply chain, see page 100 on Value chain partnerships.

Organisational leadership and culture

This year we developed specific training for general managers (and their direct reports where appropriate), which is being rolled out by each of our markets. We also continued our focus on line managers with the Leaders of Integrity toolkit and training, as this middle tier of our organisation is central to developing a more fundamental culture of ethics and integrity.

Risk management

Our risk management standard requires all markets and functions to perform risk assessments at least annually to ensure that risks concerning human rights, bribery and corruption, anti-money laundering, and all other relevant laws and regulations, as well as our own Code, policies and standards, have been considered, and that mitigation plans for their most significant risks have been established.

Training and communications

During the year we took all our employees through a refresher training session on our Code. 16,819 employees completed the training in one of 16 languages via a new interactive online course, with the rest of our employees receiving face-to-face training.

Each market also has its own training plan for our Code and key policies, which they deliver through locally organised, risk-based training. To further embed ownership of this agenda with employees, some regions go beyond basic training with annual engagement events such as the Pathway of Pride programme in Africa, and Ethics Day in Asia Pacific.

When an employee joins Diageo, he or she must complete training about our Code within 30 days. The estimated 3,085 employees who joined us this year were taken through a one hour induction on compliance and ethics.

Monitoring, auditing, and reporting

We strive to have a culture in which employees feel comfortable raising concerns about potential breaches of our Code or policies. We expect anyone who comes across a breach to report it immediately, either through SpeakUp, our confidential whistleblowing helpline, to their line manager, or to a member of the controls, compliance and ethics, human resources or legal teams. SpeakUp is also available to suppliers.

There were 831 suspected breaches reported this year, of which 440 were subsequently substantiated. Of the suspected breaches, 299 were reported through SpeakUp, compared with 242 in 2013. We believe that there are two contributing factors to this increase. First, we have seen an increase in reporting of concerns from some of our acquisitions and emerging markets as our Code and policies have been embedded further in these areas.

Business review (continued)

Second, there is greater awareness about SpeakUp amongst all our employees, following refresher training on our Code which everyone went through this year.

Response and continuous improvement

All identified breaches are taken very seriously and those that require action are investigated.

Our response to proven breaches varies depending on the severity of the matter. Internally, we carefully monitor our breaches to identify any trends or common areas where further action may be required, and respond accordingly. This year, 146 people exited the business as a result of breaches of our Code or policies.

Enforcement and incentive

Wherever possible, we look to improve our culture through training, coaching and incentives. Annual performance appraisals are weighted with 70% based on performance and the other 30% based on behaviour including the individual s commitment to Diageo s controls, compliance, and ethics agenda. Employees overall performance affects their pay increases, and where relevant, their bonuses.

Controls

We have a strong internal control environment, and we have an annual programme to assess, test, and report on the effectiveness of internal controls across our company. Our controls cover all aspects of risk, ranging from financial to operational to reputational risk, and all markets and functions are required to certify annually whether their internal controls are operating effectively and quickly remediate any weaknesses identified.

Further details in the S&R Performance Addendum 2014

Further details at www.diageo.com

Business review (continued)

7. OUR VALUE CHAIN PARTNERSHIPS

PERFORMANCE

Percentage of potential high risk supplier sites registered on SEDEX that were audited in 2014

17% (vs 12% in 2013)

Percentage of agricultural materials sourced locally across Africa in 2014

66% (vs 52% in 2013)

About our supply chain

We source goods and services from a wide variety of businesses around the world, and our procurement systems depend on relationships with suppliers that are local, regional, and global. Alignment with our Sustainability & Responsibility standards, which include our Partnering with Suppliers Standard, is among the many factors we consider in choosing our suppliers, alongside cost, quality, and service.

The goods and services we buy include marketing materials, raw materials and utilities, information services and business support, packaging materials and logistics. This year, in total we purchased 1.8 million tonnes of agricultural raw materials like barley, wheat and maize, and approximately one million tonnes of packaging. See the graphs above for a breakdown.

Responsible sourcing

Given our large network of suppliers in more than 100 countries, we are working to develop our understanding of the full range of social and environmental impacts we have throughout our supply chain. We see our role as a catalyst, working in partnership with others to help suppliers embed ethical, social and environmental principles.

