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**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 2012

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 Ordinary shares of 28 ¹⁰ / ₁₀₀ pence each	New York Stock Exchange 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: 2,754,115,985 ordinary shares of 28¹⁰/₁₀₀ 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 No

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 No

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 No

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 No

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 Accelerated Filer Non-Accelerated Filer

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

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

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 Item 18

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 No

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2012 of Diageo plc (the 2012 Form 20-F).

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This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2012. 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 2012, 2011 or 2010. KPMG Audit Plc has reported on those accounts; 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 2012, 2011 or 2010. The accounts for 2011 and 2010 have been delivered to the registrar of companies and those for 2012 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 30 to 32.

The content of the company's website (www.diageo.com and www.diageoreports.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. The brand ranking information presented in this report, when comparing volume information with competitors, has been sourced from data published during 2011 by Impact Databank. Market data information and competitive set classifications are taken from independent industry sources in the markets in which Diageo operates.

Information presented 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 'Business review' for an explanation of organic movement calculations. The market data and competitive set classifications contained in this document are taken from independent industry sources in the markets in which Diageo operates.

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Historical information

The following table presents selected consolidated financial data for Diageo prepared under 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) for the five years ended 30 June 2012 and as at the respective year ends. 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. The data presented below has been derived from Diageo's audited consolidated financial statements.

	Notes	Year ended 30 June				
		2012	2011	2010	2009	2008
		£ million	£ million	£ million	£ million	£ million
Income statement data						
Sales		14,594	13,232	12,958	12,283	10,643
Operating profit	1,2	3,158	2,595	2,574	2,418	2,212
Profit for the year						
Continuing operations	1,2	2,083	2,017	1,762	1,704	1,560
Discontinued operations	3	(11)	—	(19)	2	26
Total profit for the year	1,2	<u>2,072</u>	<u>2,017</u>	<u>1,743</u>	<u>1,706</u>	<u>1,586</u>
		pence	pence	pence	pence	pence
Per share data						
Dividend per share	4	43.50	40.40	38.10	36.10	34.35
Earnings per share						
Basic						
Continuing operations	1	78.2	76.2	66.3	64.5	58.0
Discontinued operations		(0.4)	—	(0.8)	0.1	1.0
Basic earnings per share	1	<u>77.8</u>	<u>76.2</u>	<u>65.5</u>	<u>64.6</u>	<u>59.0</u>
Diluted						
Continuing operations	1	77.8	76.0	66.2	64.3	57.6
Discontinued operations		(0.4)	—	(0.8)	0.1	1.0
Diluted earnings per share	1	<u>77.4</u>	<u>76.0</u>	<u>65.4</u>	<u>64.4</u>	<u>58.6</u>
		million	million	million	million	million
Average shares		2,495	2,493	2,486	2,485	2,566
As at 30 June						
		2012	2011	2010	2009	2008
		£ million	£ million	£ million	£ million	£ million
Balance sheet data						
Total assets	1	22,350	19,777	19,454	18,018	15,992
Net assets		6,811	5,985	4,786	3,874	4,133
Net borrowings	5	7,570	6,450	6,954	7,419	6,447
Equity attributable to the parent company's						
equity shareholders		5,588	5,245	4,007	3,169	3,463
Called up share capital	6	797	797	797	797	816

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Historical information (continued)

Notes to the historical information

1 Accounting policies The consolidated financial statements for the five years ended 30 June 2012 were prepared in accordance with IFRS. The IFRS accounting policies applied by the group to the financial information in this document are presented in 'Accounting policies of the group' in the consolidated financial statements.

2 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 the user to obtain a proper 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				
	2012	2011	2010	2009	2008
	£ million	£ million	£ million	£ million	£ million
Items included in operating profit					
Restructuring programmes	(96)	(111)	(142)	(170)	(78)
Pension changes – past service credits	115	—	—	—	—
Duty settlements	—	(127)	—	—	—
Brand impairment	(59)	(39)	(35)	—	—
SEC settlement	—	(12)	—	—	—
	<u>(40)</u>	<u>(289)</u>	<u>(177)</u>	<u>(170)</u>	<u>(78)</u>
Sale of businesses	147	(14)	(15)	—	9
Items included in taxation					
Tax on exceptional operating items	19	51	39	37	8
Tax on sale of businesses	—	3	10	—	—
Loss of future tax amortisation	(524)	—	—	—	—
Settlements with tax authorities	—	66	—	155	—
	<u>(505)</u>	<u>120</u>	<u>49</u>	<u>192</u>	<u>8</u>
Exceptional items in continuing operations	(398)	(183)	(143)	22	(61)
Discontinued operations net of taxation (note 3)	<u>(11)</u>	<u>—</u>	<u>(19)</u>	<u>2</u>	<u>26</u>
Exceptional items	<u>(409)</u>	<u>(183)</u>	<u>(162)</u>	<u>24</u>	<u>(35)</u>

3 Discontinued operations In the year ended 30 June 2012 discontinued operations represent a charge after taxation of £11 million (2011 – £nil; 2010 – £19 million) in respect of the discounted value of anticipated future payments to additional thalidomide claimants. In the years ended 30 June 2009 and 30 June 2008 discontinued operations are in respect of the packaged food business (Pillsbury sold 31 October 2001).

4 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.

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Historical information (continued)

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 noon buying rate on each of the respective dividend payment dates.

		Year ended 30 June				
		2012	2011	2010	2009	2008
		pence	pence	pence	pence	pence
Per ordinary share	Interim	16.60	15.50	14.60	13.90	13.20
	Final	26.90	24.90	23.50	22.20	21.15
	Total	43.50	40.40	38.10	36.10	34.35
		\$	\$	\$	\$	\$
Per ADS	Interim	1.05	1.02	0.90	0.82	1.05
	Final	1.69	1.59	1.48	1.46	1.46
	Total	2.74	2.61	2.38	2.28	2.51

Note: Subject to shareholders' approval the final dividend for the year ended 30 June 2012 will be paid on 22 October 2012, and payment to US ADR holders will be made on 26 October 2012. In the table above, an exchange rate of £1 = \$1.57 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 22 October 2012.

5 Net borrowings definition 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 and other liquid resources.

6 Share capital During the year ended 30 June 2009 the company purchased 38 million (2008 – 97 million) ordinary shares for cancellation or to be held as treasury shares at a cost of £354 million (2008 – £1,008 million) as part of a share buyback programme.

7 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 23 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				
		2012	2011	2010	2009	2008
		\$	\$	\$	\$	\$
Year end		1.57	1.61	1.50	1.65	1.99
Average rate(a)		1.59	1.59	1.57	1.60	2.01

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

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Historical information (continued)

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 24 August 2012, expressed in US dollars per £1. The information in respect of the month of August is for the period up to and including 24 August 2012. The US dollar/pound sterling noon buying exchange rate on 24 August 2012 was 1.58.

	2012					
	<u>August</u>	<u>July</u>	<u>June</u>	<u>May</u>	<u>April</u>	<u>March</u>
	\$	\$	\$	\$	\$	\$
Month end	1.58	1.57	1.57	1.54	1.62	1.60
Month high	1.59	1.57	1.57	1.62	1.63	1.60
Month low	1.55	1.54	1.54	1.54	1.58	1.56
Average rate(b)	1.57	1.56	1.56	1.59	1.60	1.58

(b) The average of the noon buying rates on each business day of the month.

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 2(e) to the consolidated financial statements for the actual rates used in the preparation of the consolidated financial statements.

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Business description

Diageo is the world's leading premium drinks business. Its geographic breadth and range of leading brands across categories is unparalleled. The business is balanced having a strong presence in the world's largest and most profitable beverage alcohol market, the United States; an integrated Western European business; and a large and increasing presence in the faster growing markets of Asia, Africa, Latin America, Russia and Eastern Europe. Diageo's strong financial position has been built through the growth of its brands, the development of its routes to market and the value creating acquisitions it has made. Diageo maintains the strength of its brands through excellence in marketing and innovation. Diageo has scale but acts with agility to deliver top line growth, margin improvement and improving shareholder returns. Diageo is proud of the role its brands play in the social life and celebrations of consumers around the globe.

Diageo plc is incorporated as a public limited company in England and Wales. Diageo was incorporated as Arthur Guinness Son & 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.

Strategy

Diageo's strategy is to drive top line growth and margin improvement in a sustainable and responsible way, to deliver consistent value creation for shareholders over the long term. It will do this through its geographic breadth, its outstanding brands across beverage alcohol categories and the expertise of its people.

Diageo's broad range of leading brands covers all major categories. It owns seven of the world's top 20 brands, including Smirnoff, the number one brand by volume and Johnnie Walker, the number one brand by value and manages Jose Cuervo, making Diageo the leading premium spirits business in the world by volume, net sales and operating profit. In beer, Diageo owns one of the truly global beer brands, Guinness. Diageo's wine brands are sold predominantly in North America and Great Britain. Diageo's global brands are complemented by strong local brands to create category breadth. Diageo's brands cover a range of price points, from Diageo's reserve brands, including Johnnie Walker Blue Label, Ciroc and Ketel One vodka to more affordable brands, tailored for the growing number of emerging middle class consumers, such as VAT69 in India, White Horse in Russia and 20cl bottles of Johnnie Walker Red Label across Africa.

Diageo is a global company selling products in more than 180 markets around the world. In the developed markets, primarily, in North America and Europe, Diageo has built scale and strong routes to market. In the emerging markets, Diageo is the number one international spirits company in Asia, Latin America and Africa. These rapidly growing markets now contribute nearly 40% of Diageo's net sales, up from a fifth in 2005. These markets are expected to contribute 50% of Diageo's net sales by 2015 through double digit organic growth and targeted acquisitions.

Diageo, consistent with its current strategy, will continue to focus on growing its brands on a worldwide basis and expects to make selective acquisitions in both its developed and emerging markets. Diageo explores the potential to make acquisitions on an ongoing basis and is currently evaluating a number of such opportunities of which some could be significant although no agreements or commitments for any significant acquisitions currently exist. Funds for any such acquisitions would be drawn from internally generated cash, bank borrowings or the issuance of equity or debt securities (in an amount that cannot now be determined) and the proceeds of any potential disposals. No material disposals are currently contemplated.

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Business description (continued)

In evaluating financing of any such acquisitions, Diageo's management remains committed to enhancing shareholder value in the long term, both by investing in the businesses and brands so as to improve the return on investment and by managing the group's capital structure. The acquisitions of Mey İçki in Turkey, Ypióca in Brazil, the Serengeti and Meta breweries in Africa and the investments in Shuijingfang and Halico in Asia were partially driven by this strategy.

Diageo leads the industry in marketing and innovation combining expertise and creative alliances to engage consumers via digital and traditional media channels. This expertise and collaboration, combined with the benefits of global scale and consumer insights, delivers world class marketing campaigns. For example, the global Johnnie Walker 'Keep Walking' campaign has been in place for over 10 years. While the campaign is based on the universal appeal of personal progress, each market has local creative executions which reflect local insights.

Diageo's innovation programme is also based on consumer insights. Recent launches have focused on the consumers' wish for luxury, the tastes and increasing affluence of the emerging middle class consumer and have increased the accessibility of spirits through flavour extensions and packaging and drink formats.

Diageo has strong routes to market which leverage local expertise. In the United States Diageo is required by law to operate via a three-tier distribution system which separates suppliers, distributors and retailers. Diageo works with distributors who provide a substantial dedicated sales team of over 2,900 people. Outside of the United States Diageo owns and controls the route to market in many markets, and where Diageo has not established its own subsidiary, the route to market is through joint ventures, associates and third party distributors. Diageo works in collaboration with its customers to drive profitable category growth, by building partnerships with retailers and on-premise customers. The 'Diageo Way of Selling' programme equips both Diageo and its customers with the tools to be the best sales force in the industry and to create commercial and strategic value for all parties. The European Customer Collaboration Centre provides a state of the art facility to bring consumer, shopper, retailer and distributor insights together to facilitate integrated planning with customers. These tools enable Diageo to realise its ambition to become an indispensable business partner to its customers.

Diageo has a history of being a sustainable and responsible company dating from Arthur Guinness who was responsible for philanthropic community programmes and through the 1930s when its predecessor companies marketed their brands in a responsible manner. Diageo understands the social, environmental and economic impact of its activities and has adopted a structured approach to manage these impacts, to build engagement across stakeholders, to create value, especially in emerging markets; and to protect Diageo's license to operate.

Diageo and its employees are proud of the responsible manner in which its brands are marketed and the role that moderate consumption of its brands can play as part of the balanced lifestyle for millions of people. Diageo seeks to be at the forefront of industry efforts to promote responsible drinking and works with key stakeholders to combat alcohol misuse.

Diageo's supply organisation is responsible for producing, distilling, brewing, bottling, packaging and distributing its brands. It is committed to efficient, sustainable production. Diageo has created a competitive advantage in both its cost base and in the first class customer service it delivers. Investment in production facilities is focused on building capacity for the production of scotch, beer and rum, with both high speed and high volume, cost efficient production lines and with flexible production facilities to create an industry leading supply chain for innovation, especially in luxury products. The business recognises that it operates in a world where natural resources are limited. Diageo has set itself

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Business description (continued)

challenging environmental targets covering water efficiency; increasing use of sustainable packaging and reduction in pollution, carbon emissions and waste-to-landfill. Diageo's production teams have created award winning technologies to meet these targets with the aim of reducing Diageo's environmental footprint, delivering business efficiencies and securing supply into the future.

Diageo is committed to generating prosperity in the communities in which it operates, especially in the emerging markets by integrating its supply chain into the local community and via direct community initiatives such as 'Learning for Life' and 'Water of Life'.

Diageo believes that industry leading performance will be delivered through a talented and diverse workforce and great leadership. The company has active programmes that ensure the development of its management and leaders. Great leadership combined with a culture of good governance and ethics, protect Diageo's reputation and supports the sustainable efficient growth of the business.

Business overview

Market participation Diageo manages its business through five regions: North America, Europe, Africa, Latin America and Caribbean and Asia Pacific. North America is the biggest region by net sales and operating profit. Here the business is focused on using scale to drive cost advantage, to drive continued growth in the on trade, to deliver industry leading innovation and broaden its reach to the multicultural consumer. Europe comprises Western Europe, Russia and Eastern Europe and Turkey. The country teams within Western Europe focus on sales execution, whilst marketing and back office functions are integrated at a Western Europe level to drive flexibility and efficiency. The remaining emerging markets of Europe are resourced to capture the opportunity presented by the growing number of middle class consumers. The strategy in Africa is to grow Diageo's leadership across beverage alcohol, increasing its presence in beer and growing the international spirits business. In Latin America and Caribbean the primary focus is continued leadership in scotch, whilst broadening category breadth to include vodka and liqueurs. The strategy in Asia Pacific is to drive net sales growth through the continued development of super and ultra premium scotch and leverage the emerging middle class consumer opportunity in the faster growing markets via a combination of organic and inorganic growth.

Market leading brands In calendar year 2011, the Diageo brand range included eight of the top 20 premium spirits brands worldwide by volume estimated by Impact Databank. Diageo classifies its brands as spirits, beer, wine and ready to drink.

An analysis of the group's volume is as follows:

	2012 Volume	2011 Volume	2010 Volume
	units million	units million	units million
Spirits	121	113	109
Beer	27	26	25
Wine	3	3	3
Ready to drink	6	6	6
Total	<u>157</u>	<u>148</u>	<u>143</u>

Strategic brands Diageo classifies 14 brands as strategic brands worldwide. These brands are considered to have the greatest current and future earnings potential. Figures for strategic brands

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Business description (continued)

exclude related ready to drink products. In the year ended 30 June 2012, strategic brands accounted for 61% of volume and 60% of net sales. 72% of the group's marketing spend supports these brands.

<u>Brand</u>	<u>2012 Volume</u> <u>units million</u>	
Johnnie Walker Scotch whisky	19	The number one Scotch whisky in the world*
Crown Royal Canadian whisky	5	The number one Canadian whisky in the world**
J&B Scotch whisky	5	The number five Scotch whisky in the world*
Buchanan's Scotch whisky	2	The number two premium Scotch whisky in Latin America*
Windsor Premier Scotch whisky	1	The number one super premium Scotch whisky in Asia Pacific*
Bushmills Irish whiskey	1	Distilled at Ireland's oldest working distillery
Smirnoff vodka	26	The number one premium vodka in the world**
Ketel One vodka (exclusive worldwide distribution rights)	2	The number two super premium vodka in the United States***
Ciroc vodka	2	The number two ultra premium vodka in the world*
Captain Morgan rum and rum based products	10	The number two brand in the rum category in the world**
Baileys Irish Cream liqueur	7	The number one liqueur in the world**
Jose Cuervo tequila (agency brand in North America and many other markets)†	4	The number one premium tequila in the world**
Tanqueray gin	2	The number one imported gin in the United States****
Guinness stout	11	The number one stout in the world*****

* Source: IWSR 2011;

** Source: Impact Databank;

*** Source: IRI;

****Source: Adams Market Research Alcohol Beverage Industry;

*****Source: Plato Logic

† Portfolio of premium drinks comprises brands owned by the company as a principal and some brands held by the company under agency or distribution agreements. Diageo's principal agency brand is Jose Cuervo in North America and many other markets (with distribution rights extending to 1 July 2013).

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Business description (continued)

<u>Other spirits brands include</u>	<u>Other beer brands include*</u>	<u>Wine brands include</u>	<u>Ready to drink brands include</u>
Gordon's gin and vodka	Malta Guinness non-alcoholic malt	Blossom Hill	Smirnoff Ice
Old Parr Scotch whisky	Harp lager	Sterling Vineyards	Smirnoff cocktails
Bundaberg rum	Tusker lager	Beaulieu Vineyard	Bundaberg ready to drink
Seagram's 7 Crown whiskey	Senator lager		Jose Cuervo cocktails
Bell's Scotch whisky	Red Stripe lager		
The Classic Malts Scotch whiskies			
Yeni Raki			

* Diageo also brews and sells other companies' beer brands under licence, including Budweiser and Carlsberg lagers in Ireland, Heineken lager in Jamaica and Tiger beer in Malaysia. There can be no assurance that Diageo will be able to prevent termination of distribution, manufacturing or licence agreements or to renegotiate distribution, manufacturing or licence agreements on favourable terms when they expire.

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.

Approximately 84% of total manufacturing is undertaken by Global Supply organised into four production centres: Europe Supply, America Supply, Global Beer Supply and Asia Pacific Supply. The remaining production activities of the group are integrated into the distribution organisation, principally in Africa. The locations, principal activities, products, packaging production capacity and packaging production volume of Diageo's principal production centres in the year ended 30 June 2012 are set out in the table below:

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Business description (continued)

Production centre	Location	Principal products	Production capacity in millions of equivalent units*	Production volume in 2012 in millions of equivalent units
Europe Supply	United Kingdom	Scotch whisky, Irish whiskey, gin, vodka, rum, ready to drink	80	52
	Ireland (Baileys)	Irish cream liqueur, vodka	12	8
	Italy (Santa Vittoria)	Vodka, wine, rum, ready to drink	10	6
	Turkey	Raki, vodka, gin, liqueur, wine	10	7
America Supply	United States, Canada, US Virgin Islands	Vodka, gin, tequila, rum, wine, Canadian whisky, American whiskey, progressive adult beverages, ready to drink	44	38
	United States	Wine	2	1
Global Beer Supply	Ireland (Guinness)	Beer	9	8
	Jamaica	Beer	1	1
Asia Pacific Supply	Australia	Rum, vodka, ready to drink	4	3
	Singapore	Finishing centre	4	2
Africa Supply	Nigeria	Beer	6	5
	South Africa	Beer and spirits	3	3
	East Africa	Beer	10	9
	Africa Regional Markets	Beer	3	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 2012 adjusted for the elimination of unplanned losses and inefficiencies, and taking into account planned manning levels for the coming year.

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 with the production of some brands such as Gordon's vodka (United States) or Cîroc (France) being managed in one location. 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, blended and bottled in the US Virgin Islands, Australia, Venezuela and also as a result of an acquisition of a controlling interest in Zacapa in July 2011, in Guatemala. Diageo's

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Business description (continued)

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 June 2012, Diageo acquired a controlling equity stake in Sichuan Shuijingfang Co., Ltd (Shuijingfang). Shuijingfang owns a distillery which produces a Chinese white spirit, in Chengdu, Sichuan province in China.

In August 2011 Diageo acquired Mey İçki which owns ten plants in Turkey. Six of these plants are intermediate and finishing plants for raki. Two plants are for vodka, gin and liqueur production and two for wine production.

In May 2011 Diageo announced the closure of the Menlo Park bottling plant in California and the specialty product building at the Relay plant in Maryland, in the United States. New investment is being made in the North American spirits supply chain principally in the packaging plants at Plainfield in Illinois and Relay in Maryland.

A restructuring of the group's supply operations in Scotland was announced in July 2009. This resulted in the consolidation of production activities into fewer sites. The Kilmarnock packaging plant ceased operations in March 2012 after production was moved to the newly expanded packaging facility at Leven in Fife.

The group plans to lay down maturing scotch inventory in order to be able to meet future demand and to invest at a cost of over £500 million in maturing spirit over the next five years. This requires the construction of a new malt distillery and additional distillation and warehousing capacity in Scotland for over £500 million in the same period.

A distillery was opened in November 2010 in St. Croix as a result of a public/private initiative formed by Diageo and the government of the US Virgin Islands. This new facility has the capacity to distil up to 13 million equivalent units annually and will supply all bulk rum used to produce Captain Morgan branded products for the United States.

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

Diageo's principal brewing facilities are at the St James's Gate brewery in Dublin, Ireland and also in Nigeria, Kenya, Ghana, Cameroon, Tanzania, Malaysia and Jamaica. In addition, Diageo owns a 25% equity interest in Sedibeng brewery in South Africa and in January 2012 completed the acquisition of Meta Abo Brewery in Ethiopia. Additionally, Guinness is brewed by more than 35 third parties around the world under licence arrangements. Guinness flavour extract is shipped from Ireland to all overseas Guinness brewing operations. In January 2012 Diageo announced that its Irish breweries will be centralised in Dublin's St James's Gate site as part of an investment project at a cost of €153 million (£123 million). The brewing activities at Dundalk and Kilkenny are expected to cease by the end of 2013.

All Guinness Draught production in the Republic of Ireland is at the St James's Gate brewery in Dublin. 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, transported to the United Kingdom in bulk for the Great Britain market.

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Business description (continued)

Diageo's principal wineries are in the United States and Argentina. For European markets, wines are mainly bottled in Diageo's facilities in Italy. Wines are sold both in their local markets and overseas.

Property, plant and equipment Diageo owns approximately 90% of the manufacturing, distilling, brewing, bottling and administration facilities it uses across the group's worldwide operations. It holds approximately 5% of properties on leases in excess of 50 years. The principal production facilities are described above. As at 30 June 2012, Diageo's land and buildings are included in the group's consolidated balance sheet at a net book value of £877 million. Diageo's two largest individual facilities, in terms of book value, are the Leven bottling and blending facility in Scotland and St James's Gate brewery in Dublin. Of the book value of Diageo's lands and buildings approximately 37% are properties located in Great Britain, 18% in Ireland and 16% in the United States.

During the years ended 30 June 2011 and 30 June 2010 a number of vineyards and facilities located in Napa Valley, California were sold and leased back to Diageo under a 20-year lease, with Diageo holding options to extend the lease at fair value for up to 80 years in total. Diageo remains the operator of the properties under the lease agreement and retains ownership of the brands, vines and grapes, which remain a strategic part of Diageo's wine business.

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, tequila, bulk whisky, neutral spirits, cream, rum and grapes. In addition, forward contracts are in place for the purchase of other raw materials including sugar and 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 are sourced from suppliers in the United States and Argentina. 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 suppliers located around the world, the principal supplier being the Owens Illinois group.

Diageo has a supply agreement with Casa Cuervo SA de CV, a Mexican company, for the supply of bulk tequila used to make the Jose Cuervo line of tequilas and tequila drinks in the United States. The supply agreement extends to June 2013. Diageo is currently in negotiations with Casa Cuervo SA regarding the relationship between the two companies.