Diageo works through SEDEX, a not-forprofit organisation that enables suppliers to share assessments and audits of ethical and responsible practices with their customers. We are an active member of AIM-PROGRESS, a forum of 37 leading consumer goods companies which promotes responsible sourcing practices and sustainable supply chains. We also have an internal Know Your Business Partner (KYBP) programme to assess our third parties against the risk of bribery and corruption, which we do not tolerate in any form.

To date, 1,193 of the company s potential high risk supplier sites have registered with SEDEX, up from 1,095 last year. Of these, 718 have completed a SEDEX self-assessment questionnaire. More than 200 of the highest risk companies were independently audited during the last three years; audits were commissioned by Diageo (7), or accessed through SEDEX and AIM-PROGRESS (194). Among the issues most frequently raised were those related to health, safety, hygiene and working hours.

Merchandising materials remain one of our highest risk categories, because they are often made in higher risk countries and we often buy through intermediaries and therefore may not know where they were produced. We continue to work with our key merchandising suppliers to develop assurance further down the supply chain, with around 160 of our second-tier suppliers now audited.

Our confidential whistleblowing service, SpeakUp, is also shared with our suppliers. This year Diageo received four calls relating to suppliers and vendors through SpeakUp, though none were substantiated breaches.

Agricultural value chain partnerships

Historically, we have focused our attention on agricultural value chains in Africa, where we see significant potential for developing more sustainable farming practices. We have a goal to source 70%* of agricultural materials locally across Africa by 2015 locally being defined as materials sourced within Africa and used by our African markets. We are well along our way to reaching this target having sourced 66% of agricultural materials locally in 2014.

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* The target we have disclosed previously included packaging materials, but we determined that agricultural materials were the most material.

Business review (continued)

To support these partnerships, Diageo invests in a variety of initiatives. In Kenya, for example, we work with a large number of farmers who supply barley to our malting facility. Diageo s partnerships with these farmers are focused on crop rotation, soil and crop management, and are aimed at improving yield and quality. We are working to develop scalable business models, supporting the creation of farmer groups and co-operatives, and giving farmers and processors access to financial services companies who provide credit facilities and basic insurance against loss of income due to drought.

Similarly, we are putting in place a scalable barley value chain in Ethiopia, which is being delivered in partnership with over 1,000 smallholders, the Ethiopian Government s Agricultural Transformation Agency (ATA) and the not-for-profit organisation, Technoserve.

We are also taking what we have learned from agricultural development in Africa to other countries particularly where we have recently acquired businesses with a significant agricultural footprint.

Business review (continued)

Definitions and reconciliations of non-GAAP measures to GAAP measures

Diageo s strategic planning process is based on the following non-GAAP measures. They are chosen for planning and reporting, and some of them are used for incentive purposes. The group s management believes these measures provide valuable additional information for users of the financial statements in understanding the group s performance. These non-GAAP measures should be viewed as complementary to, and not replacements for, the comparable GAAP measures and reported movements therein.

Volume

Volume is a non-GAAP measure that is measured on an equivalent units basis to nine-litre cases of spirits. An equivalent unit represents one nine-litre case of spirits, which is approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer. Therefore, to convert volume of products other than spirits to equivalent units, the following guide has been used: beer in hectolitres divide by 0.9; wine in nine-litre cases, divide by five; ready to drink in nine-litre cases, divide by 10; and certain pre-mixed products that are classified as ready to drink in nine-litre cases, divide by five.

Organic movements

In the discussion of the performance of the business, organic information is presented using pounds sterling amounts on a constant currency basis, excluding the impact of exceptional items and acquisitions and disposals. Organic measures enable users to focus on the performance of the business which is common to both years and which represents those measures that local managers are most directly able to influence.

Calculation of organic movements

The organic movement percentage is the amount in the row headed Organic movement in the tables below, expressed as a percentage of the amount in the row headed 2013 adjusted . Organic operating margin is calculated by dividing operating profit before exceptional items by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.

(a) Exchange rates

Exchange in the organic movement calculation reflects the adjustment to recalculate the prior year results as if they had been generated at the current year s exchange rates. Exchange impacts in respect of the external hedging of intergroup sales of products and the intergroup recharging of third party services are allocated to the geographical segment to which they relate. Residual exchange impacts are reported in Corporate.

(b) Acquisitions and disposals

For acquisitions in the current year, the post acquisition results are excluded from the organic movement calculations. For acquisitions in the prior year, post acquisition results are included in full in the prior year but are included in the organic movement calculation from the anniversary of the acquisition date in the current year. The acquisition row also eliminates the impact of transaction costs that have been charged to operating profit in the current or prior year in respect of acquisitions that, in management s judgement, are expected to complete.

Where a business, brand, brand distribution right or agency agreement was disposed of, or terminated, in the current or prior year, the group, in the organic movement calculations, excludes the results for that business from the current and prior year. In the calculation of operating profit, the overheads included in disposals are only those directly attributable to the businesses disposed of, and do not result from subjective judgements of management.

(c) Exceptional items

Exceptional items are those which, in management s judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information. Such items are included within the income statement caption to which they relate but are excluded from the organic movement calculations.

Business review (continued)

Organic movement calculations for the year ended 30 June 2014 were as follows:

	North America units million	Western Europe units million	Africa, Eastern Europe and Turkey units million	Latin America and Caribbean units million	Asia Pacific units million	Corporate units million	Total units million
Volume							
2013 reported	53.7	33.6	37.9	23.3	16.5		165.0
IFRS 11*	(0.1)				(0.7)		(0.8)
2013 reported (restated)	53.6	33.6	37.9	23.3	15.8		164.2
Disposals***	(4.3)	(0.6)		(0.2)	(0.2)		(5.3)
2013 adjusted	49.3	33.0	37.9	23.1	15.6		158.9
Acquisitions and disposals* **	**0.7**	**0.1**		**0.1**			**0.9**
Organic movement	**(0.7)**	**(0.1)**	**(1.9)**	**(0.2)**	**(0.8)**		**(3.7)**
2014 reported	**49.3**	**33.0**	**36.0**	**23.0**	**14.8**		**156.1**
Organic movement %	**(1)**		**(5)**	**(1)**	**(5)**	**n/a**	**(2)**

	North America £ million	Western Europe £ million	Africa, Eastern Europe and Turkey £ million	Latin America and Caribbean £ million	Asia Pacific £ million	Corporate £ million	Total £ million
Sales							
2013 reported	4,272	3,686	3,423	1,745	2,285	76	15,487
IFRS 11*	(10)	(17)	(4)	(4)	(176)		(211)
2013 reported (restated)	4,262	3,669	3,419	1,741	2,109	76	15,276
Exchange**	(176)	8	(358)	(389)	(167)		(1,082)
Disposals***	(336)	(64)	(8)	(11)	(11)		(430)
2013 adjusted	3,750	3,613	3,053	1,341	1,931	76	13,764
Acquisitions and disposals* **	**52**	**9**		**1**			**62**
Organic movement	**113**	**22**	**84**	**62**	**(130)**	**3**	**154**
2014 reported	**3,915**	**3,644**	**3,137**	**1,404**	**1,801**	**79**	**13,980**
Organic movement %	**3**	**1**	**3**	**5**	**(7)**	**4**	**1**
Net sales							
2013 reported	3,733	2,220	2,280	1,457	1,667	76	11,433
IFRS 11*	(10)	(17)	(4)	(4)	(95)		(130)
2013 reported (restated)	3,723	2,203	2,276	1,453	1,572	76	11,303
Exchange**	(156)	9	(210)	(328)	(112)		(797)
Disposals***	(272)	(45)	(6)	(9)	(7)		(339)
2013 adjusted	3,295	2,167	2,060	1,116	1,453	76	10,167
Acquisitions and disposals* **	**41**	**7**		**1**			**49**
Organic movement	**108**	**(5)**	**15**	**27**	**(106)**	**3**	**42**
2014 reported	**3,444**	**2,169**	**2,075**	**1,144**	**1,347**	**79**	**10,258**
Organic movement %	**3**		**1**	**2**	**(7)**	**4**	