Diageo sources rum for its Captain Morgan products from the Diageo distillery in the US Virgin Islands.

Marketing and distribution Diageo is committed to investing in its brands. In the year ended 30 June 2012, £1,691 million was spent worldwide on marketing brands with a focus on its 14 strategic brands that accounted for 72% of total marketing spend.

Diageo makes extensive use of a diverse range of new and traditional media, from magazine, newspaper, point of sale and billboard advertising, and uses radio, cinema, television and online advertising where appropriate and permitted by law to engage with consumers and customers. Diageo runs consumer promotional programmes in the on trade (for example, licensed bars and restaurants) and supports customers in both the on and off trades with shopper/consumer promotions.

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Business description (continued)

Sponsorship also plays an important role in Diageo's brand marketing and commercial profile. Diageo has formed innovative global partnerships in music with Madonna and Live Nation, the Guinness 'Arthur's Day' concerts and the Buchanan's 'Share Yourself' platform. Diageo also has important partnerships in sport, such as the Vodafone McLaren Mercedes Formula One Team, Manchester United, in rugby, with the English, Irish, Scottish and Welsh rugby teams as well as the Six Nations Championship, and in golf as title sponsor of the Johnnie Walker Championship and sponsor and host of the 2014 Ryder Cup at Gleneagles.

Business analysis In the year ended 30 June 2012, North America, Europe, Africa, Latin America and Caribbean and Asia Pacific contributed 40%, 27%, 11%, 11% and 10%, respectively, of the group's operating profit before exceptional items and corporate costs.

An analysis of net sales and operating profit by operating segment for the year ended 30 June 2012 is set out in the table below.

	2012			2011 (restated)*		
	Net sales	Operating profit/(loss) before exceptional items	Operating profit/(loss)	Net sales	Operating profit/(loss) before exceptional items	Operating profit/(loss)
	£ million	£ million	£ million	£ million	£ million	£ million
North America	3,556	1,354	1,343	3,366	1,275	1,252
Europe	2,949	925	966	2,703	796	639
Africa	1,447	380	375	1,357	333	326
Latin America and Caribbean	1,239	383	381	1,063	318	312
Asia Pacific	1,501	342	332	1,377	299	249
Global Supply	—	—	(40)	—	—	(35)
Corporate	70	(186)	(199)	70	(137)	(148)
Total	10,762	3,198	3,158	9,936	2,884	2,595

* Restated for changes in reporting segments, see page 35.

North America North America is the largest market for Diageo in terms of operating profit, and the largest market for premium drinks in the world. Diageo sells and markets its products through four operating units: US Spirits & Wines, Diageo-Guinness USA, Diageo Chateau & Estate Wines and Diageo Canada. From the year ended 30 June 2012, North America includes the North American operations of Global Travel.

The United States Spirits & Wines business, while managed as a single business unit, executes sales and marketing activities through seven divisions. Within the United States, there are generally two types of regulatory environments for spirits and wine: open states and control states. In open states, companies are permitted to sell spirits directly to independent distributors. In these open states, Diageo generally trades through a three-tier distribution system, where the product is initially sold to distributors, who then sell it to on and off trade retailers. In most control states, Diageo sells its spirits products to state liquor control boards through the bailment warehousing system, and from there to state or agency liquor stores. There are variations – for example, certain states control distribution but not retail sales. Generally, wines are treated in the same way as spirits, although most states that are

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Business description (continued)

control states for spirits are open states for wines. Five of the US Spirits & Wine divisions execute against open states and two execute against control states.

National brand strategy and strategic accounts marketing are managed at the North America level. The Spirits & Wines divisions market Diageo's collection of spirits and wine brands across the United States.

Diageo-Guinness USA markets Diageo's US beer brands nationally as well as the group's progressive adult beverages. Beer distribution generally follows the three-tier open state regulations across the US.

Diageo Chateau & Estate Wines (DC&E) owns, leases and operates wineries in California. In the US, the majority of the wine is sold through the Spirits & Wines divisions with the remainder sold through the winery visitors centres and club sales. In the year ended 30 June 2012, DC&E completed its portfolio rationalisation strategy disposing of certain brands and terminating other agency brands.

The Canada business unit distributes the group's collection of spirits, beer and wine brands across all Canadian territories. In Canada, beer and spirits distribution laws are generally consistent and similar to those of control states in the United States. Diageo, however, has some licences to deliver keg beer directly to licensed accounts, which account for approximately 20% of Diageo's beer business in Canada.

Across the United States, Diageo's distributors and brokers have over 2,900 dedicated sales people focused on selling its spirits and wine brands. Diageo has pursued a distribution strategy centred on consolidating the distribution of Diageo's US spirits and wine brands into a single distributor or broker in each state where possible. The strategy is designed to provide a consolidated distribution network, which will limit the duplication of activities between Diageo and the distributor, improve selling capabilities and enable a number of alternative approaches to optimise product distribution. To date, Diageo has consolidated its business in 41 markets (40 states plus Washington DC), representing over 80% of Diageo's US spirits and wine volume. The remaining states will be consolidated as opportunities arise. Diageo continues to focus on building the capabilities and selling tools of the distributors' dedicated sales forces and creating a more efficient and effective value chain.

Europe In the year ended 30 June 2012 Europe comprises Western Europe, Russia and Eastern Europe, Turkey and the European operations of Global Travel.

Western Europe comprises Great Britain, Ireland, Iberia, Italy, Switzerland, Germany, Austria, Benelux, Nordics, France, Greece, the Western European reserve brands, Diageo Guinness Continental Europe and European wines.

In Great Britain, Diageo sells and markets its products via 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 the major grocers, convenience and specialist stores. In the on trade (for example, licensed bars and restaurants), products are sold through the major brewers, multiple retail groups and smaller regional independent brewers and wholesalers. The customer base in Great Britain has seen consolidation in recent years in both the on trade and home consumption channels.

Ireland comprises the Republic of Ireland and Northern Ireland. In both territories, Diageo sells and distributes directly to both the on trade and the off trade (for example, retail shops and wholesalers) through a telesales operation, extensive sales calls to outlets and third party logistics providers.

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Business description (continued)

Across the remainder of Western Europe, Diageo distributes its spirits brands primarily through its own distribution companies with the following exceptions. In France Diageo sells its spirits and wine products through a joint arrangement with Moët Hennessy, and its beer products through Brasseries Kronenbourg (part of the Carlsberg group). In the Nordic countries Diageo has sales offices in Sweden, Norway and Denmark, and representation through third party distributors in Finland and Iceland. In all Nordic markets except Denmark, off trade sales are controlled by state monopolies, with alcohol tax rates among the highest in the world, and border trade and duty free are important sources of sales. Smirnoff Ice is sold in Nordic countries through Carlsberg.

A specialist unit, Diageo Guinness Continental Europe, has been established for the distribution of Diageo's beer brands in mainland Europe in order to achieve synergies in the marketing and distribution of the Guinness and Kilkenny brands. The distribution of these brands is managed by this specialist unit with particular focus on Germany, Russia and France, which are the largest mainland European beer markets by size for Diageo.

Russia and Eastern Europe comprises Russia, Poland and 32 distributor serviced countries in Central and Eastern Europe. In Russia and Poland Diageo operates through wholly owned subsidiaries. Throughout the whole of the former Soviet Union and Eastern Block (excluding Russia and Poland) plus Iceland, Finland, Malta, Cyprus and Israel, Diageo sells and markets its brands via local distributors. In Hungary, Diageo sells its brands through its associate company Zwack.

In Turkey, Diageo sells its products via the distribution network of its wholly owned subsidiary, Mey İçki. Mey İçki distributes both local brands which are produced in its distilleries (raki, other spirits and wine) and Diageo's global spirits brands. Sales to traditional on and off trade outlets are made through Mey İçki's exclusive distributors and sales to some large store chains are made directly by Mey İçki.

Africa In the year ended 30 June 2012, Africa comprises Nigeria, East Africa (Kenya, Tanzania, Uganda, Burundi, Rwanda and South Sudan), South Africa, Africa Regional Markets (including Ghana, Cameroon, Ethiopia, Angola and Mozambique) and the African operations of Global Travel. Diageo has 14 breweries in Africa including Sedibeng in South Africa which is 25% owned by Diageo. In addition, Diageo's beer and spirits brands are produced by third parties in 20 other African countries. Diageo also owns six other manufacturing facilities including glass manufacturing, blending, malting and cider plants.

In Nigeria, Guinness, Harp and Malta are principal brands that are brewed and distributed by Guinness Nigeria plc. Diageo owns 53.8% of the company, which has been brewing Guinness locally since 1962. Diageo's spirits brands are distributed by a wholly owned subsidiary.

East African Breweries Limited (EABL) is the leading premium drinks business in East Africa and produces and distributes beer and spirits brands to a range of consumers. Diageo owns 50.03% of EABL which in turn owns 100% of Kenya Breweries Limited, 98% of Uganda Breweries Limited and 51% of Serengeti Breweries Limited in Tanzania. South Sudan, Rwanda and Burundi are serviced through third party arrangements. EABL also owns a glass manufacturer and a malting business.

In South Africa Diageo's business consists of its spirits business through its wholly owned subsidiary Diageo South Africa Limited (DSA); a 42.25% share in DHN Drinks (Pty) Ltd (DHN), a joint venture with Heineken International (Heineken) and Namibia Breweries Ltd in respect of beer, cider and ready to drink brands; and a 25% interest in Sedibeng Brewery (Pty) Ltd, the remainder being owned by Heineken. The route to market for DSA and DHN's brands in South Africa is managed by brandhouse Beverages (Pty) Ltd (brandhouse). Brandhouse is a cost sharing joint venture

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Business description (continued)

owned equally between DSA and DHN. Diageo also owns 15.01% of Namibia Breweries Ltd. Namibia Breweries is the producer of Windhoek lager which is sold mainly in Namibia and through DHN in South Africa.

Within Africa Regional Markets, Diageo has wholly owned subsidiaries in Cameroon, Ethiopia and Reunion and majority owned subsidiaries in Ghana and the Seychelles. Angola and Mozambique are currently supplied by third party arrangements. In 2012 Diageo acquired 100% of the equity of Meta Abo Brewery from the Ethiopian government, of which Meta beer is the principal brand.

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.

Latin America and Caribbean In the year ended 30 June 2012, Latin America and Caribbean comprises PUB (Paraguay, Uruguay, Brazil), West LAC, Andean (Venezuela, Colombia), Mexico and the LAC operations of Global Travel.

In Latin America and Caribbean, distribution is achieved through a mixture of Diageo companies and third party distributors. In addition, Diageo owns a controlling interest in Desnoes & Geddes Limited, the Jamaican brewer of Red Stripe lager.

In PUB, Diageo sells directly to international retailers in Brazil, while selling through distributors and wholesalers for the remainder of the business. In Paraguay the majority of customers are served by Diageo with a portion of sales completed through wholesalers. In Uruguay, Diageo's distribution company manages approximately half of the sales in the market with the other half managed through wholesalers. In August 2012 Diageo completed the acquisition of 100% of Ypióca, the leading producer and distributor of a cachaça brand from Ypióca Agroindustrial Limitada.

West LAC comprises Central America and Caribbean, Jamaica, Argentina, Chile, Peru, Ecuador and Bolivia. In select markets such as the Free Trade Zone, Bolivia and Ecuador, sales are managed directly by Diageo. Key markets such as Costa Rica and the Dominican Republic sell via exclusive distributors, while in Puerto Rico, Trinidad, Guatemala and Panama, third party distributors purchase directly from Diageo and sell on to the local trade. In Chile, Diageo sells directly to international retailers, partnering with an exclusive distributor in the remainder of the country for other channels. In Argentina, Diageo's business is managed through a combination of wholesalers and distributors outside of major grocers, to whom Diageo sells directly. Diageo Argentina also owns and operates the Navarro Correas winery in Mendoza, Argentina. The winery sells directly to consumers. Jamaica sells to wholesalers and directly to retail trade accounts on the island.

In Andean, all products in Venezuela are sold through dedicated third party distributors. In Colombia, Diageo sells directly to major grocers, serving all other accounts and channels through distributors.

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

Asia Pacific In the year ended 30 June 2012, Asia Pacific comprises South East Asia (Vietnam, Thailand, Philippines, Indonesia, Malaysia and Singapore), Australia, North Asia (Korea and Japan), Greater China (China, Taiwan, Hong Kong and Macau), India and Global Travel Asia and Middle East. Diageo operates via a combination of Diageo companies, joint ventures and third party distributors in the region.

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Business description (continued)

In South East Asia, Diageo distributes its spirits brands through joint venture arrangements with Moët Hennessy in Thailand, Malaysia and Singapore. In Indonesia, Guinness is brewed by PT Multi Bintang Indonesia, and is distributed through a distribution agreement with PT Dima Indonesia while spirit brands are distributed by government licensed distributors. In Malaysia, Diageo's own and third party beers are brewed and distributed by a listed business (Guinness Anchor Berhad) in which Diageo and its partner, Asia Pacific Breweries, have a majority share through a jointly controlled entity. In Singapore, Diageo's beer brands are brewed and distributed by Asia Pacific Breweries. In Vietnam, Diageo's brands are distributed through its own distribution company. Diageo entered into a strategic partnership agreement with Hanoi Liquor Joint Stock Company (Halico) in January 2011. During the year Diageo acquired additional shares that increased its equity stake to 45.5% in Halico. Diageo also increased its ownership in Diageo Philippines Inc, a company that distributes Diageo's spirits brands in the Philippines, by 49% to 100%.

In Australia, Diageo has its own production and distribution company. The previous distribution agreement with VOK Beverages that included a number of smaller brands like J&B and Dimple was terminated on 31 January 2012. Diageo also has a licensed brewing arrangement with Foster's which will transfer to Lion Nathan from November 2012. In New Zealand, Diageo operates through third party distributors and has a licensed brewing arrangement with Lion Nathan.

In North Asia, Diageo has its own distribution company in Korea. In Japan, the joint venture with Moët Hennessy distributes super premium brands such as the super deluxe variants of Johnnie Walker, while the joint venture with Kirin distributes Diageo's other premium spirits such as Johnnie Walker Black Label and Smirnoff, as well as Guinness and Smirnoff Ice. Other spirit brands, which are not distributed by either Moët Hennessy or the Kirin joint venture, are distributed by third parties.

In Greater China, Diageo distributes the majority of its spirits brands through a joint venture arrangement with Moët Hennessy in China, Hong Kong and Macau. Diageo also owns a wholly owned subsidiary in China that distributes brands not included in the joint venture such as Smirnoff, Windsor and Baileys. Diageo's beer brands are sold through a distribution agreement with Carlsberg in China and Hong Kong. In July 2011, Diageo acquired an additional 4% equity stake in Sichuan Chengdu Quanxing Company Ltd. (Quanxing) bringing its equity stake to 53%. Quanxing is a holding company controlling a 39.7% equity stake in Shuijingfang a super premium Chinese white spirits company which itself became a subsidiary of Diageo following the appointment of additional directors in June 2012. Diageo is the sole distributor of Shuijingfang's Chinese white spirits outside of China. In Taiwan, Diageo has its own distribution company for spirits.

In India, Diageo has its own spirits distribution company.

Airport shops and airline customers in Asia Pacific are serviced through a dedicated Diageo sales and marketing organisation. In the Middle East, distribution is achieved through third party distributors. Lebanon is an exception, where a Diageo subsidiary distributes the majority of the Diageo brands sold there.

Global Supply Global Supply is responsible for the production of approximately 81% of Diageo's products sold globally, for sourcing materials and services through global procurement, for providing consistent technical support through the global technical function and providing logistic and customer services through the global supply chain organisation.

Global procurement has responsibility for sourcing goods and services on behalf of the Diageo group. A global network of suppliers provides for a wide range of raw materials and packaging items that are necessary to ensure consistency of quality to support the brands. With the high level of

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Business description (continued)

dependency on agricultural commodities such as cereals, hops and sugar, forward-buying takes place to minimise value at risk. In marketing, global procurement supports the business in sourcing creative media solutions, sponsorship and point of sale activities. Global procurement also supports business services, facilities and computer services.

The global technical function develops and implements consistent engineering solutions across the Global Supply organisation and in other production sites in Africa and Asia. The global supply chain function also provides logistics services in Europe and is responsible for a consistent customer service globally.

Corporate Corporate costs which cannot be directly allocated to the business areas are reported separately within Corporate in the analysis of business performance. Also included in Corporate are the revenues and costs related to rents receivable in respect of properties not used by Diageo in the manufacture, sale or distribution of premium drink products and the results of Gleneagles Hotel.

Seasonal impacts Approximately 40% of annual net sales occur in the last four months of each calendar year.

Employees Diageo's people, its culture and its values are at the heart of the company's strategy and Diageo's directors believe this to be a source of competitive advantage. It continues to be Diageo's goal to release the potential of all of its people.

Diageo's review of its operating model during the past year and the resulting changes have presented new challenges for its employees. In developed markets the new operating model has meant a focus on efficiency and customer orientation. For emerging markets, it has resulted in a greater focus on investment in brands and in commercial and leadership capability. As a consequence, there has been an internal shift of employees and resources to the areas of greatest potential growth. Early indicators suggest that Diageo's employees feel that they have benefited from this new and focused approach. Diageo has been committed to providing its employees with appropriate support during this transition period, both in the case of employees that have left the company following the changes and those that have taken on new roles within the company.

Diageo prides itself on creating an environment that is both welcoming and inspirational for its employees and is proud to have been included in the prestigious Great Place to Work Institute's '25 Best Multinational Workplaces', achieving an 11th place ranking confirming its place as a leading global employer. Diageo has also been recognised in reports published by Great Place to Work Institute as a leading workplace in Argentina, Australia, Brazil, Canada, Colombia, the European Union, Germany, Ireland, the Latin America region, Mexico, the Netherlands, Nigeria, Portugal, Uganda, the United Kingdom, Uruguay and Venezuela. These achievements have only been possible through the commitment of the thousands of talented and inspirational employees who have collectively made Diageo a great place to work.

Diageo values diversity in its workforce and works to ensure that the group is inclusive of all people, regardless of their background or style. To enhance diversity, Diageo aims to create opportunities that are attractive to a wide range of candidates, including those with disabilities, and seeks to make working for Diageo compatible with a variety of lifestyles. Diageo sponsors an ever growing number of employee networks around the world that seek to support diverse interest groups. The company also seeks to design and adjust roles to accommodate people's lifestyles and increasingly encourages flexible working. Not only is this approach to inclusion and diversity consistent with Diageo's values, it is also believed to be important for the long term health of the organisation. As part

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Business description (continued)

of Diageo's global policies, Diageo emphasises the importance of treating individuals justly and in a non-discriminatory manner in all aspects of employment, including recruitment, compensation and benefits, training, promotion, transfer and termination. Accordingly, factors not relevant to the requirements of a role, including without limitation race, religion, colour, ethnic or national origin, disability, sexual orientation, gender or marital status, are not considered, and reasonable adjustments are considered (and if necessary appropriate training provided) so that no individual is disadvantaged.

Diageo strongly believes in the value of its employees sharing in the company's success and actively encourage employees to become shareholders. The group seeks out opportunities to extend employee share ownership around the world and in 2012 31 countries operated an all employee share plan. A further two countries will be invited to participate in Diageo's International Sharematch Plan later this year. This, combined with existing employee share plans, will further extend the opportunity to the majority of employees across a significant number of Diageo's markets to share in the company's growth and success. As at 30 June 2012, 16,531 past and present employees held 1.16% (2011 – 1.17%) of Diageo's ordinary issued share capital.

<u>Average number of employees</u>	<u>2012</u>	<u>2011</u> <u>(restated)*</u>	<u>2010</u> <u>(restated)*</u>
North America	1,105	1,229	1,331
Europe	3,802	2,913	2,949
Africa	5,116	4,253	3,674
Latin America and Caribbean	1,631	1,413	1,261
Asia Pacific	2,902	2,639	2,585
Global Supply	8,120	8,202	8,491
Corporate and other	3,022	3,137	2,996
	<u>25,698</u>	<u>23,786</u>	<u>23,287</u>

* Following the changes in the regional structure the employee information by segment for the years ended 30 June 2011 and 2010 has been restated which better reflects the segment for which the employees provide the majority of their services.

The average number of employees from 30 June 2011 to 30 June 2012 for developed markets has decreased by 393 from 15,984 to 15,591 and for emerging markets has increased by 2,305 from 7,802 to 10,107.

Competition Diageo competes on the basis of consumer loyalty, quality and price.

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

In beer, the Guinness brand 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, Coors Brewing (Carling) and Carlsberg.

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

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Business description (continued)

Research and development The overall nature of the group's business does not demand substantial expenditure on research and development. However, the group has ongoing programmes for developing new drinks products. 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 worlds. The strength and depth of Diageo's brand range provide solid platforms from which to drive innovation, while insights into shopper trends and changing consumer habits inform product and packaging development.

In the year ended 30 June 2012, the group's research and development expenditure amounted to £18 million (2011 – £17 million; 2010 – £13 million). 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 protections are 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.

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

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Business description (continued)

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.

Business services Diageo continues to standardise its key business activities with customers, consumers, suppliers and the processes that summarise and report financial performance. In that regard, global processes have been designed, built and implemented across a number of markets and operational entities.

Diageo uses shared services operations to deliver transaction processing and certain central finance activities, using captive and outsourced centres. A captive business service centre in Budapest, Hungary, performs various process tasks for markets and operational entities. In the year ended 30 June 2012, Diageo announced the opening of new captive business service centres in Nairobi, Kenya and Bogota, Colombia. Diageo also uses third party service centres in Manila, Shanghai and Bucharest to perform tasks for basic processes. Certain central finance activities, including elements of group financial planning and reporting and treasury, are performed in the business service centre in Budapest.

Associates Diageo's principal associate is Moët Hennessy. It also owns shares in a number of other associates. In the year ended 30 June 2012, the share of profits of associates after tax was £213 million (2011 – £176 million; 2010 – £142 million), of which Moët Hennessy accounted for £205 million (2011 – £179 million; 2010 – £134 million).

Diageo owns 34% of Moët Hennessy, the spirits and wine subsidiary of LVMH Moët Hennessy – Louis Vuitton SA (LVMH). LVMH is based in France and is listed on the Paris Stock Exchange. Moët Hennessy is also based in France and is a producer and exporter of a number of brands in its main business areas of champagne and cognac. Its principal champagne brands are Moët & Chandon (including Dom Pérignon), Veuve Clicquot and Mercier, all of which are included in the top 10 champagne brands worldwide by volume. Moët Hennessy also owns Hennessy, which is the top cognac brand worldwide by volume, and Glenmorangie, a malt whisky.

Since 1987, a number of joint distribution arrangements have been established with LVMH, principally covering distribution of Diageo's premium brands of Scotch whisky and gin and Moët Hennessy's premium champagne and cognac brands in the Asia Pacific region and France. Diageo and LVMH have each undertaken not to engage in any champagne or cognac activities competing with those of Moët Hennessy. The arrangements also contain certain provisions for the

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Business description (continued)

protection of Diageo as a minority shareholder in Moët Hennessy. The operations of Moët Hennessy in France are conducted through a partnership in which Diageo has a 34% interest and, as a partner, Diageo pays any tax due on its share of the results of the partnership to the tax authorities.