Business review (continued)

	North America £ million	Western Europe £ million	Africa, Eastern Europe and Turkey £ million	Latin America and Caribbean £ million	Asia Pacific £ million	Corporate £ million	Total £ million
Marketing							
2013 reported	585	328	265	233	370	6	1,787
IFRS 11*	(4)				(14)		(18)
2013 reported (restated)	581	328	265	233	356	6	1,769
Exchange**	(27)		(24)	(30)	(27)		(108)
Disposals***	(27)	(4)	(1)	(2)			(34)
2013 adjusted	527	324	240	201	329	6	1,627
Acquisitions and disposals* **	**3**						**3**
Organic movement	**10**	**(1)**	**2**	**2**	**(24)**	**1**	**(10)**
2014 reported	**540**	**323**	**242**	**203**	**305**	**7**	**1,620**
Organic movement %	**2**		**1**	**1**	**(7)**	**17**	**(1)**
Operating profit before exceptional items							
2013 reported	1,484	656	654	471	414	(149)	3,530
IFRS 11 and amendment to IAS 19*	(6)	(6)	(1)	(3)	(33)	(2)	(51)
2013 reported (restated)	1,478	650	653	468	381	(151)	3,479
Exchange**	(54)	(5)	(95)	(151)	(35)	4	(336)
Acquisitions and disposals***	(59)	(8)	1	2	(1)		(65)
2013 adjusted	1,365	637	559	319	345	(147)	3,078
Acquisitions and disposals* **	**(12)**		**(3)**		**(18)**	**(2)**	**(35)**
Organic movement	**107**	**2**	**(2)**	**9**	**(44)**	**19**	**91**
2014 reported	**1,460**	**639**	**554**	**328**	**283**	**(130)**	**3,134**
Organic movement %	**8**			**3**	**(13)**	**13**	**3**
Organic operating margin %							
2014	**43.26%**	**29.56%**	**26.84%**	**28.70%**	**22.35%**	**n/a**	**31.04%**
2013	41.43%	29.40%	27.14%	28.58%	23.74%	n/a	30.27%
Margin improvement (bps)	**183**	**16**	**(29)**	**11**	**(140)**	**n/a**	**77**

(1) For the reconciliation of sales to net sales and operating profit before exceptional items to operating profit see page 46 and page 159.

(2) Percentages and margin improvement are calculated on rounded figures.

Notes: Information in respect of the organic movement calculations

* Prior year figures are restated following the adoption of IFRS 11 and the amendment to IAS 19, see note 1 and 18 to the consolidated financial statements.

** The exchange adjustments for sales, net sales, marketing and operating profit are principally in respect of the Venezuelan bolivar, the US dollar, the Turkish lira and the South African rand.

*** In the year ended 30 June 2014 the acquisitions and disposals that affected volume, sales, net sales, marketing and operating profit were as follows:

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Business review (continued)

	Volume units million	Sales £ million	Net sales £ million	Marketing £ million	Operating profit £ million
2013					
Acquisitions					
Transaction costs					4
Integration costs					4
					8
Disposals					
Jose Cuervo	(4.7)	(379)	(295)	(29)	(72)
Nuvo	(0.2)	(14)	(13)	(5)	3
Other disposals	(0.4)	(37)	(31)		(4)
	(5.3)	(430)	(339)	(34)	(73)
Acquisitions and disposals	(5.3)	(430)	(339)	(34)	(65)
2014					
Acquisitions					
DeLeón				**3**	**(3)**
Transaction costs					**(13)**
Integration costs					**(12)**
				3	**(28)**
Disposals					
Jose Cuervo	**0.7**	**53**	**42**		**(9)**
Other disposals	**0.2**	**9**	**7**		**2**
	0.9	**62**	**49**		**(7)**
Acquisitions and disposals	**0.9**	**62**	**49**	**3**	**(35)**

Earnings per share before exceptional items

Earnings per share before exceptional items is calculated by dividing profit attributable to equity shareholders of the parent company before exceptional items by the weighted average number of shares in issue.

Earnings per share before exceptional items for the years ended 30 June 2014 and 30 June 2013 are set out in the table below:

	2014 £ million	2013 (restated) £ million
Profit attributable to equity shareholders of the parent company	**2,248**	2,452
Exceptional operating items	**261**	99
Non-operating items	**(140)**	83
Tax in respect of exceptional operating and non-operating items	**(58)**	(55)
Discontinued operations	**83**	
	2,394	2,579
Weighted average number of shares in issue (million)	**2,506**	2,502

Earnings per share before exceptional items (pence)	**95.5**	103.1

Business review (continued)

Free cash flow

Free cash flow comprises the net cash flow from operating activities aggregated with the net movements in loans receivable and other investments and with the net purchase of property, plant and equipment and computer software that are included in net cash flow from investing activities.

The remaining components of net cash flow from investing activities that do not form part of free cash flow, as defined by the group s management, are in respect of the acquisition and sale of businesses.

The group s management regards the purchase and disposal of property, plant and equipment and computer software as ultimately non-discretionary since ongoing investment in plant, machinery and technology is required to support the day-to-day operations, whereas acquisitions and sales of businesses are discretionary.

Where appropriate, separate explanations are given for the impacts of acquisitions and sale of businesses, dividends paid and the purchase of own shares, each of which arises from decisions that are independent from the running of the ongoing underlying business.

Free cash flow reconciliations for the years ended 30 June 2014 and 30 June 2013 are set out in the table below:

	2014 £ million	2013 (restated) £ million
Net cash from operating activities	**1,790**	2,033
Disposal of property, plant and equipment and computer software	**80**	39
Purchase of property, plant and equipment and computer software	**(642)**	(636)
Movements in loans and other investments	**7**	16
Free cash flow	**1,235**	1,452

Return on average total invested capital

Return on average total invested capital is used by management to assess the return obtained from the group s asset base and is calculated to aid evaluation of the performance of the business.

The profit used in assessing the return on average total invested capital reflects operating profit before exceptional items plus share of after tax results of associates and joint ventures after applying the tax rate before exceptional items for the year. Average total invested capital is calculated using the average derived from the consolidated balance sheets at the beginning, middle and end of the year. Average capital employed comprises average net assets for the year, excluding post employment benefit net liabilities (net of deferred tax) and average net borrowings. This average capital employed is then aggregated with the average restructuring and integration costs net of tax, and goodwill written off to reserves at 1 July 2004, the date of transition to IFRS, to obtain the average total invested capital.

Calculations for the return on average total invested capital for the years ended 30 June 2014 and 30 June 2013 are set out in the table below:

	2014 £ million	**2013 (restated) £ million**
Operating profit	**2,707**	3,380
Exceptional operating items	**427**	99
Share of after tax results of associates and joint ventures	**252**	217
Tax at the tax rate before exceptional items of 18.2% (2013 17.4%)	**(616)**	(643)
	2,770	3,053
Average net assets (excluding post employment liabilities)*	**8,414**	8,183
Average net borrowings	**8,783**	7,956
Average integration and restructuring costs (net of tax)	**1,498**	1,413
Goodwill at 1 July 2004	**1,562**	1,562
Average total invested capital	**20,257**	19,114
Return on average total invested capital	**13.7%**	16.0%

* The opening balance sheet for the year ended 30 June 2014 was adjusted to include £342 million in respect of the acquisition of an additional investment in USL on 4 July 2013.

Tax rate before exceptional items

Tax rate before exceptional items is calculated by dividing the total tax charge on continuing operations before tax charges and credits, classified as or in respect of exceptional items, by profit before taxation adjusted to exclude the impact of exceptional operating and non-operating items, expressed as a percentage. The measure is used by management to assess the rate of tax applied to the group s continuing operations before tax on exceptional items.