Acquisitions and disposals Diageo has made a number of acquisitions of brands, distribution rights and equity interests in premium drinks businesses. Since 1 July 2009 the following acquisitions and disposals have been made:

Acquisitions	Date acquired	Consideration* £ million	Location	Principal brands acquired	Status
Ypióca	9 August 2012	284	Brazil	Ypióca cachaça	Acquisition of 100% of the equity share capital of Ypióca Agroindustrial Limitada
Meta	9 January 2012	153	Ethiopia	Meta beer	Acquisition of 100% of the equity share capital of Meta Abo Brewery Share Company SC
Philippines	14 December 2011	15	Philippines	Distribution company	Acquisition of 49% of Diageo Philippines Inc not already owned by the group
Kenya Breweries	25 November 2011	134	Kenya	Distribution company	Acquisition of 20% of Kenya Breweries Ltd not already owned by the group
Halico	13 May 2011 – 24 June 2012	60	Vietnam	Vodka Hanoi	Acquisition of 45.5% of the equity share capital of Hanoi Joint Stock Company (Halico)
Mey İçi	23 August 2011	1,260	Turkey	Yeni raki, Terkirdağ raki and Istanbul vodka	Acquisition of 100% of the equity share capital of Mey İçi Sanayi ve Ticaret A.Ş.
Quanxing and Shuijingfang	27 January 2007 – 14 July 2011 (control of Shuijingfang from 29 June 2012)	69**	China	Shui Jing Fang Chinese white spirit	Acquisition of 53% equity stake in Sichuan Chengdu Quanxing Group Company Ltd (Quanxing). Quanxing owns a 39.7% controlling equity interest in Sichuan Shuijingfang Co., Ltd.
Zacapa	5 July 2011	148	Guatemala	Zacapa rum	Acquisition of a 50% controlling equity stake in Rum Creations Products Inc.
Serengeti	22 October 2010	60	Tanzania	Serengeti lager	Acquisition of a 51% equity stake in Serengeti Breweries Limited via a 50.03% equity owned subsidiary
22 Marquis	30 September 2010	6	United States	22 Marquis sparkling liqueur	Acquisition of a 20% equity stake in LNJ Group
Nuvo	29 June 2010	29	United States	Nuvo – vodka based sparkling liqueur	Acquisition of an additional 28.75% equity interest in the London Group taking the group's interest to 71.25%

* Includes net borrowings acquired but excludes the value of put options and transaction costs.

** Excludes cash acquired in Shuijingfang when first consolidated.

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Business description (continued)

<u>Disposals</u>	<u>Date disposed of</u>	<u>Consideration £ million</u>	<u>Location</u>	<u>Status</u>
Tanzania Breweries	18 January 2012	47	Tanzania	Disposal of 20% equity in Tanzania Breweries Ltd
Wine brands	Years ended 30 June 2011 and 2012	25	United States and France	Disposal of a number of non-strategic wine businesses
Gilbeys distribution	31 August 2010	7	Ireland	Disposal of Gilbeys wine distribution and wholesale drinks business

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 results of operations 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. The following are examples of ways that any of the risks below may become exacerbated. 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 factors may also lead to intensified competition for market share, with consequential potentially adverse effects on volumes 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 results of operations, financial condition and liquidity. Diageo has taken and may take further steps to manage its business through this challenging economic environment and position its business to benefit from economic recovery as and when it may occur in the various markets in which Diageo operates, but there can be no assurance that the steps taken will have the intended results.

If there is an extended period of constraint in the capital markets, with debt markets in particular experiencing a lack of liquidity, at a time when cash flows from Diageo's business may be under pressure, this may have an impact on Diageo's ability to maintain current long term strategies, with a consequent effect on the group's growth rate. 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. Decreases in the trustees' valuations 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 and economic developments or industrial action in any of the countries where Diageo 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 the United States or in the countries that form the European Union do 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

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Business description (continued)

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 results of operations. In particular, the ongoing sovereign debt crisis in certain countries in Europe has increased concerns that, were one or more countries to leave the euro, Diageo's investment in any countries concerned could be impaired and may be subject to redenomination and other risks going forward. This crisis, as well as other economic events, may lead to reduced economic growth and, in turn, reduced demand for Diageo's products, in Europe and other markets in which Diageo operates, which could have a material adverse effect on Diageo's business and results of operations.

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 (including pandemic 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 nearly 40% of Diageo's net sales for the year ended 30 June 2012, are carried out in emerging markets, including Brazil, Venezuela, Mexico, Russia and emerging markets in Africa and Asia. Emerging markets are also generally exposed to relatively higher risk of liquidity, 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 prospects for growth. There is no guarantee that this strategy will be successful and some of the 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. The competitive position of Diageo's brands could also be affected adversely by any failure to achieve consistent, reliable quality in the product or service levels to customers.

In addition, the social acceptability of Diageo's products may decline due to public concerns about alcohol consumption, including alcohol abuse, drink driving, underage drinking or potential health consequences. These concerns may also result in regulatory action, litigation or customer complaints against companies in the industry and may have an adverse effect on Diageo's profitability.

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Business description (continued)

The launch and ongoing success of new products is inherently uncertain, especially as to their appeal to consumers. The failure to launch a new product successfully can give rise to inventory write-offs and other costs and can affect consumer perception of an existing brand. Growth in Diageo's business has been based on both the launch of new products and the creation of brand extensions, and can impact growth of existing products. Product innovation remains a significant aspect of Diageo's plans for growth. There can be no assurance as to Diageo's continuing ability to develop and launch successful new products or variants of existing products or as to the profitable lifespan of newly or recently developed products. Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for Diageo's products and erosion of its competitive and financial position. Continued economic pressures could lead to consumer selection of products at lower price points, whether Diageo's or those of competitors, which may have an adverse effect on Diageo's profitability.

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 be subject to litigation with tax, customs and other regulatory authorities, including with respect to the methodology for assessing importation value, transfer pricing and compliance matters, and Diageo is routinely subject to litigation in the ordinary course of its operations. Diageo may also be subject to litigation arising from legacy and discontinued activities. 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 31 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 quality could negatively impact Diageo's production costs and capacity

There is a growing concern that carbon dioxide and other 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 less favourable 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. It is also a limited resource in many parts of the world, facing unprecedented challenges from climate change, overexploitation, increasing pollution, and poor management. As demand for water continues to increase around the world, 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 results of 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. In addition, energy cost increases result 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. Diageo may experience significant increases in commodity costs and energy costs.

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Business description (continued)

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 which include those in respect of production, product liability, distribution, importation, marketing, promotion, sales, pricing, labelling, packaging, advertising, labour, pensions, 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 advertising and/or promotion activities used to market beverage alcohol, restrictions on retail outlets, other restrictions on marketing, promotion, 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 its sales or damage its reputation. An increase in the stringency of the regulatory environment could cause Diageo to incur material additional costs or liabilities that could adversely affect its business.

In addition, beverage alcohol products are the subject of 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.

Risks related to Diageo's business

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. Diageo competes with drinks companies across a wide range of consumer drinking occasions. Within a number of categories, consolidation or realignment is still possible. Consolidation is also taking place amongst Diageo's customers in many countries. Increased competition and unanticipated actions 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, which would adversely affect Diageo's results and hinder its 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 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

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Business description (continued)

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. 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 benefits, cost savings or synergies. There can be no guarantee that any such business combination, acquisition, disposal, joint venture or partnership would deliver the benefits, cost savings or synergies anticipated, if any.

Similarly, 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.

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 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. In addition, Diageo may voluntarily recall products in the event of contamination or damage. A significant product liability judgement or a widespread product recall may negatively impact on 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, resulting negative publicity could adversely affect Diageo's reputation with existing and potential customers and its corporate and brand image.

In addition, to the extent that third parties sell products which are either counterfeit versions of Diageo brands or inferior brands that look like Diageo brands, consumers of Diageo brands could confuse Diageo products with them. This 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 labour 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 operations and financial results.

Diageo's operating results may be adversely affected by disruption to production facilities, business service centres or information systems and change programs may not deliver the benefits intended Diageo would be affected if there were a catastrophic failure of its major production facilities or business service centres. See 'Business description – Premium drinks – Production' for details of Diageo's principal production areas. Diageo operates production facilities around the world. If there were a technical integrity failure, fire or explosion at one of Diageo's production facilities, it could result in damage to the facilities, plant or equipment, their surroundings or the environment, could lead to a loss in production capacity, or could result in regulatory action, legal liability or damage to

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Business description (continued)

Diageo's reputation. In addition, the maintenance and development of information systems may result in systems failures which may adversely affect business operations.

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. This could lead to an inability to supply future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks.

Any failure of information systems 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 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 disruption arising from system failure or physical plant issues could impact a large portion of Diageo's global business.

Certain change programmes designed to improve the effectiveness and efficiency of end-to-end operating, administrative and financial systems and processes continue to be undertaken. This includes moving transaction processing from a number of markets to business service centres. There can be no certainty that these programmes will deliver the expected operational benefits. There may be disruption caused to production processes and to administrative and financial systems as further changes to such processes are effected. They could also lead to adverse customer or consumer reaction.

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. 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 and, 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, and Diageo's actual experience may be significantly more negative.

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 37% of sales in the year

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Business description (continued)

ended 30 June 2012 were in US dollars, approximately 13% were in euros and approximately 10% 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. To partly delay any adverse impact from interest rate movements, the group's policy is to maintain fixed rate borrowings within a certain percentage of forecast net borrowings, and the overall net borrowings portfolio is managed according to a duration measure. See note 23 to the consolidated financial statements.

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 they expire or that these agreements 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.

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, any tax disputes or 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

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Business description (continued)

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.

Data security and reliability is important to maintaining Diageo's business operations, and a breach of Diageo's data security could negatively affect Diageo The security and reliability of Diageo's data infrastructure are critical to maintaining the availability and reliable operation of Diageo's business applications, including technology used in Diageo's business operations, in the collection and processing of financial and operational data and in the maintenance of the confidentiality of certain third-party information. A breach of the security or reliability of Diageo's data infrastructure, whether by intentional actions, negligence or otherwise, could result in interruption of and serious damage to Diageo's business operations and, in some circumstances, could result in property damage, breaches of regulations, litigation, legal liabilities and reparation costs.

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.

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:

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

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Business description (continued)

- 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;
- 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;
- 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;
- developments in the Colombian litigation, Korean customs dispute, thalidomide litigation or any similar proceedings;
- 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;
- changes in the cost or supply of raw materials, labour, energy and/or water;
- 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;
- levels of marketing, promotional and innovation expenditure by Diageo and its competitors;
- renewal of supply, distribution, manufacturing or licence agreements (or related rights) and licenses on favourable terms when they expire;
- termination of or failure to renegotiate existing distribution or licence manufacturing rights on agency brands;
- 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;
- technological developments that may affect the distribution of products or impede Diageo's ability to protect its intellectual property rights; and
- 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 in the value of Diageo's pension funds.

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 those described

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Business description (continued)

in 'Business description – Risk factors'. 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. All readers, wherever located, should take note of these disclosures.

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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.

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Business review

Introduction

Information presented Diageo is the world's leading premium drinks business and operates on an international scale selling all types of beverage alcohol. It is one of a small number of premium drinks companies that operate across spirits, beer and wine. Diageo's brands have broad consumer appeal across geographies, and as a result, the business is organised under the business areas of North America, Europe, Africa, Latin America and Caribbean, Asia Pacific and Global Supply. In view of the focus on reporting results by the location of third party customers in explaining the group's performance in the business review, the results of the Global Supply segment have been allocated to the geographic segments. The following discussion is based on Diageo's results for the year ended 30 June 2012 compared with the year ended 30 June 2011, and the year ended 30 June 2011 compared with the year ended 30 June 2010.

In the discussion of the performance of the business, net sales, defined as sales after deducting excise duties, are presented in addition to sales, as sales figures include significant excise duties which are set by external regulators and over which Diageo has no control. Diageo incurs excise duties throughout the world. In some countries, excise duties are based on sales and are separately identified on the face of the invoice to the external customer. In others, it is effectively a production tax, which is incurred when the spirit is removed from bonded warehouses. In these countries, excise duties are part of the cost of goods sold and are not separately identified on the sales invoice. Changes in the level of excise duties can significantly affect the level of reported sales and cost of sales without directly reflecting changes in volume, mix or profitability, which are the variables that have an impact on the element of sales retained by the group.

References to emerging markets comprise Russia and Eastern Europe, Turkey, Africa, Latin America and Caribbean and Asia Pacific excluding Australia, Korea and Japan.

References to reserve brands include Johnnie Walker Green Label, Johnnie Walker Gold Label 18 year old, Johnnie Walker Gold Label Reserve, Johnnie Walker Blue Label, Johnnie Walker Blue Label King George V, Johnnie Walker Platinum Label 18 year old, The John Walker, Classic Malts, Buchanan's Special Reserve, Buchanan's Red Seal, Dimple 18 year old, Bulleit Bourbon, Tanqueray No. TEN, Ciroc, Ketel One vodka, Don Julio, Zacapa, Godiva and Nuvo.

References to ready to drink 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.

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.

Presentation of information in relation to the business In addition to describing the significant factors that have impacted the income statement for the years ended 30 June 2012 and 30 June 2011, in each case as compared to the immediately preceding year, additional information is also presented on the operating performance and cash flows of the group.

There are several principal financial key performance indicators not specifically used in the consolidated financial statements themselves (non-GAAP measures) that are used by the group's management to assess the performance of the group in addition to income statement performance

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Business review (continued)

measures. These are volume, organic movements in volume, sales, net sales, marketing spend, operating profit and operating margin and free cash flow. These key performance indicators are described below:

Volume is a non-GAAP measure that has been 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 volume, sales, net sales, marketing spend, operating profit and operating margin are non-GAAP measures. The performance of the group is discussed using these measures.

In the discussion of the performance of the business, organic information is presented using pounds sterling amounts on a constant currency basis. This retranslates prior year reported numbers at current year exchange rates and enables an understanding of the underlying performance of the market that is most closely influenced by the actions of that market's management. The risk from exchange rate movements is managed centrally and is not a factor over which local managers have any control. Residual exchange impacts are reported within Corporate.

Acquisitions, disposals and exceptional items also impact the reported performance and therefore the reported movement in any year in which they arise. Management adjusts for the impact of such transactions in assessing the performance of the underlying business.

The underlying performance on a constant currency basis and excluding the impact of exceptional items, acquisitions and disposals is referred to as 'organic' performance. Organic movement calculations enable the reader to focus on the performance of the business which is common to both years.

Diageo's strategic planning and budgeting process is based on organic movements in volume, sales, net sales, marketing spend, operating profit and operating margin, and these measures closely reflect the way in which operating targets are defined and performance is monitored by the group's management.

These measures are chosen for planning, budgeting, reporting and incentive purposes since they represent those measures which local managers are most directly able to influence and they enable consideration of the underlying business performance without the distortion caused by fluctuating exchange rates, exceptional items and acquisitions and disposals.

The group's management believes these measures provide valuable additional information for users of the financial statements in understanding the group's performance since they provide information on those elements of performance which local managers are most directly able to influence and they focus on that element of the core brand portfolio which is common to both years. They should be viewed as complementary to, and not replacements for, the comparable GAAP measures and reported movements therein.

Organic operating margin improvement is the movement in the group's organic operating margin. Organic operating margin is the ratio calculated by dividing organic operating profit by organic net sales expressed as a percentage.

Free cash flow is a non-GAAP measure that comprises the net cash flow from operating activities aggregated with the net purchase and disposal of investments, property, plant and equipment and

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Business review (continued)

computer software that form part of net cash flow from investing activities. The group's management believes the measure assists users of the financial statements in understanding the group's cash generating performance as it comprises items which arise from the running of the ongoing business.

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 subsidiaries, associates and 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. However, free cash flow does not necessarily reflect all amounts which the group has either a constructive or legal obligation to incur. Where appropriate, separate discussion is given for the impacts of acquisitions and sale of businesses, equity 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.

The free cash flow measure is used by management for their own planning, budgeting, reporting and incentive purposes since it provides information on those elements of performance which local managers are most directly able to influence.

Exceptional items Exceptional items are items 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. Some figures are presented before exceptional items such as operating profit before exceptional items, taxation before exceptional items, the tax rate before exceptional items and earnings per share before exceptional items. The amounts before exceptional items are non-GAAP measures, used by management for their own reporting and incentive purposes since they provide information on the underlying performance of the group. The tax rate before exceptional items is calculated by dividing the tax charge on continuing operations before tax charges and credits in respect of exceptional items by profit before taxation, adjusted to exclude the impact of the sale of businesses and exceptional operating costs before taxation, expressed as a percentage.

Revised segmental information for prior reporting periods On 25 May 2011 Diageo announced changes to its regional structure. From 1 July 2011 two autonomous regions, Africa and Latin America and Caribbean replaced the International region. The Global Travel and duty free operations are now reported within the five geographical regions in which the external sales take place. The Middle East business has become part of Asia Pacific.

As a result of this change Diageo now reports the following operating segments externally: North America, Europe, Africa, Latin America and Caribbean, Asia Pacific and Corporate. In addition, for the year ended 30 June 2012, changes have been made to the allocation of specific corporate items better reflecting the geographic segments for which they are in respect of. As a consequence of these changes the figures for the operating segments for prior years have been restated. Revised segmental information for the years ended 30 June 2011 and 2010 are as follows.

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Business review (continued)

	Year ended 30 June 2011			Year ended 30 June 2010		
	As reported	Analysis of International	Restated	As reported	Analysis of International	Restated
	units million	units million	units million	units million	units million	units million
Volume						
North America	51.6	0.7	52.3	51.8	0.7	52.5
Europe	38.5	2.0	40.5	39.2	2.1	41.3
International	44.3	(44.3)	—	40.3	(40.3)	—
Africa	—	23.1	23.1	—	21.1	21.1
Latin America and Caribbean	—	15.7	15.7	—	14.1	14.1
Asia Pacific	13.1	2.8	15.9	12.1	2.3	14.4
Total volume	<u>147.5</u>	<u>—</u>	<u>147.5</u>	<u>143.4</u>	<u>—</u>	<u>143.4</u>

	Year ended 30 June 2011			Year ended 30 June 2010		
	As reported	Analysis of International	Restated	As reported	Analysis of International	Restated
	£ million	£ million	£ million	£ million	£ million	£ million
Sales						
North America	3,853	42	3,895	3,853	34	3,887
Europe	4,190	89	4,279	4,371	89	4,460
International	3,384	(3,384)	—	3,222	(3,222)	—
Africa	—	1,764	1,764	—	1,582	1,582
Latin America and Caribbean	—	1,293	1,293	—	1,364	1,364
Asia Pacific	1,735	196	1,931	1,442	153	1,595
Corporate	70	—	70	70	—	70
Total sales	<u>13,232</u>	<u>—</u>	<u>13,232</u>	<u>12,958</u>	<u>—</u>	<u>12,958</u>

Net sales						
North America	3,324	42	3,366	3,306	34	3,340
Europe	2,614	89	2,703	2,759	89	2,848
International	2,747	(2,747)	—	2,627	(2,627)	—
Africa	—	1,357	1,357	—	1,228	1,228
Latin America and Caribbean	—	1,063	1,063	—	1,123	1,123
Asia Pacific	1,181	196	1,377	1,018	153	1,171
Corporate	70	—	70	70	—	70
Total net sales	<u>9,936</u>	<u>—</u>	<u>9,936</u>	<u>9,780</u>	<u>—</u>	<u>9,780</u>

Marketing spend						
North America	502	6	508	472	4	476
Europe	390	13	403	412	10	422
International	368	(368)	—	302	(302)	—
Africa	—	140	140	—	119	119
Latin America and Caribbean	—	184	184	—	151	151
Asia Pacific	278	25	303	233	18	251
Total marketing spend	<u>1,538</u>	<u>—</u>	<u>1,538</u>	<u>1,419</u>	<u>—</u>	<u>1,419</u>

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Business review (continued)

	Year ended 30 June 2011				Year ended 30 June 2010			
	As reported	Analysis of International	Corporate costs	Restated	As reported	Analysis of International	Corporate costs	Restated
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
Operating profit before exceptional items								
North America	1,255	17	3	1,275	1,170	13	1	1,184
Europe	778	28	(10)	796	859	30	(8)	881
International	804	(804)	—	—	771	(771)	—	—
Africa	—	330	3	333	—	304	(3)	301
Latin America and Caribbean	—	336	(18)	318	—	355	(19)	336
Asia Pacific	208	93	(2)	299	176	69	(5)	240
Corporate	(161)	—	24	(137)	(225)	—	34	(191)
Total operating profit before exceptional items	<u>2,884</u>	<u>—</u>	<u>—</u>	<u>2,884</u>	<u>2,751</u>	<u>—</u>	<u>—</u>	<u>2,751</u>

Operating results 2012 compared with 2011

Summary consolidated income statement

	Year ended 30 June	
	2012	2011
	£ million	£ million
Sales	14,594	13,232
Excise duties	(3,832)	(3,296)
Net sales	10,762	9,936
Operating costs before exceptional items	(7,564)	(7,052)
Operating profit before exceptional items	3,198	2,884
Exceptional operating items	(40)	(289)
Operating profit	3,158	2,595
Sale of businesses	147	(14)
Net finance charges	(397)	(397)
Share of associates' profits after tax	213	176
Profit before taxation	3,121	2,360
Taxation	(1,038)	(343)
Profit from continuing operations	2,083	2,017
Discontinued operations	(11)	—
Profit for the year	<u>2,072</u>	<u>2,017</u>
Attributable to:		
Equity shareholders of the parent company	1,942	1,900
Non-controlling interests	130	117
	<u>2,072</u>	<u>2,017</u>

Sales and net sales On a reported basis, sales increased by £1,362 million from £13,232 million in the year ended 30 June 2011 to £14,594 million in the year ended 30 June 2012 and net sales increased

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Business review (continued)

by £826 million from £9,936 million in the year ended 30 June 2011 to £10,762 million in the year ended 30 June 2012. Exchange rate movements decreased reported sales by £123 million and reported net sales by £90 million. Acquisitions increased reported sales by £741 million and reported net sales by £320 million. Disposals decreased reported sales by £31 million and reported net sales by £29 million.

Operating costs before exceptional items On a reported basis, operating costs before exceptional items increased by £512 million from £7,052 million in the year ended 30 June 2011 to £7,564 million in the year ended 30 June 2012 due to an increase in cost of sales of £245 million from £3,983 million to £4,228 million, an increase in marketing spend of £153 million from £1,538 million to £1,691 million, and an increase in other operating expenses before exceptional costs of £114 million, from £1,531 million to £1,645 million. Exchange rate movements benefited total operating costs before exceptional items by £80 million.

Exceptional operating items Exceptional operating charges of £40 million for the year ended 30 June 2012 comprised:

- a gain of £115 million (2011 – £nil) in respect of changes in the calculation of future pension increases for Diageo's principal UK and Irish pension schemes;
- a brand impairment charge of £59 million (2011 – £39 million);
- a charge of £69 million (2011 – £77 million) for the operating model review announced in May 2011; and
- £27 million (2011 – £34 million) for the restructuring of the group's Global Supply operations in Scotland, Ireland and in the United States.

In the year ended 30 June 2011 exceptional operating items also included a charge of £139 million in respect of duty settlements with the Turkish and the Thai customs authorities and settlements with the Securities and Exchange Commission (SEC) in respect of various regulatory and control matters.

In the year ended 30 June 2012 total restructuring cash expenditure was £158 million (2011 – £118 million). In the year ended 30 June 2011 cash payments of £141 million were also made for the duty and the SEC settlements. An exceptional charge of approximately £50 million is expected to be incurred in the year ending 30 June 2013 in respect of the restructuring of Global Supply operations principally in Ireland, while cash expenditure is expected to be approximately £80 million.

Post employment plans The deficit in respect of post employment plans before taxation increased by £247 million from £838 million at 30 June 2011 to £1,085 million at 30 June 2012 primarily as a result of a decrease in the discount rate assumptions used to calculate the liabilities of the plans partly offset by a decrease in the inflation assumptions and changes in the calculation of future pension increases. Cash contributions to the group's UK and Irish pension plans in the year ended 30 June 2012 were £133 million (2011 – £151 million) and are expected to be approximately £140 million for the year ending 30 June 2013.

Operating profit Reported operating profit for the year ended 30 June 2012 increased by £563 million to £3,158 million from £2,595 million in the prior year. Before exceptional operating items, operating profit for the year ended 30 June 2012 increased by £314 million to £3,198 million from £2,884 million in the prior year. Exchange rate movements decreased both operating profit and operating profit before exceptional items for the year ended 30 June 2012 by £10 million. Acquisitions increased reported operating profit by £79 million and disposals decreased reported operating profit by £3 million.

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Business review (continued)

Exceptional non-operating items In the year ended 30 June 2012 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 Quaxing and Shuijingfang to fair value as the associates became subsidiaries during the year. In addition, exceptional non-operating items include a gain of £23 million on the sale of the group's investment in Tanzania Breweries. In the year ended 30 June 2011 a net loss before taxation of £14 million on sale of businesses arose on the disposal of a number of small wine businesses in Europe and in the United States and on the termination of a joint venture in India.