Business review (continued)

The tax rates from continuing operations before and after exceptional items for the years ended 30 June 2014 and 30 June 2013 are set out in the table below:

	2014 £ million	2013 (restated) £ million
Tax before exceptional items (a)	**546**	562
Tax in respect of exceptional items	**(99)**	(55)
Taxation on profit from continuing operations (b)	**447**	507
Profit from continuing operations before taxation and exceptional items (c)	**2,998**	3,239
Non-operating items	**140**	(83)
Exceptional operating items	**(427)**	(99)
Profit before taxation (d)	**2,711**	3,057
Tax rate before exceptional items (a/c)	**18.2%**	17.4%
Tax rate from continuing operation after exceptional items (b/d)	**16.5%**	16.6%

Other definitions

Volume share is a brand s volume expressed as a percentage of the volume of all brands in its segment. Value share is a brand s retail sales expressed as a percentage of the retail sales of all brands in its segment. Unless otherwise stated, share refers to value share.

Price/mix is the number of percentage points by which the organic movement in net sales exceeds the organic movement in volume. The difference arises because of changes in the composition of sales between higher and lower priced variants or as price changes are implemented.

References to **emerging markets** include Russia, Eastern Europe, Turkey, Africa, Latin America and Caribbean, and Asia Pacific (excluding Australia, Korea and Japan).

References to **reserve brands** include Johnnie Walker Blue Label, Johnnie Walker Green Label, Johnnie Walker Gold Label 18 year old, Johnnie Walker Gold Label Reserve, Johnnie Walker Platinum Label 18 year old, John Walker & Sons Collection, Johnnie Walker The Gold Route, Johnnie Walker The Royal Route, and other Johnnie Walker super premium brands; The Singleton, Cardhu, Talisker, Lagavulin and other malt brands; Buchanan s Special Reserve, Buchanan s Red Seal; Bulleit Bourbon, Bulleit Rye; Tanqueray No. TEN, Tanqueray Malacca; Cîroc, Ketel One vodka; Don Julio, Zacapa and Bundaberg SDlx.

References to **premium core brands** include brands that markets identified as their core offerings. These are selected on a market by market basis and generally include brands such as Johnnie Walker Red Label, Johnnie Walker Black Label, Crown Royal, Buchanan s, J B, Baileys, Smirnoff, Captain Morgan, Guinness, Shui Jing Fang and Yenì Raki.

References to **ready to drink** (RTD) also include ready to serve products, such as pre-mix cans in some markets, and progressive adult beverages in the United States and certain markets supplied by the United States.

References to **beer** include non-alcoholic malt based products such as Guinness Malta.

Business review (continued)

Reconciliations of non-GAAP measures to GAAP measures 2013 compared with 2012

Organic movements

Organic movement calculations for the year ended 30 June 2013 were as follows:

	North America units million	Western Europe units million	Africa, Eastern Europe and Turkey units million	Latin America and Caribbean units million	Asia Pacific units million	Corporate units million	Total units million
Volume							
2012 reported	53.0	34.7	35.4	17.2	16.2		156.5
IFRS 11*	(0.1)				(0.7)		(0.8)
2012 reported (restated)	52.9	34.7	35.4	17.2	15.5		155.7
Disposals***	(4.3)	(0.4)	(0.1)	(0.1)	(0.1)		(5.0)
2012 adjusted	48.6	34.3	35.3	17.1	15.4		150.7
Acquisitions and disposals* **	4.3	0.4	1.2	5.5	0.5		11.9
Organic movement	0.7	(1.1)	1.4	0.7	(0.1)		1.6
2013 reported	53.6	33.6	37.9	23.3	15.8		164.2
Organic movement %	1	(3)	4	4	(1)	n/a	1

	North America £ million	Western Europe £ million	Africa, Eastern Europe and Turkey £ million	Latin America and Caribbean £ million	Asia Pacific £ million	Corporate £ million	Total £ million
Sales							
2012 reported	4,094	3,834	3,001	1,491	2,104	70	14,594
IFRS 11*	(9)	(14)	(3)	(3)	(173)		(202)
2012 reported (restated)	4,085	3,820	2,998	1,488	1,931	70	14,392
Exchange**	25	(47)	(41)	(33)	10	4	(82)
Disposals***	(372)	(37)	(12)	(16)	(10)		(447)
2012 adjusted	3,738	3,736	2,945	1,439	1,931	74	13,863
Acquisitions and disposals* **	349	40	136	78	142		745
Organic movement	175	(107)	338	224	36	2	668
2013 reported	4,262	3,669	3,419	1,741	2,109	76	15,276
Organic movement %	5	(3)	11	16	2	3	5
Net sales							
2012 reported	3,556	2,345	2,051	1,239	1,501	70	10,762
IFRS 11*	(9)	(14)	(3)	(3)	(94)		(123)
2012 reported (restated)	3,547	2,331	2,048	1,236	1,407	70	10,639
Exchange**	22	(36)	(28)	(26)	4	4	(60)
Disposals***	(306)	(22)	(7)	(13)	(7)		(355)