Net finance charges Net finance charges amounted £397 million in the year ended 30 June 2012 (2011 – £397 million).

Net interest charge increased by £13 million from £369 million in the prior year to £382 million in the year ended 30 June 2012. The effective interest rate was 4.7% (2011 – 4.9%) in the year ended 30 June 2012 and average net borrowings increased by £1.1 billion 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. The income statement interest cover was 8.9 times and cash interest cover was 9.4 times (2011 – 8.3 times and 10.6 times, respectively).

Net other finance charges for the year ended 30 June 2012 were £15 million (2011 – £28 million). There was a change of £10 million in finance charges in respect of post employment plans from a charge of £3 million in the year ended 30 June 2011 to an income of £7 million in the year ended 30 June 2012. Other finance charges also included £17 million (2011 – £16 million) on unwinding of discounts on liabilities, a hyperinflation adjustment of £3 million (2011 – £9 million) in respect of the group's Venezuela operations and £2 million (2011 – £nil) in respect of net exchange movements on certain financial instruments. In the year ending 30 June 2013 the finance charge in respect of post employment plans is expected to be £12 million.

Associates The group's share of associates' profits after interest and tax was £213 million for the year ended 30 June 2012 compared to £176 million in the prior year. Diageo's 34% equity interest in Moët Hennessy contributed £205 million (2011 – £179 million) to share of associates' profits after interest and tax.

Profit before taxation Profit before taxation increased by £761 million from £2,360 million in the prior year to £3,121 million in the year ended 30 June 2012.

Taxation The reported tax rate increased from 14.5% in the year ended 30 June 2011 to 33.3% in the year ended 30 June 2012. During the year tax authority negotiations were concluded resulting in a favourable change to the taxation basis of certain overseas profit and intangible assets which has reduced the ongoing tax rate but which 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 2012 was 17.7% compared with 17.4% in the year ended 30 June 2011. In the future it is expected that the tax rate before exceptional items will remain at approximately 18%.

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Business review (continued)

The tax rates from continuing operations before exceptional and after exceptional items for the years ended 30 June 2012 and 30 June 2011 were calculated as follows:

	Year ended 30 June	
	2012	2011
	£ million	£ million
Taxation on profit from continuing operations (A)	1,038	343
Tax credits in respect of exceptional items	19	54
Exceptional tax (charges)/credits	(524)	66
Tax before exceptional items (B)	533	463
Profit before taxation (C)	3,121	2,360
(Gains)/losses on sale of businesses	(147)	14
Exceptional operating costs	40	289
Profit from continuing operations before taxation and exceptional items (D)	3,014	2,663
Tax rate after exceptional items (A/C)	33.3%	14.5%
Tax rate before exceptional items (B/D)	17.7%	17.4%

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

Exchange rate and other movements Foreign exchange movements in the year ended 30 June 2012 decreased net sales, operating profit before exceptional items and profit from associates by £90 million, £10 million and £2 million, respectively, and reduced net finance charges by £19 million.

For the year ending 30 June 2013 foreign exchange movements are not expected to materially affect operating profit or net finance charge based on applying current exchange rates (£1 = \$1.57 : £1 = €1.28). This guidance excludes the impact of IAS 21 and IAS 39.

Dividend The directors recommend a final dividend of 26.9 pence per share, an increase of 8% from the year ended 30 June 2011. The full dividend will therefore be 43.5 pence per share, an increase of 8% from the year ended 30 June 2011. Subject to approval by shareholders, the final dividend will be paid on 22 October 2012 to shareholders on the register on 7 September 2012. Payment to US ADR holders will be made on 26 October 2012. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 1 October 2012.

Analysis by business area and brand

In order to assist the reader of the financial statements, the following comparison of 2012 with 2011 includes tables which present the exchange, acquisitions and disposals and organic components of the year on year movement for each of volume, sales, net sales, marketing spend and operating profit. Organic movements in the tables below are calculated as follows:

(a) The organic movement percentage is the amount in the column headed 'Organic movement' in the tables below expressed as a percentage of the aggregate of the amount in the column headed '2011 Reported', the amount in the column headed 'Exchange' and the amount, if any, in respect of acquisitions and disposals that have impacted the comparable prior year included in the column headed 'Acquisitions and disposals'. The inclusion of the column headed 'Exchange' in the organic movement

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Business review (continued)

calculation reflects the adjustment to recalculate the prior year results as if they had been generated at the current year's exchange rates.

(b) Where a business, brand, brand distribution right or agency agreement was disposed of, or terminated, in the current or prior year, the group, in organic movement calculations, excludes the results for that business from the current year 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. 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 column 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 assessment are expected to complete.

The organic movement calculations for volume, sales, net sales, marketing spend and operating profit for the year ended 30 June 2012 were as follows:

	2011 Reported (restated)	Acquisitions and disposals ⁽²⁾	Organic movement	2012 Reported	Organic movement
	units million	units million	units million	units million	%
Volume					
North America	52.3	(0.1)	0.8	53.0	2
Europe	40.5	5.1	(0.4)	45.2	(1)
Africa	23.1	0.6	1.2	24.9	5
Latin America and Caribbean	15.7	—	1.5	17.2	10
Asia Pacific	15.9	—	0.3	16.2	2
Total volume	<u>147.5</u>	<u>5.6</u>	<u>3.4</u>	<u>156.5</u>	<u>2</u>

	2011 Reported (restated)	Exchange ⁽¹⁾	Acquisitions and disposals ⁽²⁾	Organic movement	2012 Reported	Organic movement
	£ million	£ million	£ million	£ million	£ million	%
Sales						
North America	3,895	22	(26)	203	4,094	5
Europe	4,279	(35)	700	22	4,966	1
Africa	1,764	(106)	36	175	1,869	11
Latin America and Caribbean	1,293	(32)	—	230	1,491	18
Asia Pacific	1,931	29	—	144	2,104	7
Corporate	70	(1)	—	1	70	1
Total sales	<u>13,232</u>	<u>(123)</u>	<u>710</u>	<u>775</u>	<u>14,594</u>	<u>6</u>

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Business review (continued)

	2011 Reported (restated) £ million	Exchange ⁽¹⁾ £ million	Acquisitions and disposals ⁽²⁾ £ million	Organic movement £ million	2012 Reported £ million	Organic movement %
Net sales						
North America	3,366	18	(26)	198	3,556	6
Europe	2,703	(25)	288	(17)	2,949	(1)
Africa	1,357	(77)	29	138	1,447	11
Latin America and Caribbean	1,063	(22)	—	198	1,239	19
Asia Pacific	1,377	17	—	107	1,501	8
Corporate	70	(1)	—	1	70	1
Total net sales	9,936	(90)	291	625	10,762	6
Excise duties	3,296				3,832	
Total sales	13,232				14,594	
Marketing spend						
North America	508	2	1	37	548	7
Europe	403	(4)	30	10	439	3
Africa	140	(8)	4	14	150	11
Latin America and Caribbean	184	(6)	1	31	210	17
Asia Pacific	303	6	—	35	344	11
Total marketing spend	1,538	(10)	36	127	1,691	8
Operating profit						
North America	1,275	3	(3)	79	1,354	6
Europe	796	(4)	107	26	925	3
Africa	333	(22)	4	65	380	20
Latin America and Caribbean	318	(2)	(2)	69	383	22
Asia Pacific	299	—	(11)	54	342	18
Corporate	(137)	15	(19)	(45)	(186)	(37)
Total operating profit before exceptional items	2,884	(10)	76	248	3,198	9
Exceptional items ⁽³⁾	(289)				(40)	
Total operating profit	2,595				3,158	

Notes: Information relating to the organic movement calculations.

- (1) The exchange adjustments for sales, net sales, marketing spend and operating profit are the retranslation of prior year reported results at current year exchange rates and are principally in respect of the euro, the US dollar and African currencies, primarily the Kenyan shilling, the Nigerian naira and the South African rand.

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Business review (continued)

- (2) The impacts of acquisitions and disposals are excluded from the organic movement. In the year ended 30 June 2012 the acquisitions and disposals that materially affected volume, sales, net sales, marketing spend and operating profit were as follows:

	Volume	Sales	Net sales	Marketing spend	Operating profit
	units million	£ million	£ million	£ million	£ million
Mey İçki	5.1	705	291	27	95
Zacapa	—	—	—	6	8
Meta	0.3	16	13	1	—
Quanxing	—	—	—	—	(19)
Serengeti	0.3	20	16	2	(2)
Other acquisitions*	—	—	—	—	(28)
Acquisitions – 2012	5.7	741	320	36	54
Acquisitions – 2011**	—	—	—	—	25
Disposals	<u>(0.1)</u>	<u>(31)</u>	<u>(29)</u>	<u>—</u>	<u>(3)</u>
	<u>5.6</u>	<u>710</u>	<u>291</u>	<u>36</u>	<u>76</u>

* Includes transaction costs in respect of acquisitions not yet completed.

** Represents transaction and integration costs in respect of acquisitions incurred in the year ended 30 June 2011.

In the year ended 30 June 2012 there were no material disposals impacting organic growth but adjustment is made to exclude the impact of the disposals completed under the reorganisation of the group's US wines operations and the Gilbeys wholesale wine business in Ireland in the year ended 30 June 2011.

- (3) Exceptional operating charges of £40 million for the year ended 30 June 2012 (2011 – £289 million) comprised a gain of £115 million (2011 – £nil) in respect of changes in the calculation of future pension increases for Diageo's principal UK and Irish pension schemes, a brand impairment charge of £59 million (2011 – £39 million), a charge of £69 million (2011 – £77 million) for the operating model review announced in May 2011 and £27 million (2011 – £34 million) for the restructuring of the group's Global Supply operations in Scotland, Ireland and in the United States. In the year ended 30 June 2011 exceptional operating items also included a charge of £139 million in respect of duty settlements with the Turkish and the Thai customs authorities and settlements with the Securities and Exchange Commission (SEC) regarding various regulatory and control matters.

Cost of sales

Reported cost of sales for the year ended 30 June 2012 increased by £249 million from £4,010 million in the year ended 30 June 2011 to £4,259 million in the year ended 30 June 2012. Included in cost of sales in the year ended 30 June 2012 were exceptional items of £31 million (2011 – £27 million). Acquisitions and disposals added £91 million, with Mey İçki being the principal contributor, and favourable exchange movements reduced cost of sales by £38 million. The 2% volume increase together with some mix benefits added £110 million to cost of sales. Cost increases on materials, utilities and logistics amounted to 5% of cost of sales, and half of this increase was offset by cost reductions through asset rationalisation, procurement benefits and operational efficiencies.

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Business review (continued)

Corporate revenue and costs

Net sales were £70 million in the year ended 30 June 2012, flat relative to the comparable prior period. Net operating charges were £186 million in the year ended 30 June 2012 having been £137 million in the year ended 30 June 2011. The movement was made up of:

- a charge of £12 million versus a benefit of £21 million in the year ended 30 June 2011, arising from currency transaction hedging which is controlled centrally;
- £19 million in respect of transaction costs incurred on acquisitions; and
- a £3 million reduction in underlying corporate costs.

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Business review (continued)

Category review

	Volume* movement	Organic net sales movement	Reported net sales movement
	%	%	%
Category performance			
Spirits	3	8	12
Beer	2	5	4
Wine	(3)	(7)	(9)
Ready to drink	(3)	—	—
Total	<u>2</u>	<u>6</u>	<u>8</u>
Strategic brand performance**			
Whisk(e)y:	4	10	9
Johnnie Walker	7	15	14
Crown Royal	(4)	(3)	(3)
J&B	(1)	(3)	(5)
Buchanan's	12	24	23
Windsor	(4)	(1)	—
Bushmills	<u>18</u>	<u>20</u>	<u>19</u>
Vodka:	5	13	15
Smirnoff	5	6	5
Ketel One vodka	9	9	10
Cîroc	<u>60</u>	<u>62</u>	<u>63</u>
Rum:	6	8	8
Captain Morgan	<u>9</u>	<u>9</u>	<u>9</u>
Liqueurs:	(2)	1	—
Baileys	<u>(4)</u>	<u>(1)</u>	<u>(1)</u>
Tequila:	(2)	—	—
Jose Cuervo	<u>(4)</u>	<u>(5)</u>	<u>(5)</u>
Gin:	1	3	3
Tanqueray	<u>1</u>	<u>2</u>	<u>2</u>
Beer:	2	5	4
Guinness	<u>1</u>	<u>4</u>	<u>3</u>

* Organic equals reported movement for volume, except for: total volume 6%, spirits 7%, beer 4%, wine (4)%, vodka 8% reflecting the Mey İçki, Meta Abo and Serengeti Breweries acquisitions and disposals last year.

** Spirits brands excluding ready to drink.

Spirits was 66% of Diageo net sales and delivered over 80% of the group's growth. Developed markets grew net sales 4% on flat volume and emerging markets grew 18% with 9 percentage points of positive price/mix through strong pricing and favourable mix as consumers move up the price ladder.

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Business review (continued)

Total Whisk(e)y was 35% of Diageo portfolio by net sales. Scotch delivered strong growth with net sales up 12%. Premium and super premium drove this growth and price/mix was up 7 percentage points as a result. In the developed markets, weakness in Southern Europe led to declines in value and standard scotch brands. These segments grew double digit in the emerging markets as Diageo continued to drive recruitment through the more affordable brands. Premium and super premium brands grew in all regions on the back of successful innovations and strong marketing. The Singleton more than doubled net sales in Germany and France behind the 'Best tasting Single Malt – You decide' campaign and Old Parr grew 23% with 10 percentage points of positive price/mix through exceptional growth in PUB and Colombia. In the growing North America whiskey segment Bulleit delivered over 60% growth in net sales on the back of the success of Bulleit Rye.

Johnnie Walker had another exceptional year, posting 15% net sales growth, with the fastest growth coming from super deluxe variants. The growth of Red Label was driven by the emerging middle class recruitment programmes with the 'Step Up' activation delivering almost 60% net sales growth in South Africa and the 'Keep Walking Brazil' campaign driving 16% net sales growth in PUB. The continued success of Johnnie Walker Double Black, priced at a 20% premium to Black Label, together with price increases drove 15% net sales growth for the Black Label variant. Super deluxe grew 28% in the year as the brand experienced a significant shift to higher marks in North America, driven by the new Blue Label packaging and the successful engraving advertising campaign, and as Gold Label net sales more than doubled in Asia Pacific. Johnnie Walker XR21 was also very successful within its core geographical target region of Asia Pacific, reaching near 20% share in its segment since launch. Total marketing spend increased 11% with over 80% of the incremental investment directed towards emerging markets, especially Asia Pacific and Latin America, and behind proven global growth drivers, including the 'Walk with Giants' and 'Step Inside the Circuit' campaigns and ongoing grand prix sponsorships.

While the economic challenges in Europe have resulted in a 3% reduction in **J&B** net sales globally, this represented a significant slowing in the rate of decline versus last year as the J&B business is rebalancing between developed and emerging markets. Slowdown in the second half reflected the reversal of the pre excise duty increase buy-in in France, while underlying consumption trends did not change materially. Turkey posted 21% net sales growth and Africa and Latin America also saw double digit top line growth on the back of the 'City Remix' programme significantly increasing consumer engagement with the brand.

Buchanan's delivered strong double digit net sales growth for the third consecutive year, supported by the launch of the 'Share Yourself' campaign and the solid growth of Buchanan's Special Reserve, especially in Venezuela and Colombia. The 12 percentage points of positive price/mix was a result of price increases and premiumisation across the Americas, helped by the successful roll-out of Buchanan's Master, trading consumers up beyond deluxe at an 18% price premium. The brand posted 11% net sales growth in North America.

Windsor grew share and remained the leading scotch brand in Korea, net sales however declined 1% as the whisky market contracted further in the country. Share gain has been achieved through the 'Share the Vision' campaign in the first half, followed by point of sale promotions in the second half. Windsor 12 and 17 variants enjoyed 4 and 2 percentage points of positive price/mix, respectively on the back of price increases put through last year.

While **Crown Royal** held share in the highly competitive non flavoured North America whiskey segment, the brand's performance was impacted by the lapping of the successful launch of Crown Royal Black last year and also by its segment losing share to flavoured whiskey. Marketing spend was focused

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Business review (continued)

behind the launch of the 'Crown Life' programme appealing to the African-American and Hispanic consumers in the United States.

Bushmills delivered double digit increases in both volume and net sales. Its performance was particularly strong in Eastern Europe, where it made some important share gains. Bushmills Honey was launched successfully in the United States and delivered a third of the brand's growth globally.

Vodka, 12% of Diageo net sales, saw 13% growth with positive price/mix as value vodka brands declined and super premium brands grew strongly with volume up almost 30%. The category drove a quarter of the group net sales growth with the super premium segment delivering 74% of that increase through the continued strong performance of Cîroc.

Smirnoff returned to strong growth, driven by a marked acceleration in developed markets and double digit growth in Africa and Latin America. Marketing spend increased 10% focusing on proven growth drivers. Fifty countries participated in the Smirnoff 'Nightlife Exchange Project', which in its second year was expanded by the collaboration with Live Nation and Madonna. In the United States, Smirnoff grew volume share with the highly successful innovation launches of Smirnoff Whipped Cream and Fluffed Marshmallow and also as a result of the Smirnoff 21 'I Choose' campaign. Great Britain, Germany and the Benelux led Smirnoff's growth in Europe through the execution of 'Madonna Limited Edition' campaigns.

Ketel One vodka delivered 8% net sales growth in North America with continued share gains fuelled by the highly successful 'Gentlemen, this is Vodka' campaign. Ketel One vodka is now sold in 63 markets. Latin America and Asia Pacific posted net sales growth over 50%, with PUB, Australia and South East Asia being the key drivers of growth in these regions on the back of leveraging the brand's association with cocktail culture through the media.

Cîroc had another outstanding year with 62% global top line growth supported by 52% increase in marketing spend, mainly behind the 'Cîroc the New Year' campaign and in the digital space. The highly successful launch of Cîroc Peach together with the continued double digit growth of Red Berry and Coconut depletions helped the brand to gain further share and it is the fastest growing ultra premium vodka in the United States. Outside North America, the brand more than doubled its net sales.

Rum, which was 6% of Diageo net sales, posted 8% growth with 2 percentage points of positive price/mix helped by 32% growth in Latin America and a 7% increase in North America.

The leading brand of the portfolio, **Captain Morgan** posted 9% net sales growth. In North America, the new 'Life, Love and Loot' campaign supplemented with the launch of Captain Morgan Black Spiced and marketing innovations, such as the 'Captain's Conquest', resulted in share gains and 7% net sales growth. Elsewhere the brand continued to benefit from the long running 'Got a Little Captain in You?' and the 'Captain's Island' campaigns, which drove the 15% increase in marketing spend globally and resulted in strong double digit top line growth in Germany, Ireland, Russia and Eastern Europe, and the brand almost tripled in the Benelux.

The wider rum category saw very strong double digit growth in Zacapa due to Latin America, Europe and North America. The successful extension of Bundaberg into the white rum segment and the launch of the limited edition premium Bundy Masters Distillers Collection drove growth of Bundaberg in Australia.

Liqueurs were 5% of Diageo net sales. The challenging commercial environment in Western Europe together with the reduction in the depth and frequency of promotions in Great Britain continued to

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Business review (continued)

impact **Baileys'** performance. However, Baileys posted 6% growth outside Europe with net sales up 42% in China on the back of a new marketing campaign aimed at female consumers.

Tequila represented 3% of Diageo net sales. Don Julio continued its strong performance with 26% growth, outperforming the fast growing super premium tequila segment with the continued acceleration of 1942, Reposado, Anejo and the successful launch of Tequila Don Julio 70, the world's first Anejo Claro.

Jose Cuervo Especial declined 5%, driven by the impact of distributor destocking on Jose Cuervo Especial Gold in the first half and also by consumers shifting away from dark tequilas. This was partially offset by an increase in Jose Cuervo Especial Silver net sales, helped by consumer trends and the recruitment from the ProBeach Volleyball Series.

Gin represented 3% of Diageo net sales and grew 3%. Emerging market consumer demand drove double digit net sales growth of value gin brands in Africa, while super premium gin grew over 20% in Asia Pacific and Latin America as the category saw a resurgence as the 'white spirit of choice' with bartenders.

Tanqueray grew net sales 2% globally, despite a slight decline in its biggest market, North America, as the brand grew over 10% in its new markets across Western Europe, with Iberia up 24%, and grew 17% in the emerging markets, with both Africa and Latin America posting double digit growth. The new brand strategy and the supporting 'Tonight We Tanqueray' communications campaign drove 11% increase in marketing spend.

Premium local spirits: During the year Diageo completed the acquisition and integration of Mey İçki, the leading spirits company in Turkey. Mey İçki posted £291 million net sales in the year with 5.1 million equivalent units of volume. Raki is the main spirits category in the Turkish market and Mey İçki is a clear market leader in the category with Yeni Raki being the most recognised brand. Mey İçki gained share during the year as marketing spend was focused on modern and traditional raki occasions, building strong brand equities and maintaining executional excellence in store. Diageo also increased its shareholding in Quanxing by 4% and from 29 June has control of Shuijingfang, fiscal 2013 will be the first full year Diageo consolidates the company's results. Chinese white spirits delivered 36% net sales growth outside China, driven by price increases and expanded distribution footprint with Shui Jing Fang now available in the duty free channel at forty airports and on two airlines worldwide and also in seven domestic markets. During the year Diageo also acquired an additional 20.6% stake in Hanoi Liquor Joint Stock Company in Vietnam and agreed to acquire Ypióca, the leading premium cachaça brand in Brazil.

Beer brands represented 21% of Diageo net sales and grew 5% with the developed markets up 1% despite declining volumes and emerging markets growing 9% with 6 percentage points of positive price/mix.

Guinness made up 52% of Diageo's beer business by net sales. The brand delivered 2% net sales growth in the developed markets as the successful launch of Guinness Black Lager together with price increases on Guinness Kegs drove 9% net sales growth for Guinness in North America. In the emerging markets, net sales were up 8% with strong growth across Africa and continued share gains and price increases in Indonesia. Nigeria is now the biggest market for Guinness by net sales and the brand further extended its footprint this year with double digit growth across the other Africa markets. Marketing spend behind the 'Guinness The Match' and 'Guinness Football Challenge' campaigns tapped into African consumers' fervent love of football, and the launch of a landmark new TV campaign 'The Ticket', and 'Guinness VIP', a mobile phone relationship marketing programme with the participation of 2.4 million consumers, drove 7% increase in spend globally.

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Business review (continued)

Local African beers continued to perform strongly, with Tusker and Harp posting strong double digit top line growth supported by innovations, such as the launch of Harp Lime in Nigeria and Tusker Lite in Kenya. Senator delivered more than a quarter of the beer net sales growth, driven by price increases and footprint expansion in Kenya.

Wine was 4% of Diageo net sales. It remained a challenging category with volume declining in North America and Europe and with a shift to the lower end of the portfolio.

Ready to drink, 7% of Diageo net sales, was flat. Emerging markets posted a 7% increase, offset by a 2% reduction in developed markets, driven by a decline in Australia despite share gains. The transfer of production and sales of Smirnoff ready to drink in South Africa to Diageo's associate had a full point impact on growth rates. Excluding this the category grew 1% globally. Smirnoff Ice posted strong growth across the emerging middle class consumers of Africa and Latin America and the launch of Parrot Bay and Smirnoff Frozen Pouches proved to be a huge success in the United States. The launch of Smirnoff Ice Green Apple and Raspberry Splash revived the Smirnoff Ice portfolio in Asia driving accessibility and recruiting female consumers to the category.

2012

North America

“The North American business has delivered another strong set of results. We have continued to drive price/mix by staying focused on: disciplined promotional spend, growth of our strategic brands and the continued growth of our premium and super premium brands, most notably Johnnie Walker and Ciroc. We've achieved this through consistent investment in targeted campaigns that have improved brand equities. Innovation continues to be a competitive strength and we have both sustained past launches and delivered exciting new products. Previously identified enhancements to our distribution system were implemented in the year and will benefit our future growth. Strong pricing and mix shift to premium products, coupled with our continued focus on cost, drove margin improvement, however this was offset by higher marketing. These measures, taken together, have delivered efficient growth and strengthened our business.”

Larry Schwartz

President, Diageo North America

Key highlights

- Strong delivery of the strategic brands in the **United States** resulted in spirits net sales growth of 7% and drove performance in North America. Incremental net sales were driven by Ciroc, up 61%, as the strong performance of existing variants was amplified by the launch of Ciroc Peach, Diageo's most successful North American product launch to date.
- The performance of beer improved overall as Guinness more than offset softness in other beer brands. The launch of Guinness Black Lager, the performance of Guinness and selective price increases across the brand drove price/mix improvements in beer, and Guinness gained share in the imported beer segment.
- Ready to drink net sales returned to growth, as the strong performance of innovation launches such as Parrot Bay and Smirnoff pouches, and cocktails, including Jose Cuervo Light Margarita, Zero Calorie Margarita Mix and Light Margarita Flavours offset declines on Smirnoff ready to drink.

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Business review (continued)

- The wine restructuring is complete, improving the economics of the business. Wine continues to play a valuable role in the route to market, but it remains a challenging category and pricing pressure is intense.
- Marketing investment was up 7%, an increase of 20 basis points as a percentage of net sales, primarily behind strategic brands. Captain Morgan and Smirnoff regained momentum on the back of compelling new advertising campaigns 'To Life, Love and Loot' and a new version of 'I choose' which included the launch of Smirnoff Whipped Cream and Fluffed Marshmallow. The strong performance of Johnnie Walker was the result of a scotch marketing spend increase of 24%, as the launch of Johnnie Walker Double Black in October, the 'Say it without saying it' campaign and Blue Label engraving, drove a significant shift into higher priced variants and net sales increased 18%.
- Net sales growth of 5% in **Canada** was driven by category leaders Smirnoff and Captain Morgan which delivered increases of 5% and 8% respectively. Guinness net sales grew 8% supported by a national television campaign in English and French, the first of its kind in three years.

Performance

Key financials	2011	Exchange	Acquisitions	Organic	2012	Reported
	Reported (restated)		and disposals	movement	Reported	movement
	£ million	£ million	£ million	£ million	£ million	%
Net sales	3,366	18	(26)	198	3,556	6
Marketing spend	508	2	1	37	548	8
Operating profit before exceptional items	1,275	3	(3)	79	1,354	6
Exceptional items	(23)				(11)	
Operating profit	<u>1,252</u>				<u>1,343</u>	7

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Business review (continued)

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Key markets and categories:			
North America	2	6	6
United States	1	6	6
Canada	2	5	5
Spirits	2	7	7
Beer	1	4	5
Wine	(5)	(7)	(17)
Ready to drink	—	3	3
The strategic brands:**			
Johnnie Walker	9	18	18
Crown Royal	(4)	(3)	(2)
Buchanan's	9	11	11
Smirnoff	3	4	5
Ketel One vodka	8	8	8
Cîroc	58	61	62
Captain Morgan	5	7	7
Baileys	3	5	5
Jose Cuervo	(6)	(7)	(7)
Tanqueray	(2)	(1)	(1)
Guinness	9	9	10

* Organic equals reported movement for volume except for: total North America volume 1% and wine (13)% due to disposals.

** Spirits brands excluding ready to drink.

2012

Europe

“The economy remains very uneven in Europe. We continue to deliver substantial sales and profit growth in Europe’s emerging countries of Russia, Eastern Europe and Turkey, as well as a good performance across Northern Europe. Clearly though, Southern Europe remains challenging. From a category point of view, scotch remained very strong in the emerging markets offsetting decline in Southern Europe. Smirnoff continued to grow in Great Britain and Captain Morgan continued to perform strongly with 18% net sales growth. Weaker Baileys performance was driven by the change in promotional strategy in Great Britain and the challenges in Southern Europe. Overall marketing campaign activity has been maintained and the reinvestment rate increased as we spent more behind scotch and emerging markets while improving effectiveness in Western Europe. In Turkey, the integration of Mey İçki has been completed successfully and the enhanced route to market will be a key growth driver as we bring our international brands to the expanding middle class consumer base there. Finally, the new operating model has delivered further efficiencies and improved operating margin.”

Andrew Morgan

President, Diageo Europe

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Business review (continued)

Key highlights

- In increasingly challenging economic conditions in Southern Europe, Diageo Europe's underlying performance remained relatively consistent throughout the year. Organic net sales growth in Turkey was (12)% in the second half against 114% in the first half as it lapped the customs dispute that was resolved in April 2011. The second half was also impacted by the decision to increase H1 shipments into Eastern European markets to avoid custom administration delays which had occurred in H2 in prior years.
- Formerly material markets for Diageo, Iberia, Greece and Italy in total represent 5% of net sales globally after a number of years of tough trading. These Southern European markets declined 6% in volume and 9% in net sales as deeper austerity measures put additional pressure on consumption and sales mix. J&B and Baileys were the brands impacted most, both declining 8% in net sales in these markets. However, growth of Tanqueray, Captain Morgan and Bushmills partially offset these declines.
- In Ireland, Guinness Draught and Smithwick's grew share in the on trade and Harp in the off trade, but the beer market remains in decline and net sales fell 5%.
- In Great Britain, reduced promotional activities across the portfolio drove 2% decline in net sales with 4 percentage points of positive price/mix. Smirnoff delivered 6% net sales growth, driven by Smirnoff Red gaining share despite the promotional reductions. Beer net sales grew 6% with price increases on Guinness and a successful year for Red Stripe as the brand's sales, distribution and marketing were brought in house.
- The rest of **Western Europe** delivered 6% growth in spirits, fuelled by double digit top line growth of Smirnoff and Captain Morgan. Germany maintained strong momentum on the back of increased customer marketing focus and benefited from the premiumisation trend for international spirits. Captain Morgan saw almost 60% net sales growth with 4 percentage points of share gain. Net sales in France were flat as the second half saw the reversal of the pre excise tax increase buy in coupled with difficult market conditions. The Singleton more than doubled in net sales as the brand gained share in France supported by improved distribution.
- In **Russia and Eastern Europe**, double digit net sales growth was driven by scotch, with Johnnie Walker up 11%, Bell's up 57% and White Horse up 17%. Marketing spend was focused behind Johnnie Walker and also on launching the first ever local campaign for White Horse, the biggest whisky brand in Russia. Black & White, targeting consumers seeking a more affordable entry into the scotch category, performed well following its launch last August. As a result of broadening from scotch into other categories in these fast growing markets, Captain Morgan and Bushmills also contributed to top line growth with net sales growth over 30% for both and share gains within the growing rum and Irish whiskey categories.
- In **Turkey** the integration of Mey İçki has been completed successfully. Net sales growth of 28% reflected the resolution in 2011 of the customs dispute which had impacted imports and also the share gains made as a result of marketing investment behind Johnnie Walker, J&B and Smirnoff. The inorganic part of the Turkish business delivered £291 million of net sales as Yeni Raki continued to be the market leader and while the recent duty increase impacted sales in the category, Mey İçki gained 3 percentage points of share on the back of very effective on trade marketing activities and increased penetration into beer led outlets.

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Business review (continued)

Performance

Key financials	2011	Exchange	Acquisitions	Organic	2012	Reported
	Reported (restated)		and disposals	movement	Reported	movement
	£ million	£ million	£ million	£ million	£ million	%
Net sales	2,703	(25)	288	(17)	2,949	9
Marketing spend	403	(4)	30	10	439	9
Operating profit before exceptional items	796	(4)	107	26	925	16
Exceptional items	(157)				41	
Operating profit	<u>639</u>				<u>966</u>	51

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Key markets and categories:			
Europe	(1)	(1)	9
Western Europe	(3)	(3)	(4)
Russia and Eastern Europe	14	16	13
Turkey	7	28	983
Spirits	—	1	17
Beer	(3)	—	(1)
Wine	(5)	(10)	(5)
Ready to drink	(8)	(7)	(7)
The strategic brands:**			
Johnnie Walker	5	4	3
J&B	(4)	(7)	(8)
Smirnoff	1	5	4
Captain Morgan	20	18	18
Baileys	(9)	(7)	(8)
Guinness	(4)	(2)	(3)

* Organic equals reported movement for volume except for: total Europe volume 12%, spirits 16%, wine (2)% and Turkey 1,081% reflecting the acquisition of Mey İçki this year and sale of Gilbeys in the previous year.

** Spirits brands excluding ready to drink.

2012

Africa

“Diageo Africa’s strong routes to market and leading brands have harnessed the growth opportunities presented by the region. This has delivered another year of double digit net sales growth with particularly strong growth in East Africa, Ghana and Cameroon. While it was a further year of strong net sales growth in beer, spirits are now making a meaningful contribution, driving over 40% of total growth and representing 25% of net sales in the region. This increased breadth together with price

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Business review (continued)

increases was reflected in operating margin improvement. Fiscal 2012 was another year of investment for growth. We invested in marketing our brands, primarily Guinness, Tusker and Johnnie Walker, and behind innovations such as the launch of Harp Lime in Nigeria. We invested in capital expenditure to expand capacity in Nigeria and East Africa and we broadened our presence across Africa, with the acquisition of the Meta Abo Brewery in Ethiopia.”

Nick Blazquez

President, Diageo Africa

Key highlights

- Net sales in **Nigeria** grew 4%. Harp delivered another year of double digit net sales growth, however, net sales of Guinness declined slightly as price increases were implemented to maintain its premium position in a difficult economic environment. Strong spirits net sales growth resulted from more volume of premium plus brands and price increases across the portfolio, delivering positive price/mix. Marketing spend increased 3% driven by the successful launch of Harp Lime.
- **East Africa** delivered a strong performance driven by Senator, Tusker, Guinness and the strong growth of spirits. Investment behind marketing, innovation such as Tusker Lite and improved distribution drove the strong beer performance. Increased sales focus on international spirits and Kenya Cane in new glass bottles drove very strong double digit growth across spirits.
- Cameroon and Ghana represent three quarters of Diageo’s **Africa Regional Markets** and delivered approximately 90% of incremental net sales. This was driven by Guinness in Cameroon, and Malta, Guinness and Star in Ghana. Marketing spend increased 5% across Africa Regional Markets, principally focused on Johnnie Walker, with a campaign that included outdoor advertising, trade visibility and mentoring programmes. During the year Diageo completed the acquisition of the Meta Abo Brewery in Ethiopia and continued to build the spirits business in Angola, expanding the distribution footprint in the region.
- Increased headcount and outlet coverage delivered improvements in the route to market in **South Africa**. This drove strong double digit net sales growth of Smirnoff and Johnnie Walker, which offset a decline in ready to drink. Price increases followed a 20% increase in excise duty and net sales grew 7%. Marketing spend was focused behind Johnnie Walker with the ‘Step Up’ campaign, contributing to brandhouse’s 70 basis points of volume share gain in the off trade scotch category. Overall brandhouse grew share of total beverage alcohol by 90 basis points.

Performance

<u>Key financials</u>	<u>2011 Reported (restated) £ million</u>	<u>Exchange £ million</u>	<u>Acquisitions and disposals £ million</u>	<u>Organic movement £ million</u>	<u>2012 Reported £ million</u>	<u>Reported movement %</u>
Net sales	1,357	(77)	29	138	1,447	7
Marketing spend	140	(8)	4	14	150	7
Operating profit before exceptional items	333	(22)	4	65	380	14
Exceptional items	(7)				(5)	
Operating profit	<u>326</u>				<u>375</u>	15

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Business review (continued)

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Key markets and categories:			
Africa	5	11	7
Nigeria	(1)	4	1
East Africa	8	19	16
Africa Regional Markets	7	15	13
South Africa	8	7	(3)
Spirits	9	20	11
Beer	4	9	6
Ready to drink	(11)	—	(6)
The strategic brands:**			
Johnnie Walker	35	39	31
J&B	18	12	4
Smirnoff	25	20	10
Captain Morgan	1	—	(9)
Baileys	22	26	21
Guinness	3	7	3

* Organic equals reported movement for volume except for: Africa 8%, East Africa 11%, Africa Regional Markets 14%, beer 8% and Smirnoff 26% reflecting the acquisition of Serengeti and Meta Abo Breweries.

** Spirits brands excluding ready to drink.

2012

Latin America and Caribbean

“Our performance in Latin America and Caribbean during the year demonstrated the strength and sustainability of our business. In order to capture the consumer opportunity in the emerging middle class, we increased marketing spend to enhance our brand equities in scotch, increase the resonance of vodka and support innovation. We enhanced our routes to market with more dedicated distributors in Brazil, a new distributor agreement in Costa Rica and a new supply distribution centre in Panama. Additionally we have helped more than 12,000 people acquire vocational skills through our Learning for Life programme. We finished the year with the exciting acquisition of Ypióca, which will dramatically expand our presence in Brazil. This sustained investment is building a strong and successful business.”

Randy Millian

President, Diageo Latin America and Caribbean

Key highlights

- Price increases and accelerated reserve brand performance drove 9 percentage points of positive price/mix in **Paraguay, Uruguay and Brazil (PUB)**. Over 60% of net sales growth was driven by scotch, primarily Johnnie Walker and Old Parr. Investment continued behind the route to

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Business review (continued)

market, with more distributors on an exclusive basis and behind brands with a 14% increase in marketing spend, over half of which was focused behind Johnnie Walker and the 'Keep Walking Brazil' campaign, driving 17% net sales growth for the brand. The balance of spend focused on vodka, which accounted for over 20% of incremental net sales, driven by both the impressive growth of Smirnoff and Cîroc.

- Venezuela and Colombia make up the **Andean** market. Here growth was driven by a recovery of Venezuelan imports in line with currency availability and a 32% increase in net sales in Colombia. Scotch delivered over two thirds of the market growth while double digit net sales growth in rum and liqueurs also made significant contributions. Diageo gained share in both deluxe and super deluxe scotch, with two thirds of the increase in marketing spend directed towards the scotch category, principally Buchanan's in Venezuela, Old Parr in Colombia and Johnnie Walker and the launch of Haig Supreme across the market.
- Strong growth of scotch drove 16% net sales growth in **Mexico**. Solid growth of Captain Morgan and Zacapa coupled with the launch of Nuvo drove double digit growth in rum and liqueurs. This increased Diageo's category breadth and increased its share of total spirits. Marketing spend increased 12% and focused on both scotch and rum.
- A very good performance in **West Latin America** and **Caribbean** was delivered by strong growth in Argentina, Chile, Peru, the free trade zones, Costa Rica and Jamaica. Price increases and double digit net sales growth of scotch and reserve brands delivered 7 percentage points of positive price/mix. Marketing spend focused on Johnnie Walker and Smirnoff which grew net sales 9%.

Performance

<u>Key financials</u>	<u>2011 Reported (restated)</u> £ million	<u>Exchange</u> £ million	<u>Acquisitions and disposals</u> £ million	<u>Organic movement</u> £ million	<u>2012 Reported</u> £ million	<u>Reported movement</u> %
Net sales	1,063	(22)	—	198	1,239	17
Marketing spend	184	(6)	1	31	210	14
Operating profit before exceptional items	318	(2)	(2)	69	383	20
Exceptional items	(6)				(2)	
Operating profit	<u>312</u>				<u>381</u>	22

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Business review (continued)

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Key markets and categories:			
Latin America and Caribbean	10	19	17
PUB	11	20	15
Andean	18	42	44
Mexico	15	16	9
West Latin America and Caribbean	9	16	16
Spirits	11	20	18
Beer	(2)	8	7
Wine	15	21	16
Ready to drink	2	15	10
The strategic brands:**			
Johnnie Walker	5	14	12
Buchanan's	13	28	25
Smirnoff	18	19	13
Baileys	3	9	6

* Organic equals reported movement for volume.

** Spirits brands excluding ready to drink.

2012

Asia Pacific

“We had another successful year in Asia Pacific maintaining our leadership position in international spirits and gaining share in all key markets and categories. The emerging markets of Asia grew double digit with South East Asia up 15%, Greater China 13% and India 24%. Uncertainty around the global economy led to further contraction of the whisky market in Korea and weaker consumer confidence in Australia which led to roughly flat net sales in developed Asia Pacific. The price increases we implemented in South East Asia, China and Global Travel Asia drove more than half of our incremental top line, and this together with the premiumisation of our portfolio delivered 6 percentage points of positive price/mix. Scotch remained the growth engine of the region delivering more than 80% of net sales growth and almost half of this growth came from our super deluxe brands. Other reserve brands also performed well, with very strong net sales growth from Zacapa, Ketel One vodka and Cîroc. I am also proud of the performance of Guinness, delivering 12% net sales growth through share gains and strong pricing. We continued to invest in infrastructure, sales execution, innovation and acquisitions, including our increased stake in Shuijingfang in China and Halico in Vietnam, creating a stronger platform for future growth. Despite these investments and as a result of our successful premiumisation strategy and focus on pricing, operating margin improved in the year.”

Gilbert Ghostine

President, Diageo Asia Pacific

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Business review (continued)

Key highlights

- Underlying consumption trends continued to be strong in emerging Asia as reflected in the 14% increase in full year net sales. In the fourth quarter route to market changes were implemented in South East Asia which reduced shipments in the period and adversely impacted the market's second half performance. The global slowdown affected consumer sentiment in Australia and the second half was weaker. Diageo Korea net sales also slowed from the first half but Diageo gained share in scotch and vodka.
- **South East Asia** delivered 3% volume growth with 12 percentage points of price/mix as a result of price increases and premiumisation and the market was the biggest contributor to pricing, deluxe and above scotch growth and margin improvement in the region. Deluxe and super deluxe launches, such as Platinum, XR21 and Double Black helped the Johnnie Walker portfolio to gain further share which together with price increases resulted in 23% net sales growth. Guinness had another strong year, breaking the £100 million barrier, with 13% net sales growth through strong pricing and continued share gains in Indonesia on the back of St Patrick's and Arthur's Day and World Series of Pool activations.
- Net sales growth of 13% in **Greater China**, and 16% in China, with 5 and 6 percentage points of positive price/mix, respectively, was due to the successful premiumisation strategy and price increases across the portfolio. Reserve brands net sales increased over 60% in China with continued strong performance from Johnnie Walker super deluxe variants and The Singleton. Baileys posted 37% net sales growth with 18 percentage points of positive price/mix, supported by increased marketing spend, in particular the Baileys 'Perfect Place' participation platform. The launch of Guinness Original in January in Shanghai together with the strategy of super premium pricing drove 17% net sales increase for Guinness. Marketing spend increased ahead of net sales at 20%, with most of the incremental investment going behind Johnnie Walker Deluxe and Super Deluxe in China. Strong premiumisation momentum continued in the second half of the year as reflected in the 7 percentage points of price/mix achieved and underlying consumption trends remained robust. Lower top line growth in the second half was driven by lapping an unusually strong third quarter last year together with shipment phasing in Taiwan.
- Strong momentum across the scotch portfolio, with share gains in every segment, was the main driver of 24% net sales growth in **India**. VAT69 delivered 39% top line growth with 10 percentage points of price/mix, supported by increased marketing spend and the launch of VAT69 Black. Johnnie Walker Black Label net sales increased over 40%, driven by the Formula 1 sponsorship programme, along with the 'Step Inside the Circuit' campaign. Rowson's Reserve, launched in the prestige Indian Made Foreign Liquor segment in October, gained distribution and share.
- Diageo's **Global Travel Asia and Middle East** remained strong. Volume in the Middle East was impacted by price increases and despite 9% positive price/mix, net sales declined 2% as a result. In Global Travel Asia, reserve brands net sales increased 37% supported by the successful launch of Johnnie Walker Platinum, Gold Label Reserve, XR21 and the Blue Label Casks Edition. The increased focus on reserve brands together with price increases and product differentiation strategy for duty free consumers resulted in 31% net sales growth for Global Travel Asia.
- In a weaker market Diageo **Australia** net sales declined slightly, however the business delivered share gains in spirits and ready to drink. The market is expected to return to growth on the

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Business review (continued)

basis of strong fundamentals. Increased focus and marketing spend delivered over 80% net sales growth of reserve brands, with Johnnie Walker's ultra premium brands the main contributors. Innovation extended Bundaberg into new segments with the launch of Bundaberg Five into white rum and the limited edition Bundy Masters Distillers Collection into premium to drive 5% growth. Smirnoff also grew 5% on the back of a successful advertising campaign. Baileys gained share but declined in a tough category.

- In **North Asia** strong share gains in a declining scotch category and in the growing beer category in Korea, together with share gains in vodka, resulted in 1% net sales growth. Windsor gained further market share in Korea, however the brand's net sales remained in decline as the contraction of the whisky market accelerated. Guinness grew 18% in Korea and Smirnoff more than doubled with increased marketing spend behind vodka and beer as part of the strategy to build Diageo's footprint outside of the whisky category. Japan delivered 3% net sales growth, lapping the launch of I.W. Harper ready to drink, with strategic brands growing double digit, with Guinness up 17% and Smirnoff up 33%, as the brand increased market share on the back of improved distribution and successful brand activations.

Performance

<u>Key financials</u>	<u>2011 Reported (restated)</u> £ million	<u>Exchange</u> £ million	<u>Acquisitions and disposals</u> £ million	<u>Organic movement</u> £ million	<u>2012 Reported</u> £ million	<u>Reported movement</u> %
Net sales	1,377	17	—	107	1,501	9
Marketing spend	303	6	—	35	344	14
Operating profit before exceptional items	299	—	(11)	54	342	14
Exceptional items	(50)				(10)	
Operating profit	<u>249</u>				<u>332</u>	33

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Business review (continued)

	<u>Volume movement*</u>	<u>Organic net sales movement</u>	<u>Reported net sales movement</u>
	%	%	%
Key markets and categories:			
Asia Pacific	2	8	9
South East Asia	3	15	14
Greater China	8	13	16
India	17	24	13
Global Travel Asia and Middle East	(5)	11	11
Australia	—	(1)	3
North Asia	(1)	1	3
Spirits	3	10	12
Beer	1	11	11
Ready to drink	(6)	(6)	(2)
The strategic brands:**			
Johnnie Walker	4	17	18
Windsor	(4)	(1)	—
Smirnoff	1	3	2
Guinness	10	12	12

* Organic equals reported movement for volume.

** Spirits brands excluding ready to drink.

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Business review (continued)

Operating results 2011 compared with 2010

Summary consolidated income statement

	Year ended 30 June	
	2011	2010
	£ million	£ million
Sales	13,232	12,958
Excise duties	(3,296)	(3,178)
Net sales	9,936	9,780
Operating costs before exceptional items	(7,052)	(7,029)
Operating profit before exceptional items	2,884	2,751
Exceptional operating items	(289)	(177)
Operating profit	2,595	2,574
Sale of businesses	(14)	(15)
Net finance charges	(397)	(462)
Share of associates' profits after tax	176	142
Profit before taxation	2,360	2,239
Taxation	(343)	(477)
Profit from continuing operations	2,017	1,762
Discontinued operations	—	(19)
Profit for the year	2,017	1,743
Attributable to:		
Equity shareholders of the parent company	1,900	1,629
Non-controlling interests	117	114
	2,017	1,743

Sales and net sales On a reported basis, sales increased by £274 million from £12,958 million in the year ended 30 June 2010 to £13,232 million in the year 30 June 2011 and net sales increased by £156 million from £9,780 million in the year ended 30 June 2010 to £9,936 million in the year ended 30 June 2011. Exchange rate movements decreased reported sales by £252 million and reported net sales by £221 million. Acquisitions increased reported sales by £38 million and reported net sales by £30 million for the year. Disposals decreased reported sales by £94 million and reported net sales by £85 million for the year.

Operating costs before exceptional items On a reported basis, operating costs before exceptional items increased by £23 million in the year ended 30 June 2011 due to a decrease in cost of sales of £70 million from £4,053 million to £3,983 million, an increase in marketing spend of £119 million from £1,419 million to £1,538 million, and a decrease in other operating expenses before exceptional costs of £26 million, from £1,557 million to £1,531 million. The impact of exchange rate movements decreased total operating costs before exceptional items by £239 million.