2012 adjusted	3,263	2,273	2,013	1,197	1,404	74	10,224
Acquisitions and disposals*	282	23	66	75	123		569
Organic movement	178	(93)	197	181	45	2	510
2013 reported	3,723	2,203	2,276	1,453	1,572	76	11,303
Organic movement %	5	(4)	10	15	3	3	5
Marketing							
2012 reported	547	355	232	208	343	6	1,691
IFRS 11*	(4)				(16)		(20)
2012 reported (restated)	543	355	232	208	327	6	1,671
Exchange**	6	(8)	(6)	(5)	5	(1)	(9)
Disposals***	(46)	(3)	(2)	(3)	(1)		(55)
2012 adjusted	503	344	224	200	331	5	1,607
Acquisitions and disposals*	28	4	5	11	28		76
Organic movement	50	(20)	36	22	(3)	1	86
2013 reported	581	328	265	233	356	6	1,769
Organic movement %	10	(6)	16	11	(1)	20	5

Business review (continued)

	North America £ million	Western Europe £ million	Africa, Eastern Europe and Turkey £ million	Latin America and Caribbean £ million	Asia Pacific £ million	Corporate £ million	Total £ million
Operating profit before exceptional items							
2012 reported	1,360	717	575	369	342	(165)	3,198
IFRS 11 and amendment to IAS 19*	(8)	(5)	(1)	(1)	(33)	(2)	(50)
2012 reported (restated)	1,352	712	574	368	309	(167)	3,148
Exchange**	14	(12)	(12)	(4)	11	(1)	(4)
Acquisitions and disposals***	(64)	(6)	13	4	16	19	(18)
2012 adjusted	1,302	694	575	368	336	(149)	3,126
Acquisitions and disposals* **	61	5	18	5	24		113
Organic movement	115	(49)	60	95	21	(2)	240
2013 reported	1,478	650	653	468	381	(151)	3,479
Organic movement %	9	(7)	10	26	6	(1)	8
Organic operating margin %							
2013	41.18%	29.59%	28.73%	33.60%	24.64%	n/a	31.36%
2012	39.90%	30.53%	28.56%	30.74%	23.93%	n/a	30.58%
Margin improvement (bps)	128	(95)	17	286	71	n/a	78

(1) For the reconciliation of sales to net sales and operating profit before exceptional items to operating profit see page 68 and pages 159-160.

(2) Percentages and margin improvement are calculated on rounded figures.

Notes: Information relating to the organic movement calculations

* Prior year figures are restated following the adoption of IFRS 11 and the amendment to IAS 19.

** The exchange adjustments for sales, net sales, marketing and operating profit are principally in respect of the euro, the South African rand, the Australian dollar, the Turkish lira and the Brazilian real.

*** In the year ended 30 June 2013 the acquisitions and disposals that affected volume, sales, net sales, marketing spend and operating profit were as follows:

	Volume units million	Sales £ million	Net sales £ million	Marketing £ million	Operating profit £ million
2012					
Acquisitions					
Transaction costs					61

					61
Disposals					
Jose Cuervo	(4.5)	(387)	(304)	(45)	(67)
Nuvo	(0.2)	(29)	(27)	(9)	(3)
Other disposals	(0.3)	(31)	(24)	(1)	(9)
	(5.0)	(447)	(355)	(55)	(79)
Acquisitions and disposals	(5.0)	(447)	(355)	(55)	(18)
2013					
Acquisitions					
Mey Icki	0.8	113	47	3	17
SJF Holdco and Shui Jing Fang	0.4	130	115	28	