Exceptional operating items Exceptional operating costs of £289 million for the year ended 30 June 2011 (2010 – £177 million) comprised a net charge of £111 million (2010 – £142 million) in respect of restructuring programmes, an impairment charge of £39 million (2010 – £35 million) in respect of the Ursus brand reflecting the impact of the significant downturn in the economy in one of its principal

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Business review (continued)

markets, Greece, a charge of £92 million (2010 – £nil) in respect of the settlement of the dispute with the Turkish customs authorities regarding import duty payable on beverage alcohol products sold in the domestic channel in Turkey, a charge of £35 million (2010 – £nil) in respect of the settlement with the Thai customs authorities regarding a dispute over the price of imported goods and a charge of £12 million (2010 – £nil) in respect of the settlement with the Securities and Exchange Commission regarding various regulatory and control matters.

Restructuring programmes totalling £111 million comprised £77 million (2010 – £nil) for the operating model review announced in May 2011 primarily in respect of employee termination charges, £24 million (2010 – £93 million) for the restructuring of Global Supply operations in Scotland and the United States primarily in respect of accelerated depreciation and redundancies and £10 million (2010 – £12 million) for the restructuring of the group's brewing operations in Ireland announced in 2008 in respect of accelerated depreciation. In the year ended 30 June 2010 restructuring programmes also included a charge of £85 million for the global restructuring programme and a £48 million net credit for the restructuring of the wines business in the United States.

In the year ended 30 June 2011 total restructuring cash expenditure was £118 million (2010 – £145 million) and the cash payments made for the exceptional SEC and duty settlements amounted to £141 million (2010 – £nil).

Post employment plans Post employment net costs for the year ended 30 June 2011 were a charge of £105 million (2010 – £133 million) comprising £110 million (2010 – £92 million) included in operating costs before exceptional items, pension curtailment gains of £8 million (2010 – £6 million) in exceptional items and a charge of £3 million (2010 – £47 million) in net finance charges.

The deficit in respect of post employment plans before taxation decreased by £367 million from £1,205 million at 30 June 2010 to £838 million at 30 June 2011 primarily as a result of an increase in the market value of assets held by the post employment plans. Cash contributions to the group's UK and Irish pension schemes in the year ended 30 June 2011 were £151 million.

Operating profit Reported operating profit for the year ended 30 June 2011 increased by £21 million to £2,595 million from £2,574 million in the prior year. Before exceptional operating items, operating profit for the year ended 30 June 2011 increased by £133 million to £2,884 million from £2,751 million in the prior year. Exchange rate movements increased both operating profit and operating profit before exceptional items for the year ended 30 June 2011 by £18 million. Acquisitions decreased reported operating profit by £13 million for the year. Disposals decreased reported operating profit by £1 million for the year.

Exceptional non-operating items A net loss before taxation of £14 million on sale of businesses arose on the disposal of a number of small wine businesses in Europe and in the United States and on the termination of a joint venture in India. In the year ended 30 June 2010 sale of businesses comprised a charge of £26 million in respect of the anticipated loss on the disposal of certain non-strategic wine brands in the United States and a gain of £11 million arising on the revaluation of the equity holding in the London Group, the owner of the Nuvo brand, following the acquisition of a majority equity stake in the London Group.

Net finance charges Net finance charges decreased from £462 million in the year ended 30 June 2010 to £397 million in the year ended 30 June 2011.

Net interest charge decreased by £6 million from £375 million in the prior year to £369 million in the year ended 30 June 2011. The effective interest rate was 4.9% in the year ended 30 June 2011

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Business review (continued)

(2010 – 4.8%) and average net borrowings excluding interest rate related fair value adjustments decreased by £0.7 billion compared to the prior year. The income statement interest cover was 8.3 times and cash interest cover was 10.6 times (2010 – 7.7 times and 10.3 times, respectively).

Net other finance charges for the year ended 30 June 2011 were £28 million (2010 – £87 million). There was a decrease of £44 million in finance charges in respect of post employment plans from £47 million in the year ended 30 June 2010 to £3 million in the year ended 30 June 2011. Other finance charges also included £16 million (2010 – £18 million) on unwinding of discounts on liabilities and a hyperinflation adjustment of £9 million (2010 – £16 million) in respect of the group's Venezuela operations. In the year ended 30 June 2010 an additional £4 million other finance income was recognised and a £10 million charge in respect of exchange rate translation differences on inter-company funding arrangements where hedge accounting was not applicable.

Associates The group's share of associates' profits after interest and tax was £176 million for the year ended 30 June 2011 compared to £142 million in the prior year. Diageo's 34% equity interest in Moët Hennessy contributed £179 million (2010 – £134 million) to share of associates' profits after interest and tax.

Profit before taxation Profit before taxation increased by £121 million from £2,239 million in the prior year to £2,360 million in the year ended 30 June 2011.

Taxation The reported tax rate for the year ended 30 June 2011 was 14.5% compared with 21.3% for the year ended 30 June 2010. Factors that reduced the reported tax rate included settlements agreed with tax authorities that gave rise to releases of tax provisions and an increase of £115 million in the carrying value of deferred tax assets in respect of brands under the taxation basis applicable at 30 June 2011. The tax rate before exceptional items for the year ended 30 June 2011 was 17.4% compared with 21.6% for the year ended 30 June 2010.

The tax rates from continuing operations before exceptional and after exceptional items for the years ended 30 June 2011 and 30 June 2010 were calculated as follows:

	Year ended 30 June	
	2011	2010
	£ million	£ million
Taxation on profit from continuing operations (A)	343	477
Tax credits in respect of exceptional items	54	49
Exceptional tax credits	66	—
Tax before exceptional items (B)	463	526
Profit before taxation (C)	2,360	2,239
Losses on sale of businesses	14	15
Exceptional operating costs	289	177
Profit from continuing operations before taxation and exceptional items (D)	2,663	2,431
Tax rate after exceptional items (A/C)	14.5%	21.3%
Tax rate before exceptional items (B/D)	17.4%	21.6%

Discontinued operations Discontinued operations in the year ended 30 June 2010 comprised a charge after taxation of £19 million in respect of anticipated future payments to thalidomide claimants.

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Business review (continued)

Exchange rate and other movements Foreign exchange movements in the year ended 30 June 2011 decreased net sales by £221 million, increased operating profit before exceptional items by £18 million, decreased profit from associates by £5 million and reduced net finance charges by £1 million.

Foreign exchange movements in the year ended 30 June 2011 were adversely impacted by the Venezuelan bolivar.

Analysis by business area and brand

As reported on page 35, Diageo announced changes to its regional structure on 25 May 2011. As a result of this change the segmental information for the years ended 30 June 2011 and 2010 have been restated. The restated organic movement calculations for volume, sales, net sales, marketing spend and operating profit for the group's operating segments for the year ended 30 June 2011 are included below:

	2010 Reported	Acquisitions and disposals ⁽²⁾	Organic movement	2011 Reported	Organic movement
	units million	units million	units million	units million	%
Volume					
North America	52.5	(0.2)	—	52.3	—
Europe	41.3	(0.1)	(0.7)	40.5	(2)
Africa	21.1	0.6	1.4	23.1	7
Latin America and Caribbean	14.1	—	1.6	15.7	12
Asia Pacific	14.4	—	1.5	15.9	10
Total volume	<u>143.4</u>	<u>0.3</u>	<u>3.8</u>	<u>147.5</u>	<u>3</u>

	2010 Reported	Exchange ⁽¹⁾	Acquisitions and disposals ⁽²⁾	Organic movement	2011 Reported	Organic movement
	£ million	£ million	£ million	£ million	£ million	%
Sales						
North America	3,887	(33)	(58)	99	3,895	3
Europe	4,460	(39)	(33)	(109)	4,279	(3)
Africa	1,582	(28)	36	174	1,764	11
Latin America and Caribbean	1,364	(264)	—	193	1,293	18
Asia Pacific	1,595	112	(1)	225	1,931	13
Corporate	70	—	—	—	70	
Total sales	<u>12,958</u>	<u>(252)</u>	<u>(56)</u>	<u>582</u>	<u>13,232</u>	<u>5</u>

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Business review (continued)

	2010 Reported £ million	Exchange ⁽¹⁾ £ million	Acquisitions and disposals ⁽²⁾ £ million	Organic movement £ million	2011 Reported £ million	Organic movement %
Net sales						
North America	3,340	(25)	(58)	109	3,366	3
Europe	2,848	(32)	(25)	(88)	2,703	(3)
Africa	1,228	(22)	29	122	1,357	10
Latin America and Caribbean	1,123	(219)	(1)	160	1,063	17
Asia Pacific	1,171	77	—	129	1,377	11
Corporate	70	—	—	—	70	
Total net sales	<u>9,780</u>	<u>(221)</u>	<u>(55)</u>	<u>432</u>	<u>9,936</u>	<u>5</u>
Excise duties	3,178				3,296	
Total sales	<u>12,958</u>				<u>13,232</u>	
Marketing spend						
North America	476	(3)	(1)	36	508	8
Europe	422	(5)	(1)	(13)	403	(3)
Africa	119	—	4	17	140	15
Latin America and Caribbean	151	(6)	—	39	184	27
Asia Pacific	251	12	1	39	303	15
Total marketing spend	<u>1,419</u>	<u>(2)</u>	<u>3</u>	<u>118</u>	<u>1,538</u>	<u>8</u>
Operating profit						
North America	1,184	(12)	(1)	104	1,275	9
Europe	881	(12)	(7)	(66)	796	(8)
Africa	301	(17)	(2)	51	333	18
Latin America and Caribbean	336	(73)	(3)	58	318	22
Asia Pacific	240	8	(1)	52	299	20
Corporate	(191)	124	—	(70)	(137)	
Total operating profit before exceptional items	<u>2,751</u>	<u>18</u>	<u>(14)</u>	<u>129</u>	<u>2,884</u>	<u>5</u>
Exceptional items ⁽³⁾	(177)				(289)	
Total operating profit	<u>2,574</u>				<u>2,595</u>	

Notes: Information relating to the organic movement calculations

- (1) The exchange adjustments for sales, net sales, marketing spend and operating profit are the retranslation of prior year reported results at current year exchange rates and are principally in respect of the Venezuelan bolivar, the euro and the US dollar.
- (2) The impacts of acquisitions and disposals are excluded from the organic movement. In the year ended 30 June 2011 the only acquisition that affected volume, sales, net sales, marketing spend and operating profit was the acquisition of Serengeti Breweries which contributed volume, sales, net sales and operating loss of 0.6 million equivalent units, £38 million, £30 million and £7 million, respectively. Disposals in the year ended 30 June 2011 were the disposals as a result of the reorganisation of the group's US wines operations and the disposal of the Gilbeys wholesale wine business in Ireland. An adjustment is also made to exclude directly attributable transaction costs

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Business review (continued)

incurred in the year ended 30 June 2011 of £22 million, netted against acquisition costs of £12 million incurred in the year ended 30 June 2010 primarily in respect of the acquisition of Serengeti Breweries, Zacapa, Mey İçki and the additional equity stake in Quanxing.

- (3) Exceptional operating costs of £289 million for the year ended 30 June 2011 (2010 – £177 million) comprised a net charge of £111 million (2010 – £142 million) in respect of restructuring programmes, an impairment charge of £39 million (2010 – £35 million) in respect of the Ursus brand reflecting the impact of the significant downturn in the economy in one of its principal markets, Greece, a charge of £92 million (2010 – £nil) in respect of the settlement of the dispute with the Turkish customs authorities regarding import duty payable on beverage alcohol products sold in the domestic channel in Turkey, a charge of £35 million (2010 – £nil) in respect of the settlement with the Thai customs authorities regarding a dispute over the price of imported goods and a charge of £12 million (2010 – £nil) in respect of the settlement with the Securities and Exchange Commission regarding various regulatory and control matters.

Corporate revenue and costs Net sales were £70 million in the year ended 30 June 2011, flat relative to the comparable prior period. Net operating charges were £137 million in the year ended 30 June 2011 having been £191 million in the year ended 30 June 2010. The movement was made up of:

- included in corporate was a benefit of £21 million, versus a charge of £40 million in the year ended 30 June 2010 arising from currency transaction hedging which is controlled centrally;
- an £8 million increase in underlying corporate costs; and
- beneficial exchange differences of £123 million which arose on the movement between transaction exchange rates achieved in 2011 and those achieved in 2010.

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Business review (continued)

Category review

	Volume* movement	Organic net sales movement	Reported net sales movement
	%	%	%
Category performance			
Spirits	3	6	3
Beer	1	4	3
Wine	(2)	6	(11)
Ready to drink	(3)	(1)	—
Total	<u>3</u>	<u>5</u>	<u>2</u>
Strategic brand performance**			
Whisk(e)y:	4	7	2
Johnnie Walker	11	11	11
Crown Royal	1	3	2
J&B	(6)	(8)	(8)
Buchanan's	2	14	(21)
Windsor	3	8	12
Bushmills	<u>9</u>	<u>10</u>	<u>11</u>
Vodka:	2	7	7
Smirnoff	1	(1)	(1)
Ketel One vodka	1	1	—
Cîroc	<u>123</u>	<u>126</u>	<u>122</u>
Liqueurs:	3	1	7
Baileys	<u>3</u>	<u>1</u>	<u>—</u>
Rum:	2	2	(3)
Captain Morgan	<u>4</u>	<u>4</u>	<u>4</u>
Tequila:	5	5	3
Jose Cuervo	<u>4</u>	<u>3</u>	<u>1</u>
Gin:	—	2	1
Tanqueray	<u>3</u>	<u>4</u>	<u>3</u>
Beer:	1	4	3
Guinness	<u>2</u>	<u>3</u>	<u>2</u>

* Organic equals reported movement except for beer which was 3% and wine which was (11)% due to acquisitions and disposals.

** Spirits brands excluding ready to drink.

Spirits: Net sales grew across all spirits categories and across all price segments, with the super premium segment growing significantly faster than the others.

Whisk(e)y: The growth of whisk(e)y delivered almost half of Diageo's incremental net sales, driven by success in emerging markets. **Johnnie Walker** is Diageo's biggest brand and was the biggest contributor to total net sales growth, with the fastest growth coming from super deluxe variants, up 25%. Emerging markets net sales were up 20% supported by incremental marketing investment behind proven global

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Business review (continued)

growth drivers, including the 'Walk with Giants' and 'Step Inside the Circuit' campaigns and ongoing Grand Prix sponsorships.

Innovation drove the growth of **Crown Royal**, with the successful launch of Crown Royal Black, a variant which attracts super premium bourbon consumers. Sold at a higher price point than the base brand, Crown Royal Black improved brand mix, and, together with a reduction in discounting, delivered two percentage points of price/mix improvement as the brand gained share in the growing North American whiskey category.

Overall **J&B** brand performance was impacted by the weak scotch market in Spain, the brand's largest market. However, in its second largest market, France, the brand performed well with net sales up 9% supported by increased marketing spend and campaigns advertising new bottle formats.

Price increases on **Buchanan's** in Latin America, the success of the new Buchanan's Master and increased marketing investment drove double digit net sales growth. In the United States net sales grew 41%. Up-weighted marketing investment and rapidly expanded distribution allowed Buchanan's to reach more of its core multi-cultural consumers and Buchanan's is now the fastest growing scotch in the market.

Windsor extended its scotch leadership position in Korea. Windsor 12 continued to perform strongly and price increases across the variants delivered positive price/mix. Marketing spend was focused on the 'World's No.1' campaign which built on Windsor's gold medal at the prestigious 2010 International Wines and Spirits Competition.

Bushmills grew net sales in all regions with a particularly strong second half, primarily driven by a 29% net sales increase in Russia and Eastern Europe. Marketing spend was focused behind global growth drivers, the 'Bushmills Brothers' campaign and the launch of new packaging for Bushmills single malt.

Vodka: Diageo's vodka portfolio grew net sales 7% in a competitive category. Strong **Smirnoff** growth in Latin America and Caribbean, Africa and Asia partially offset net sales decline in the United States and Europe. The decision to reduce promotional activity in the United States resulted in share loss. In Europe, net sales declined due to lower volume and negative channel mix in Great Britain and challenging economic conditions in Spain and Greece. Marketing spend increased 11% behind the Smirnoff 'Nightlife Exchange Project' globally. The majority of the increase focused on emerging markets, especially Latin America and India to position the brand for emerging middle class consumers.

In the United States, **Ketel One vodka** net sales and share were maintained as the brand held its price positioning. There was some weakness in flavours but Ketel One vodka grew, supported by the 'Gentlemen this is vodka' campaign. The roll out of Ketel One vodka into markets outside the United States, particularly in Latin America, drove the net sales growth of the brand globally.

The performance of Diageo's vodka brands was led by **Cîroc**, which more than doubled its net sales. Innovation on the brand, the new Coconut and Red Berry flavours, is supporting growth. The brand's appeal continues to increase and it gained share in the ultra premium vodka segment following distribution gains and the success of its multicultural marketing programmes. Cîroc is now sold in over 70 countries outside its United States base.

Liqueur: **Baileys** returned to growth with the launch of the new campaign 'Baileys. Let's do this again'. It was supported by strong sales programmes that drove increased visibility and gifting, and the

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Business review (continued)

launch of the new Hazelnut flavour. Performance improved in North America and in emerging markets net sales grew 30%.

Rum: Diageo's largest rum brand, **Captain Morgan**, grew net sales in every region outside the United States. Growth was particularly strong in Canada, Great Britain and Germany where the brand gained share and delivered double digit growth. In the United States, the brand's net sales declined as smaller competitors have gained share by pricing and discounting aggressively in a flat category. However, Captain Morgan is one of the strongest and most enduring industry icons and the new marketing campaign will build on this.

Net sales of Diageo's second largest rum brand, **Cacique**, declined as growth in Venezuela was offset by decline in its largest market, Spain. **Bundaberg** grew in Australia driven by innovation, led by the launch of Bundy 5, a white rum, and Bundaberg limited editions. In July, Diageo acquired a controlling stake in the super premium rum, **Zacapa**. The brand grew strongly in every region delivering double digit net sales growth on the back of targeted distribution expansion and super premium sampling activities.

Tequila: Despite lower competitor pricing **Jose Cuervo** grew in the United States as a result of a successful on trade events programme, innovation in on trade dispense and the strong growth of the super premium segment. Jose Cuervo price/mix was negative but this was offset by the growth of super premium **Don Julio** and price/mix was flat for the category. Don Julio's net sales growth accounted for roughly half of the category growth.

Gin: Growth of **Tanqueray** was driven by Spain, Canada and Global Travel Asia. Spain contributed more than a third of growth, where despite the difficult economic conditions, premium gin brands performed well and Tanqueray gained volume share through strong promotional sales drivers in the off trade. In contrast, the United States gin category declined. Tanqueray reduced discounting and focused on visibility drivers to maintain net sales.

Beer: The 4% net sales growth in beer was driven by the emerging markets of Africa and Asia Pacific where incremental marketing spend on **Guinness** and local lager brands, and price increases in selected markets drove positive price/mix for the category. Africa net sales grew 11% and Guinness returned to growth led by Nigeria and Cameroon, supported by an 18% increase in marketing spend across the region. Net sales of Guinness declined in Ireland and Great Britain where the beer category was weak, particularly in the on trade. Local lager brands such as Harp, Senator and Tusker in Africa, and Tiger in Malaysia delivered further growth for the category.

Wine: Volume declined in North America, offset by improved price/mix. In Great Britain, a strong Bordeaux campaign and price increases delivered net sales growth of 14%.

Ready to drink: Weakness in Europe and North America led to a 1% drop in net sales. In the United States, a successful programme of innovation slowed the rate of decline. In Australia, there was a return to growth driven by Smirnoff Ice and the emergence of the new ready to serve segment through innovations such as Smirnoff Signature Serves. Ready to drink continued to grow in emerging markets such as Nigeria and Brazil.

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Business review (continued)

2011

North America

Key highlights

- Performance in **North America** was driven by the growth of spirits in the **United States**, where net sales were up 4%.
- Spirits volume in the United States remained flat as the reduction in promotional spend and heavy competition in the vodka and rum categories resulted in share loss.
- Positive price/mix in the United States was driven by the growth of Cîroc, Crown Royal Black, Buchanan's and the silver and super premium variants of Jose Cuervo.
- Marketing spend increased 8% mainly behind the strategic brands and campaigns such as Cîroc's 'Smooth Talk' and 'Cîroc the New Year' television campaigns; Smirnoff's continued sponsorship of 'Master of the Mix' in the United States and the Smirnoff 'Nightlife Exchange Project' in Canada; new television activations of the 'Gentlemen, this is vodka' campaign for Ketel One vodka; and dedicated television advertising behind the silver variants of Jose Cuervo Especial and Tradicional.
- Improved operating margin was driven by positive price/mix and ongoing initiatives to reduce production costs which resulted in cost of goods savings.
- Beer volume and net sales growth was driven by Guinness, which offset weakness in Harp and Smithwick's. Price increases on Guinness drove price/mix improvements in beer.
- The wine division has been restructured, a number of wine brands sold and the final sale and leaseback of vineyards and facilities in California completed. Price increases on Beaulieu Vineyards reserve tier wines and distribution gains by Acacia Vineyard drove three percentage points of price/mix in wines.
- Ready to drink net sales declined 3%. Smirnoff Ice volume was weak but innovations have been successful including Baileys Mudslide, Jeremiah Weed malt based beverages, Jose Cuervo Light Margaritas and Smirnoff Mixed Drinks.
- In **Canada** net sales grew 3% and Diageo gained share led by the strong performance of Smirnoff and Captain Morgan.

Performance*

<u>Key financials</u>	<u>2010 Reported</u> £ million	<u>Exchange</u> £ million	<u>Acquisitions and disposals</u> £ million	<u>Organic movement</u> £ million	<u>2011 Reported</u> £ million	<u>Reported movement</u> %
Net sales	3,340	(25)	(58)	109	3,366	1
Marketing spend	476	(3)	(1)	36	508	7
Operating profit before exceptional items	1,184	(12)	(1)	104	1,275	8
Exceptional items	(38)				(23)	
Operating profit	<u>1,146</u>				<u>1,252</u>	9

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Business review (continued)

	Volume** movement	Organic net sales movement	Reported net sales movement
	%	%	%
Key countries and categories:			
North America	—	3	1
United States	—	3	—
Canada	3	3	8
Spirits	—	4	3
Beer	1	2	2
Wine	(4)	(1)	(21)
Ready to drink	(3)	(3)	(4)
The strategic brands:***			
Johnnie Walker	(1)	2	1
Smirnoff	—	(1)	(2)
Baileys	1	—	—
Captain Morgan	(2)	(2)	(2)
Jose Cuervo	3	3	2
Tanqueray	1	1	—
Crown Royal	1	3	2
Ketel One vodka	(1)	—	(1)
Buchanan's	42	44	42
Cîroc	124	128	125
Guinness	3	4	3

* Restated for changes in reporting segments, see page 35.

** Organic equals reported movement for volume, except for wine where reported movement was (19)% due to disposals in the year.

*** Spirits brands excluding ready to drink.

2011

Europe

Key highlights

- Volume in **Europe** declined 2%. The challenging pricing environment and on trade weakness across most of Europe coupled with the decline of scotch in Southern Europe led to negative price/mix.
- In **Great Britain**, VAT and duty increases and the channel shift from the on to the off trade were the main drivers in the beverage alcohol market. Within this context, Diageo spirits performed well and gained share while price increases on beer and wine resulted in small share losses. Positive price/mix was primarily a result of the growth of wine, where net sales grew 14%. The growth of wine had a negative impact on gross margin. Marketing spend increased and the incremental investment was focused on super premium brands and innovation. Net sales of reserve brands grew 30% driven by super deluxe scotch. The launch of three new products and a

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Business review (continued)

strong media campaign led to share gains in the fast growing premix segment and Diageo finished the year with over 50% of the segment.

- High levels of unemployment and personal tax increases in **Ireland** continued to restrict consumer spending, particularly in the on trade. Guinness remained the best selling beer in Ireland, but net sales declined due to lower sales in the on trade, while the volume of Diageo's packaged beer increased in the growing off trade. Marketing spend on the brand increased, reflecting the growing momentum of 'Arthur's Day' and the Irish rugby sponsorship. Net sales of spirits grew 2% and Diageo gained share led by the continued success of Captain Morgan with investment behind on trade sampling and promotional activity.
- Net sales in **Iberia** declined 18%, a deterioration from the first half. This was due to a further reduction in consumer spending in the on trade, which accounts for the majority of scotch and rum sales, as well as some destocking at both the wholesale and retail level. Despite implementing a price increase on spirits in the second half, price/mix remained flat, reflecting the higher proportion of sales through the off trade. There was a strict control of costs resulting in an increase in operating margin for the year.
- Net sales in **Greece** declined 38% as significant rises in excise duties on spirits and other austerity measures dramatically reduced consumer spending and confidence. As consumers switched to at home consumption, Diageo increased its focus on the off trade, growing volume share of spirits in the off trade and this year was rated number one supplier among all beverage alcohol suppliers. Marketing spend was reduced broadly in line with net sales and activity was focused on supporting the launch of ready to serve cocktails and premix brands. Overheads were also reduced, but operating margin declined.
- In **Russia and Eastern Europe**, Diageo delivered double digit net sales growth and positive price/mix due to price increases on spirits and an improvement in brand mix as many Russian consumers began to trade back up in spirits. There was strong growth on Johnnie Walker in all markets, while Bell's and White Horse also performed well in Russia, appealing to those consumers seeking a more affordable entry into the scotch category. Marketing spend was focused on premium and super premium scotch, the roll out of Captain Morgan and driving new premium innovation launches such as White Horse 1900.
- Elsewhere in Europe, international spirits continued to gain momentum. In **Germany**, Diageo grew net sales 13% and gained share led by Johnnie Walker and the continued success of the Captain Morgan roll out. Diageo resumed shipments to **Turkey** in the second half having reached settlement in a dispute with Turkish customs authorities for which there was an exceptional charge of £92 million.

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Business review (continued)

Performance*

Key financials	2010	Exchange	Acquisitions and	Organic	2011	Reported
	Reported		disposals	movement	Reported	movement
	£ million	£ million	£ million	£ million	£ million	%
Net sales	2,848	(32)	(25)	(88)	2,703	(5)
Marketing spend	422	(5)	(1)	(13)	403	(5)
Operating profit before exceptional items	881	(12)	(7)	(66)	796	(10)
Exceptional items	(53)				(157)	
Operating profit	<u>828</u>				<u>639</u>	(23)

	Volume**	Organic	Reported
	movement	net sales	net sales
	%	movement	movement
		%	%
Key countries and categories:			
Europe		(2)	(3)
Great Britain		—	2
Ireland		(1)	(5)
Iberia		(18)	(18)
Greece		(33)	(38)
Russia		9	21
Spirits		(1)	(4)
Beer		(5)	(4)
Wine		(1)	11
Ready to drink		(5)	(8)
The strategic brands:***			
Johnnie Walker		(3)	(5)
Smirnoff		(4)	(11)
Baileys		(1)	(3)
J&B		(5)	(8)
Captain Morgan		38	37
Guinness		(5)	(4)

* Restated for changes in reporting segments, see page 35.

** Organic equals reported movement for volume, except for wine where reported movement was (5)% reflecting the disposal of the Gilbeys wine business and Barton & Guestier and in Ireland where reported movement was (2)% reflecting the disposal of Gilbeys.

*** Spirits brands excluding ready to drink.

2011

International

On 25 May 2011 Diageo announced that the International region from 1 July 2011 would operate as two autonomous regions: Africa and Latin America and Caribbean. The Global Travel and duty free

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Business review (continued)

business would be allocated to the geographic regions and the Middle East business would become part of Asia Pacific.

Key highlights

- In **Africa** continued investment behind marketing and distribution, driving the strong growth of beer and momentum behind spirits brands, delivered another successful year with double digit net sales growth.
- Volume grew 9% in **Nigeria** as Guinness returned to growth, double digit growth of Harp continued and Smirnoff Ice grew strongly as the new can format increased accessibility. Price increases and product mix drove an increase in net sales of 14%. Marketing spend increased, driven by sponsorship of 'Guinness. The Match' and relationship marketing as Guinness reinforced its association with football. Spend also increased behind 'Malta Guinness Street Dance'.
- 8% volume growth in **East Africa** was primarily driven by spirits, following a duty reduction on spirits in Kenya and growth in Senator lager. The increase in the volume of local spirits brands negatively impacted price/mix and net sales grew 7%. Increased marketing spend was focused behind Tusker and Guinness.
- In **South Africa** ready to drink contributed to an overall volume decline of 2%. Net sales growth of scotch more than offset the decline in ready to drink and total net sales increased 1%. Increased marketing spend was focused principally behind Johnnie Walker Red Label and the brand grew volume share.
- Elsewhere in Africa there was double digit volume and net sales growth in beer and spirits. Price increases and sales force focus on execution at the point of purchase drove strong Guinness growth and share gains in Cameroon. In Ghana, Guinness, Malta Guinness and Star drove strong double digit net sales growth despite some continuing supply issues due to water shortages.
- In **Latin America and Caribbean**, there was strong performance in both scotch and other spirits categories. All markets posted double digit net sales growth with the exception of Venezuela which held net sales flat in difficult market conditions and Colombia which grew 5%. Marketing spend increased as a percentage of net sales to 17.3%.
- A great performance in **Brazil** was buoyed by increased employment and average income and the wider distribution and sales focus across major cities. Growth accelerated as volume increased 23% driven by double digit growth of scotch and vodka. The growth of scotch delivered positive mix and net sales increased by 27%. The market's core innovation, Smirnoff Caipiroska, continued its strong performance with 18% net sales growth. Marketing spend was increased significantly, focused on the Johnnie Walker 'Keep Walking' campaign, on trade recruitment and strong point of sale execution across all channels.
- In **North Latin America and Caribbean** net sales grew 15%. Increased consumer demand in key Caribbean and Central American markets, improved customer relationships and pricing drove a strong performance. Johnnie Walker Black Label led net sales growth followed by Buchanan's, Baileys and Smirnoff. A 9% increase in marketing spend was focused on scotch.
- Volume in **Mexico** grew 20% driven by scotch and rum. The faster growth of non-scotch brands, as the business increased its category breadth, led to negative price/mix and net sales increased

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Business review (continued)

18%. Marketing spend increased significantly, mainly behind scotch, rum and vodka and Diageo grew its volume share of total spirits.

- In **Venezuela** a challenging economic environment with currency restrictions led to lower scotch volume. Diageo's locally produced rum brands, Cacique and Pampero, delivered strong net sales growth. Marketing spend as a percentage of net sales declined as a fall in scotch spend was only partially offset by increased spend behind local brands.

Africa

Performance*

Key financials	2010	Exchange	Acquisitions and disposals	Organic movement	2011	Reported movement
	Reported				Reported	
	£ million	£ million	£ million	£ million	£ million	%
Net sales	1,228	(22)	29	122	1,357	11
Marketing spend	119	—	4	17	140	18
Operating profit before exceptional items	301	(17)	(2)	51	333	11
Exceptional items	(3)				(7)	
Operating profit	<u>298</u>				<u>326</u>	9

	Volume** movement	Organic net sales movement	Reported net sales movement
	%	%	%
Key countries and categories:			
Africa	7	10	11
Nigeria	9	14	11
East Africa	8	7	8
Africa Regional Markets	13	20	17
South Africa	(2)	1	9
Spirits	15	13	19
Beer	4	11	10
Ready to drink	(19)	(2)	—
The strategic brands:***			
Johnnie Walker	19	15	22
Smirnoff	4	7	14
Baileys	39	64	61
Guinness	11	11	8

* Restated for changes in reporting segments, see page 35.

** Organic equals reported movement for volume, except for Africa, East Africa and beer where reported movement was 9%, 16% and 8%, respectively, reflecting the acquisition of Serengeti Breweries, and Baileys where reported movement was 40%.

*** Spirits brands excluding ready to drink.

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Business review (continued)

Latin America and Caribbean

Performance*

Key financials	2010	Exchange	Acquisitions and	Organic	2011	Reported
	Reported		disposals	movement	Reported	movement
	£ million	£ million	£ million	£ million	£ million	%
Net sales	1,123	(219)	(1)	160	1,063	(5)
Marketing spend	151	(6)	—	39	184	22
Operating profit before exceptional items	336	(73)	(3)	58	318	(5)
Exceptional items	(2)				(6)	
Operating profit	<u>334</u>				<u>312</u>	(7)

	Volume** movement	Organic net sales movement	Reported net sales movement
	%	%	%
Key countries and categories:			
Latin America and Caribbean	12	17	(5)
West Latin America and Caribbean	15	18	24
Brazil	23	27	35
Andean	(13)	1	(59)
Mexico	20	18	24
Spirits	13	20	(6)
Beer	(3)	(2)	—
Wine	(7)	17	7
Ready to drink	8	6	(10)
The strategic brands:***			
Johnnie Walker	23	26	16
Buchanan's	(3)	9	(29)
Smirnoff	12	25	22
Baileys	11	14	2

* Restated for changes in reporting segments, see page 35.

** Organic equals reported movement for volume, except for wine where reported movement was (9)%.

*** Spirits brands excluding ready to drink.

2011

Asia Pacific

Key highlights

- Growth in **Asia Pacific** was driven by scotch, in particular the super deluxe segment in emerging markets. In the developed markets of Asia Pacific, there were strong performances in Australia and Korea.

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Business review (continued)

- Marketing spend increased 15% driven by investments in proven Johnnie Walker growth drivers. Activities included ongoing Grand Prix sponsorships, mentoring programmes to build brand equity and digital campaigns that drove 15% net sales growth for the brand.
- Diageo's business in **Australia** grew in a challenging market, delivering share gains in spirits and ready to drink through increased focus on customer marketing with the largest off trade accounts, a successful innovation programme and selective price re-positioning. Spirits net sales were up 6% with positive price/mix and ready to drink net sales grew 4%.
- In **Korea**, Diageo outperformed a declining scotch market with Windsor 12 extending its leadership position and generating eight percentage points of positive price/mix.
- In response to pressure from parallel imports, Diageo adjusted its prices in **China** which led to a net sales decline of 4%. These imports caused a distortion between sell in and underlying consumer demand which was up as investment increased behind the brands. Diageo's scotch gained volume share in the standard, deluxe and especially the super deluxe segment where incremental marketing spend drove 41% net sales growth in the segment.
- The route to market changes which have been implemented in **India** resulted in stronger relationships with customers and strong double digit net sales growth. Increased marketing investment in Johnnie Walker Black Label and super deluxe variants; the re-launch of VAT69 and innovation in Smirnoff with the introduction of Smirnoff Lime drove this growth.
- The strong performance of the **South East Asia** markets was driven by growth in scotch and Guinness. In **Thailand**, increased marketing spend behind Johnnie Walker led to share gains on Black and Red Label and 23% net sales growth across the brand. Super deluxe scotch, notably Johnnie Walker Blue Label and The Singleton, drove 36% net sales growth in **Vietnam**. Guinness continued to perform well in **Indonesia** and **Malaysia** with share gains in both markets and 7% and 8% net sales growth respectively.
- Elsewhere in Asia, **Japan** was weakened as a result of the earthquake and tsunami and net sales declined 5% but Diageo gained volume share in key spirits categories. The Singleton is now the second largest single malt brand in **Taiwan** with net sales growth of 45%, and along with Johnnie Walker super deluxe variants, drove 16% net sales growth for the market.

Performance*

<u>Key financials</u>	<u>2010 Reported</u>	<u>Exchange</u>	<u>Acquisitions and disposals</u>	<u>Organic movement</u>	<u>2011 Reported</u>	<u>Reported movement</u>
	<u>£ million</u>	<u>£ million</u>	<u>£ million</u>	<u>£ million</u>	<u>£ million</u>	<u>%</u>
Net sales	1,171	77	—	129	1,377	18
Marketing spend	251	12	1	39	303	21
Operating profit before exceptional items	240	8	(1)	52	299	25
Exceptional items	(30)				(50)	
Operating profit	<u>210</u>				<u>249</u>	19

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Business review (continued)

	<u>Volume**</u> movement	<u>Organic</u> net sales movement	<u>Reported</u> net sales movement
	%	%	%
Key countries and categories:			
Asia Pacific	10	11	18
Australia	4	4	16
Korea	1	8	12
China	1	(4)	(1)
India	42	79	84
South East Asia	12	14	22
Spirits	11	13	19
Beer	(1)	7	14
Wine	4	9	(4)
Ready to drink	7	7	18
The strategic brands:***			
Johnnie Walker	16	15	22
Smirnoff	12	8	13
Windsor	3	8	12
Guinness	(1)	6	11

* Restated for changes in reporting segments, see page 35.

** Organic equals reported movement for volume, except for wine where the reported movement was (22)% due to the disposal of Barton & Guestier.

*** Spirits brands excluding ready to drink.

Trend information

The following comments were made by Paul Walsh, chief executive of Diageo, in Diageo's preliminary announcement on 23 August 2012:

“Diageo is a strong business, getting stronger and the results we released this morning show that very clearly. We have increased our presence in the faster growing markets of the world, through both acquisitions and strong organic growth. We have enhanced our leading brand positions globally, through effective marketing and industry leading innovation and we have strengthened our routes to market. 6% organic top line growth, 9% operating profit growth and 60 basis points of margin expansion is a strong performance and demonstrates our commitment to delivering efficient growth.

A year ago I set out our expectations for the medium term and these results put us firmly on track to meet those goals.

In F12, we have continued to invest to ensure this business is well positioned for the future. Our confidence in the achievement of our medium term guidance is underscored by the 8% recommended increase in our final dividend.”

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Business review (continued)

Liquidity and capital resources

Cash flows and movement in net borrowings A summary of the cash flow and reconciliation to movement in net borrowings for the three years ended 30 June 2012 is as follows:

	Year ended 30 June		
	2012	2011	2010
	(restated)	(restated)	
	£ million	£ million	£ million
Operating profit	3,158	2,595	2,574
Depreciation, amortisation and impairment	411	352	372
Net movements in working capital	(529)	(110)	329
Dividend income	166	138	111
Other items	(201)	(116)	(211)
Cash generated from operations	3,005	2,859	3,175
Net interest paid	(391)	(311)	(305)
Taxation paid	(521)	(365)	(474)
Net cash from operating activities	2,093	2,183	2,396
Net investment in property, plant and equipment and computer software	(445)	(372)	(231)
Movements in loans and other investments	(1)	1	(43)
Free cash flow	1,647	1,812	2,122
Net acquisition of businesses	(1,369)	(63)	(196)
Proceeds from issue of share capital	1	1	—
Net (purchase)/sale of own shares for share schemes	—	(9)	85
Dividends paid to equity non-controlling interests	(118)	(112)	(107)
Proceeds from non-controlling interests	11	—	—
Purchase of shares of non-controlling interests	(155)	—	—
Net increase/(decrease) in loans	512	(414)	(422)
Equity dividends paid	(1,036)	(973)	(914)
Net (decrease)/increase in cash and cash equivalents	(507)	242	568
Net (increase)/decrease in loans	(512)	414	422
Exchange differences on net borrowings	152	(17)	(429)
Borrowings acquired through acquisition of businesses	(5)	(22)	—
Other non-cash items	(248)	(113)	(96)
(Increase)/decrease in net borrowings	(1,120)	504	465
Net borrowings at the beginning of the year	(6,450)	(6,954)	(7,419)
Net borrowings at the end of the year	(7,570)	(6,450)	(6,954)

The group has revised the disclosure of certain prior year amounts in the consolidated statement of cash flows. In the year ended 30 June 2012 directly attributable acquisition transaction costs of £47 million (2011 – £20 million; 2010 – £9 million) have been included in cash flow from operating activities rather than cash flow from investing activities and dividends paid to non-controlling interests of £118 million (2011 – £112 million; 2010 – £107 million) are now disclosed as part of cash flows from financing activities rather than cash flow from operating activities. This revised presentation is considered to be more consistent with the treatment of these items in the consolidated income

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Business review (continued)

statement and the consolidated statement of changes in equity. The revision had no impact on prior period increase or decrease in cash and cash equivalents, net assets or net profit.

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, acquisitions and share repurchases.

Net cash from operating activities Cash generated from operations increased from £2,859 million in the year ended 30 June 2011 to £3,005 million in the year ended 30 June 2012. This increase of £146 million is primarily due to an increase in operating profit, higher dividends received from Moët Hennessy partially offset by an increase in working capital due to business growth, higher finished goods levels to smooth the impact of upcoming supply chain changes and higher debtors as a result of excise duty increases. Cash generated from operations is after exceptional restructuring costs of £158 million. Other items include £200 million of cash contributions to post employment schemes in excess of the income statement impact and gains on sale of property, included in operating profit, of £19 million partially offset by the fair value charge in respect of share-based incentive plans of £36 million. The increase in net interest paid was 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.

Cash generated from operations decreased from £3,175 million in the year ended 30 June 2010 to £2,859 million in the year ended 30 June 2011. This decrease of £316 million was primarily due to a lower increase in payables in the year compared with the previous year. Cash generated from operations was reduced by exceptional restructuring costs of £118 million. Other items included £119 million of cash contributions to post employment schemes in excess of the income statement charge and gains on sale of property, included in operating profit, of £20 million partly offset by the fair value charge in respect of share-based incentive plans of £34 million. Net interest paid included cash receipts of £71 million following the renegotiation of the terms of certain interest rate swaps. Tax payments in the year ended 30 June 2011 were lower than in the year ended 30 June 2010 primarily as a result of beneficial timing of settlement payments agreed with tax authorities.

Net cash from investing activities The purchase of tangible fixed assets and computer software increased from £419 million in the year ended 30 June 2011 to £484 million in the year ended 30 June 2012. The expenditure was incurred on a number of projects throughout the world with the largest investments made to increase capacity in Africa, to enhance operations in Scotland and to increase efficiencies in North America. In the year ended 30 June 2012, the group also incurred expenditure of £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 Breweries (£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 depository and clearing agency.

In the year ended 30 June 2011, the group incurred expenditure of £97 million in connection with business acquisitions. This included £32 million on the purchase of a controlling stake in Serengeti Breweries in Tanzania, £34 million on the purchase of an equity stake in Halico, an associate company in Vietnam and an additional equity investment of £18 million in DHN Drinks, an associate company in South Africa.

In the year ended 30 June 2010 the group spent £197 million on acquisitions of which \$185 million was deposited with China's securities depository and clearing agency, Shanghai branch in connection with a possible tender offer to the shareholders of Shuijingfang, £25 million in respect of the purchase

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Business review (continued)

of a further equity stake in the London Group, the owner of the Nuvo brand, and an additional equity investment in DHN Drinks in South Africa.

Free cash flow In the year ended 30 June 2012 free cash flow decreased by £165 million to £1,647 million (2011 – £1,812 million; 2010 – £2,122 million).

Cash flows from financing activities Cash flows from financing activities included dividend payments of £118 million (2011 – £112 million; 2010 – £107 million) to non-controlling interests and £119 million (2011 – £76 million; 2010 – £5 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 £119 million (2011 – £67 million; 2010 – £90 million). In the year ended 30 June 2012 equity dividends paid were £1,036 million (2011 – £973 million; 2010 – £914 million).

Movements in net borrowings Adverse non-cash movements of £248 million (2011 – £113 million; 2010 – £96 million) predominantly comprise new finance leases and fair value movements.

Net borrowings The group's net borrowings are measured at amortised cost with the exception of borrowings designated in fair value hedge relationships, interest rate hedging instruments and foreign currency forwards and swaps. For borrowings designated in fair value hedge relationships, Diageo recognises a fair value adjustment for the risk being hedged in the balance sheet, whereas interest rate hedging instruments and foreign currency forwards and swaps are measured at fair value. Analysis of net borrowings is the following:

	2012	2011	30 June 2010
	£ million	£ million	£ million
Overdrafts	(38)	(12)	(55)
Other borrowings due within one year	(1,192)	(1,435)	(532)
Borrowings due within one year	(1,230)	(1,447)	(587)
Borrowings due between one and three years	(2,645)	(2,441)	(2,189)
Borrowings due between three and five years	(1,521)	(1,741)	(2,732)
Borrowings due after five years	(3,233)	(2,566)	(3,256)
Fair value of foreign currency forwards and swaps	210	182	227
Fair value of interest rate hedging instruments	3	58	191
Finance lease liabilities	(230)	(79)	(61)
Gross borrowings	(8,646)	(8,034)	(8,407)
Offset by: Cash and cash equivalents	1,076	1,584	1,453
Net borrowings	(7,570)	(6,450)	(6,954)

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. In the year ended 30 June 2012 the group mainly financed its day to day operations through issuing short term commercial paper.

In the year ended 30 June 2011, the group repaid a \$500 million (£313 million) bond.

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Business review (continued)

In the year ended 30 June 2010, the group borrowed \$500 million (£305 million) in the form of a bond that matures in January 2015 with a coupon of 3.25%. A \$300 million (£184 million) medium term note and a \$750 million (£493 million) bond were repaid. In addition, \$696 million (£466 million) of outstanding 7.375% notes due in January 2014 were exchanged in May 2010 for \$696 million (£466 million) of 4.828% notes due in July 2020 plus an aggregate cash payment to holders of \$125 million (£84 million). The debt exchange did not represent a substantial modification of the term of the existing liability and was therefore not treated as an extinguishment of the original debt.

Based on average monthly net borrowings and net interest charge, the effective interest rate for the year ended 30 June 2012 was 4.7% (2011 – 4.9%; 2010 – 4.8%). For this calculation, 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 borrowings designated in net investment hedge relationships amounted to £4,249 million as at 30 June 2012 (2011 – £5,409 million; 2010 – £5,451 million).

The group had available undrawn committed bank facilities as follows:

	As at 30 June 2012
	£ million
Expiring within one year	745
Expiring between one and two years	—
Expiring after two years	1,484
	<u>2,229</u>

Capital structure and targeted credit rating 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 improve the return on investment and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, maximise flexibility and give the appropriate level of access to debt markets at attractive cost levels. This is achieved by targeting a range of ratios which are currently broadly consistent with an A band credit rating. Diageo would consider modifying these ratios in the medium term in order to effect strategic initiatives within its stated goals, which could have an impact on its rating.

If Diageo’s ratings were to be negatively impacted by the financing of an acquisition, it would seek over time to return to such ratios that are consistent with an A band credit rating.

Capital repayments The group regularly assesses its debt and equity capital levels against its stated policy for capital structure.

Authorisation was given by shareholders on 19 October 2011 to purchase a maximum of 250,399,000 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 expiration date for the programme is 17 October 2012.

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Business review (continued)

Capital commitments

Other capital commitments not provided for at 30 June 2012 are estimated at £145 million (2011 – £148 million; 2010 – £112 million). Diageo management believes that it has sufficient funding for its working capital requirements.

Other contractual obligations

	Payments due by period				
	Less than 1 year £ million	1-3 years £ million	3-5 years £ million	More than 5 years £ million	Total £ million
As at 30 June 2012					
Long term debt obligations	1,025	2,590	1,511	3,155	8,281
Interest obligations	442	663	392	1,399	2,896
Credit support obligations	130	—	—	—	130
Operating leases	94	156	100	325	675
Purchase obligations	754	434	153	9	1,350
Finance leases	39	72	57	165	333
Deferred consideration payable	24	20	149	—	193
Provisions and other non-current payables	124	166	61	134	485
	<u>2,632</u>	<u>4,101</u>	<u>2,423</u>	<u>5,187</u>	<u>14,343</u>

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. Where interest payments are on a floating rate basis, rates of each cash flow until maturity of the instruments are calculated based on the forward yield curve prevailing at 30 June 2012. 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 £7 million in respect of vacant properties.

Potential income tax exposures included within corporate tax payable of £317 million and deferred tax liabilities are not included in the table above, as the ultimate timing of settlement cannot be reasonably estimated.

Post employment benefit liabilities are also not included in the table above. The group makes service-based cash contributions to the UK Scheme which in the year ending 30 June 2013, are expected to be approximately £45 million. In addition, during the year ended 30 June 2011, the company agreed a deficit funding plan with the trustee of the UK Scheme based on the trustee's actuarial valuation at 31 March 2009 which provided for annual payments of approximately £25 million to be made to the UK Scheme. In 2024, depending upon the funding position of the UK Scheme at that time, the group will be required to pay an amount that is expected to be no greater than the deficit at that time, up to a maximum £430 million in cash, to the UK Scheme. In addition, as part of this funding plan, the company agreed to make conditional contributions into escrow of up to £338 million if an equivalent reduction in the deficit is not achieved over the 10 year term of the funding plan. The triennial valuation as at 31 March 2012 is in progress and may result in the payment of up to £127 million in three equal annual instalments, into escrow.

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Business review (continued)

Diageo also agreed a deficit funding arrangement with the trustee in respect of the Guinness Ireland Group Pension Scheme (the Irish Scheme). This deficit funding arrangement is expected to result in additional annual contributions to the Irish Scheme of approximately €21 million (£17 million) until the year ending 30 June 2029, and provides for additional cash contributions into escrow of up to €188 million (£152 million) if an equivalent reduction in the deficit is not achieved over the 18 year period. The first contribution was made in the year ended 30 June 2011. In addition to the deficit funding the group expects to make cash contributions of €29 million (£23 million) to the Irish Scheme in the year ending 30 June 2013. Contributions to other plans in the year ending 30 June 2013 are expected to be approximately £90 million.

Capital commitments at 30 June 2012 are excluded from the table above.

Post balance sheet events

On 9 August 2012, Diageo completed the acquisition of 100% of the equity of Ypióca Bebidas S.A. (Ypióca) from Ypióca Agroindustrial Limitada for a cash consideration of BRL 900 million (£284 million). Ypióca is a leading producer and distributor of a cachaça brand, Ypióca in Brazil. See note 30 to the consolidated financial statements for further details.

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 and interest rate risks are managed by the group's treasury department. The treasury department uses a range of financial instruments to manage these underlying risks.

Treasury operations are conducted within a framework of board approved policies and guidelines, which are recommended and subsequently monitored by the finance committee. This committee is described in the corporate governance report. The policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk. The benchmarks, hedge cover levels and overall appropriateness of Diageo's risk management policies are reviewed by the board following, for example, significant business, strategic or accounting changes. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board-approved strategies. Transactions arising on the application of this flexibility may give rise to exposures different from the defined benchmark levels that are separately monitored on a daily basis using value at risk analysis. These transactions are carried at fair value and gains or losses are taken to the income statement as they arise.

The finance committee receives monthly reports on the activities of the treasury department, including any exposures different from the defined benchmarks.

The group purchases insurance for commercial or, where required, for legal or contractual reasons. In addition, the group retains insurable risk where external insurance is not considered an economic means of mitigating these risks.

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Business review (continued)

For a detailed analysis of the group's funding, liquidity and exposure to foreign exchange and interest rate risks see note 23 to the consolidated financial statements.

Critical accounting policies

This section on critical accounting policies forms part of the audited financial statements.

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.

Brands, goodwill and other intangibles Acquired intangible assets are held on the consolidated balance sheet at cost. Where these assets are regarded as having indefinite useful economic lives, they are not amortised. Assessment of the useful economic life of an asset, or that an asset has an indefinite life, requires management judgement.

Impairment reviews are carried out to ensure that intangible assets, including brands, are not carried at above their recoverable amounts. In particular, the group performs a discounted cash flow analysis at least annually to compare discounted estimated future operating cash flows to the net carrying value of each acquired brand. The analysis is based on forecast cash flows with terminal values being calculated using the long term growth rate (the long term inflation rate of the country) of the principal markets in which the majority of the profits of each brand are or will be generated. The estimated cash flows are discounted at the weighted average cost of capital reflecting the industry and country specific risks in the relevant country.

In assessing whether goodwill is carried at above its recoverable amount, a discounted cash flow analysis is performed annually to compare the discounted estimated future operating cash flows of cash generating units of the group to the net assets attributable to the cash generating units including goodwill. The discounted cash flow review for goodwill is consistent with the brand review in its use of estimated future operating cash flows, weighted average cost of capital for the cash generating unit concerned and long term growth rates.

The tests are dependent on management's estimates and judgements, in particular in relation to the forecasting of future cash flows, the discount rates applied to those cash flows and the expected long term growth rates. Such estimates and judgements are subject to change as a result of changing economic conditions. Management attempts to make the most appropriate estimates, but actual cash flows and rates may be different.

See note 11 to the consolidated financial statements for the impact of a change in the key assumptions to the more sensitive brands.

Post employment benefits Diageo accounts for post employment benefits in accordance with IAS 19 – Employee benefits. Application of IAS 19 requires the exercise of judgement in relation to various assumptions including future pay rises in excess of inflation, employee and pensioner demographics and the future expected returns on assets.

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Business review (continued)

Diageo determines the assumptions to be adopted in discussion with its actuaries, and believes these assumptions to be in line with UK practice generally, but the application of different assumptions could have a significant effect on the amounts reflected in the income statement, other comprehensive income and balance sheet in respect of post employment benefits. The assumptions vary among the countries in which the group operates, and there may be an interdependency between some of the assumptions. The major assumptions used by the group for the three years ended 30 June 2012 are set out in note 4 to the consolidated financial statements and the sensitivity to these assumptions are given in note 4(h) to the consolidated financial statements.

Exceptional items These are items 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. The determination of which items are separately disclosed as exceptional items requires a significant degree of judgement.

Taxation The group is required to estimate the corporate tax in each of the jurisdictions in which it operates. This requires an estimation of the current tax liability together with an assessment of the temporary differences which arise as a consequence of different accounting and tax treatments. These temporary differences result in deferred tax assets or liabilities which are included within the balance sheet. Deferred tax assets and liabilities are calculated on the basis of taxation substantively enacted at the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the asset will not be realised in the future. This evaluation requires judgements to be made including the forecast of future taxable income.

Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation.

The group operates in many countries in the world and is subject to many tax jurisdictions and rules. As a consequence the group is subject to tax audits, which by their nature are often complex and can require several years to conclude. Management judgement is required to determine the total provision for income tax. Amounts accrued are based on management's interpretation of country specific tax law and the likelihood of settlement. However the actual tax liabilities could differ from the provision and in such event the group would be required to make an adjustment in a subsequent period which could have a material impact on the group's profit and loss and/or cash position.

New accounting standards

During the year a number of accounting standards, amendments and interpretations have 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.

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Board of directors and company secretary

Dr Franz B Humer Chairman, Non-executive director^{3*}, Swiss/Austrian (66)

Appointed chairman of Diageo plc in July 2008, having been a non-executive director since April 2005. He is also chairman of F. Hoffmann-La Roche Ltd in Switzerland, chairman of INSEAD's board of directors and a non-executive director of CitiGroup Inc. He was formerly chief operating director of Glaxo Holdings plc and has held a number of other non-executive directorships.

Paul S Walsh Chief executive officer, executive director^{2*}, British (57)

Appointed chief executive of Diageo plc in September 2000. He has served in a number of management roles since joining GrandMet's brewing division in 1982, including chief executive officer of The Pillsbury Company. He was appointed to the GrandMet board in October 1995 and to the Diageo plc board in December 1997. He is lead non-executive and deputy chair of the board of the Department of Energy and Climate Change, a non-executive director of Avanti Communication Group plc, a non-executive director of Unilever PLC and a non-executive director of FedEx Corporation in the United States. He was appointed a business ambassador on the UK Government's Business Ambassador network on 9 August 2012 and is also a member of the UK Government's Business Advisory Group and a member of the Council of the Scotch Whisky Association.

Deirdre Mahlan Chief financial officer, executive director², American (50)

Appointed chief financial officer and a director of Diageo plc in October 2010, prior to which she was deputy chief financial officer and before that head of tax and treasury. She joined the company in 2001, having held various senior finance positions in Joseph E Seagram & Sons Inc since 1992 and having formerly been a senior manager with Pricewaterhouse. She was appointed as a non-executive director of Experian plc with effect from September 2012 and is also a member of the Main Committee of the 100 Group of Finance Directors.

Ivan Menezes Chief operating officer², Executive director, American/British (53)

Appointed a director of Diageo plc in July 2012 and appointed chief operating officer in March 2012 having been president, North America since January 2004, chairman, Diageo Asia Pacific since October 2008 and chairman, Diageo Latin America and Caribbean since July 2011. Formerly he held various senior management positions with Guinness and then Diageo and worked across a variety of sales, marketing and strategy roles with Nestlé in Asia, Booz Allen Hamilton Inc in the United States and Whirlpool in Europe. He is also a non-executive director of Coach Inc., in the United States.

Lord Davies of Abersoch Senior non-executive director^{1,3,4*}, British (59)

Appointed a non-executive director of Diageo plc in September 2010 and senior non-executive director and chairman of the remuneration committee in October 2011. Lord Davies is a partner of Corsair Capital, non executive chairman of Pinebridge Investments Limited and chair of the advisory board of Moelis & Co. He is also a trustee of the Royal Academy of Arts and chair of the Council, University of Wales Bangor. Previously he was a non-executive director of Bharti Airtel Limited, Minister for Trade, Investment and Small Business for the UK Government between January 2009 and May 2010 and prior to this role, Lord Davies was chairman of Standard Chartered PLC.

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Board of directors and company secretary (continued)

Peggy B Bruzelius Non-executive director^{1,3,4}, Swedish (62)

Appointed a non-executive director of Diageo plc in April 2009. She is chairman of Lancelot Asset Management in Sweden and sits on the boards of Akzo Nobel NV in the Netherlands, Syngenta AG in Switzerland, Axfood AB and Skandia Mutual Life Insurance AB, both in Sweden. She was formerly managing director of ABB Financial Services AB, headed the asset management arm of Skandinaviska Enskilda Banken AB and a non-executive director of Scania AB.

Laurence M Danon Non-executive director^{1,3,4}, French (56)

Appointed a non-executive director of Diageo plc in January 2006. She is chairman of the executive board of Edmond de Rothschild Corporate Finance and a non-executive director of Groupe BPCE and TF1, both in France. Formerly she served with the French Ministry of Industry and Energy, held a number of senior management posts with Total Fina Elf and was chairman and chief executive officer of France Printemps. She was also a non-executive director of Experian Group Limited, Plastic Omnium SA and Rhodia SA.

Betsy D Holden Non-executive director^{1,3,4}, American (56)

Appointed a non-executive director of Diageo in September 2009. She is a senior adviser to McKinsey & Company and holds non-executive directorships of Tribune Company and Western Union Company, both in the United States. She is a member of the board of trustees at Duke University and a member of the Dean's advisory board at the Kellogg School of Management. She was formerly president, global marketing and category development and co-chief executive officer of Kraft Foods, Inc.

Philip G Scott Non-executive director^{1*,3,4}, British (58)

Appointed a non-executive director of Diageo plc and chairman of the Audit Committee in October 2007. He is the president of the Institute and Faculty of Actuaries and is a non-executive director of the Royal Bank of Scotland Group plc. He was previously chief financial officer of Aviva plc.

H Todd Stitzer Non-executive director^{1,3,4}, American (60)

Appointed a non-executive director of Diageo plc in June 2004. He is chairman and a non-executive director of Signet Limited and a non-executive director of Massachusetts Mutual Life Insurance Company. He is also a member of the advisory board of Hamlin Capital Management, LLC, a New York based investment advisory firm, and a member of the advisory committee of Virgin Group Holdings Limited. He was previously chief executive of Cadbury plc.

Paul D Tunnacliffe Company secretary, British (50)

Appointed company secretary of Diageo plc in January 2008. He was formerly company secretary of Hanson PLC.

Key to committees:

- ¹ Audit
- ² Executive (comprising senior management)
- ³ Nomination
- ⁴ Remuneration
- * Chairman of committee

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Executive committee

Nicholas (Nick) Blazquez President, Diageo Africa², British (51)

Appointed president, having been managing director, Diageo Africa since August 2004, prior to which he was managing director, Diageo Asia Key Markets. He held various managerial positions in United Distillers between 1989 and 1998.

Andrew (Andy) Fennell Chief marketing officer², British (45)

Appointed chief marketing officer of Diageo plc in September 2008. He held a number of marketing roles in the UK and internationally with Guinness and Diageo, prior to which he worked in various sales and marketing roles with Britvic and Bass plc.

Gilbert Ghostine President, Diageo Asia Pacific², Lebanese (52)

Appointed president, Diageo Asia Pacific in July 2009, having previously been managing director, Diageo Continental Europe, since July 2006. He was formerly managing director, Northern Europe, and president, US Major markets, and held various senior managerial positions in Africa, Asia, Europe and the United States, having joined International Distillers & Vintners in 1995.

David Gosnell President, Global Supply and Global Procurement², British (55)

Appointed president, having been managing director Global Supply and Global Procurement, Diageo plc since July 2003. He joined Diageo in 1998 as European supply director, then headed up Guinness & European RTD supply, prior to which he spent 20 years in various roles with Heinz. He is a non-executive director of Brambles plc.

James (Jim) Grover Group strategy director², British (54)

Appointed group strategy director in September 2011 having been global business support director since February 2004. Formerly he held a number of senior strategy positions in GrandMet and worked as a management consultant with Booz Allen Hamilton Inc and OC&C Strategy Consultants.

John (Randy) Millian President, Diageo Latin America and Caribbean², American (59)

Appointed president, having been managing director of Diageo Latin America and Caribbean since 2005. Prior to joining Diageo, he held senior management positions with American Express, Schering-Plough, Personal Care Group USA and Pepsi in a number of territories, including Latin America, Europe, Asia and the United States.

Andrew Morgan President, Diageo Europe², British (56)

Appointed president, Diageo Europe in October 2004, having been president, Venture Markets since July 2002. He joined United Distillers in 1987 and held various senior management positions with Guinness and then Diageo, including group chief information officer and president, new business ventures for Guinness United Distillers & Vintners and director, global strategy and innovation for United Distillers & Vintners.

Timothy (Tim) Proctor General counsel², American/British(62)

Appointed general counsel of Diageo plc in January 2000. Formerly he was director, worldwide human resources of Glaxo Wellcome and senior vice president, human resources, general counsel and secretary for Glaxo's US operating company. He has over 25 years' international legal experience, including 13 years with Merck and six years with Glaxo Wellcome.

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Executive committee (continued)

Larry Schwartz President, Diageo North America², American (59)

Appointed president, Diageo North America in 2012 having been president, Diageo USA since September 2008. He joined the company in 2001, as president of Joseph E Seagram & Sons, having held a variety of senior management positions with Seagram.

Gareth Williams Human Resources director², British (59)

Appointed human resources director in January 1999. Formerly he held a number of senior personnel management positions with GrandMet and then United Distillers & Vintners and spent 10 years with Ford of Britain in a number of personnel and employee relations positions.

Ian Wright Corporate Relations director², British (54)

Appointed corporate relations director of Diageo plc in July 2004, having previously held positions with a number of public relations consultancies and The Boots Company.

Key to committees:

² Executive (comprising senior management)

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Directors' remuneration report

Dear Shareholder

I am pleased to present the directors' remuneration report for the year ended 30 June 2012. In my first year as the chairman of the remuneration committee, I have taken the opportunity to complete a thorough review of the company's executive remuneration arrangements, with a focus on competitive pay and the link to performance. Whilst I am satisfied that the arrangements we have in place are appropriate and that rewards received under the company's incentive plans reflect performance delivered, the committee will review the remuneration arrangements in more detail during the new financial year to ensure they continue to incentivise our performance goals through simple, transparent links to our strategic objectives.

I have also engaged directly with a wide range of shareholders and their representative bodies in order to understand their perspectives on the company's reward schemes and to foster robust two-way dialogue. The remuneration committee has considered how we can respond to these different perspectives and, at the same time, maintain a competitive and relevant approach to the remuneration of our executive directors and senior management team. We have, as a result, sought opportunities to improve transparency in our disclosures both on the processes and governance supporting the execution of executive remuneration at Diageo, and on the targets and outcomes for the measures associated with the company's incentive plans. Other key actions and decisions that we have taken during the financial year include:

- Introducing a clawback condition to future long term incentive awards that enables the committee to reduce unvested awards in circumstances that result in performance being materially adversely impacted. As a result of discussions during the recent consultation with our shareholders, a clawback provision is also being introduced into the bonus arrangements for the executive directors. These are the only changes to remuneration policy being put into effect at this time.
- Increasing targets for the measures used in the long term incentive plans to ensure that they remain appropriately stretching in the context of both the company's current medium term outlook and the difficulties and uncertainties in the wider macro-economic environment. In response to shareholder requests for greater visibility, we will disclose targets for the company's Performance Share Plan at the start of the performance period in the directors' remuneration report going forward.

As described in the 'Business review', the company has delivered strong year on year organic top line growth, profit growth and margin expansion in the year ended 30 June 2012, and has also delivered a high level of free cash flow. This performance reflects an improved growth trajectory and delivery against the commitment to deliver growth efficiently, and, consequently, positions the business well for the future. The combination of strong company and individual performance has resulted in an above target outcome for the short term incentive plan with the chief executive (CEO) and chief financial officer (CFO) receiving a bonus in September equivalent to 148% and 146% of base pay, respectively. In view of the company's strong results, I am satisfied that this is appropriate.

The company has similarly delivered strong three year total shareholder return performance relative to its peer group for the performance period that ended on 30 June 2012, resulting in Diageo placing fifth out of 16 companies. Consequently, 65% of the performance shares awarded in September 2009 will vest in September 2012. For share options awarded in September 2009, three year compound annual growth in adjusted earnings per share has exceeded the maximum target at 10.2% (equivalent to total growth over three years of 33.9%) and, consequently, the options will vest in full in September

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Directors' remuneration report (continued)

2012. Over the same period, Diageo's share price grew by 88%, from 871 pence to 1641 pence and the company paid a total dividend of 117 pence per share. I am comfortable, therefore, that these incentive plan outcomes fairly reflect the strong performance delivered for our shareholders.

Finally, we have made some changes to the structure and layout of the directors' remuneration report this year to improve transparency and to provide additional information about how our remuneration arrangements are aligned with our strategy. In addition, in line with emerging guidance from the United Kingdom government and the Financial Reporting Council, we have introduced a new table at the start of the report that summarises the annual earnings of the executive directors culminating in a 'single remuneration figure'. We hope that this evolution of our disclosure practice helps to create a fuller understanding of our reward practices and forms a transparent basis for engagement with our key stakeholders going forward.

We look forward to receiving your support at the AGM in October 2012.

Lord Davies of Abersoch

Senior independent non-executive director and chairman of the remuneration committee

Executive directors' remuneration summary for the year ended 30 June 2012 (unaudited)

Performance highlights

- 2012 annual bonus payout is marginally lower than in 2011 despite higher growth rates having been delivered on sales (6%) and profit (9%).
- For the first time since 2008, both share plans will vest together, driven by financial performance and substantial share price growth over the last three years.
- Over the performance period 1 July 2009 to 30 June 2012:
 - Diageo has generated £8.8 billion in profit and over £30 billion in sales.
 - The share price has increased by 88% resulting in an increase in Diageo's market capitalisation of over £19 billion to £42 billion.
 - Diageo has paid a total dividend of 117 pence per share to shareholders.
 - Diageo has achieved its best position in its peer group for total shareholder return since 2005.

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Directors' remuneration report (continued)

PS Walsh

- Base salary to be held flat for the CEO in the annual salary review for the year ending 30 June 2013.
- 72% of the CEO's total remuneration is linked to share price performance.

PS Walsh	2012 £000	% of total pay	2011 £000	% of total pay	Commentary
Total fixed pay	1,278	12%	1,299	29%	Representing base salary and benefits earned in the year ended 30 June 2012.
Annual bonus	1,821	16%	1,884	43%	Exceeded target on all financial measures and individual objectives.
Sub total – short term remuneration (cash)	3,099	28%	3,183	72%	
Long term incentive plan – performance element(a)	3,060	27%	0	0%	Represents the value of long term incentives vesting for the performance period 2009 – 2012 as a result of outperformance of the peer group on total shareholder return.
Long term incentive plan – share appreciation element(b)	5,055	45%	1,266	28%	Represents the impact of the significant increase in Diageo's share price since award in 2009.
Sub total – long term share price based remuneration (non-cash)	8,115	72%	1,266	28%	
Total	11,214	100%	4,449	100%	

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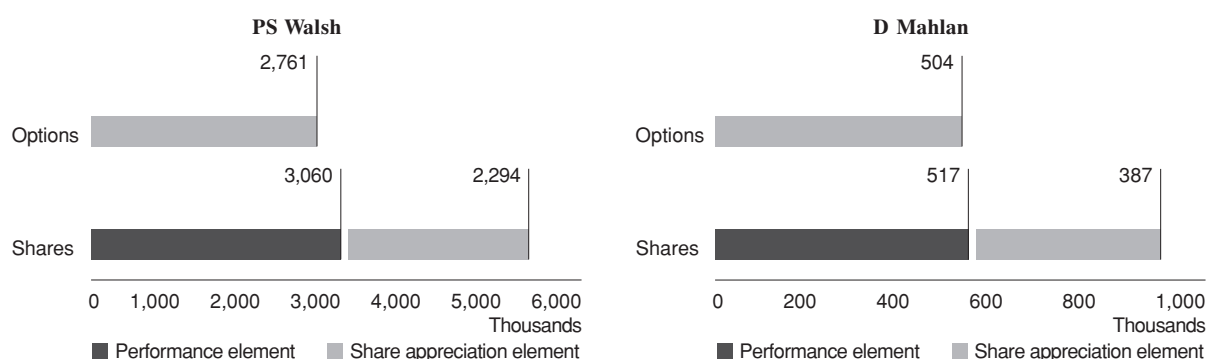
Directors' remuneration report (continued)

D Mahlan

- Base salary to be increased by 8.8% in the annual salary review for the year ending 30 June 2013, offset by a reduction in the value of the pension cash supplement from 40% to 35% of base salary. The overall increase to fixed pay is 5%.

D Mahlan	2012	% of total pay	2011(c)	% of total pay	Commentary
	£000		£000		
Total fixed pay	887	28%	757	40%	Representing base salary, benefits and cash supplement in lieu of pension earned in the year ended 30 June 2012.
Annual bonus	912	28%	920	48%	Exceeded target on all financial measures and individual objectives.
Sub total – short term remuneration (cash)	1,799	56%	1,677	88%	
Long term incentive plan – performance element(a)	517	16%	0	0%	Represents the value of long term incentives vesting for the performance period 2009 – 2012 as a result of outperformance of the peer group on total shareholder return.
Long term incentive plan – share appreciation element(b)	891	28%	230	12%	Represents the impact of the significant increase in Diageo's share price since award in 2009.
Sub total – long term share price based remuneration (non-cash)	1,408	44%	230	12%	
Total	3,207	100%	1,907	100%	

Proportion of LTIPs vesting attributable to share price appreciation



Notes to tables

- Performance element – The options vesting and performance shares due to be released in September 2012 at the grant price after applying the performance condition.
- Share appreciation element – The estimated additional value generated through share price growth for options vesting and performance shares due to be released in September 2012 at the average market value of Diageo shares between 1 April and 30 June 2012 of 1559 pence. The estimated share price used is in line with the principles for estimating the gains for

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Directors' remuneration report (continued)

awards vesting after publication of the annual report as outlined by the Financial Reporting Lab on 'A single figure for remuneration'.

- (c) For the purposes of year on year comparison, 2011 numbers for the CFO include earnings prior to her appointment to the board. The disclosure in the 2011 directors' remuneration report was on a pro-rata basis from her date of appointment to the board. The long term incentive awards vesting in September 2012 were awarded to the CFO prior to her appointment to the board.

New executive director appointment

As announced on 2 July 2012, the company has appointed Ivan Menezes, chief operating officer (COO), to Diageo's board with effect from 2 July 2012. Subject to shareholder approval, I Menezes will be formally appointed as a director at the company's AGM on 17 October 2012. It is proposed that I Menezes is paid a base salary of \$1,400,000 per annum and that he will participate in the annual bonus and long term incentive plans on the same basis as the CEO.

Governance

What is the role of the remuneration committee? The remuneration committee consists of the following independent non-executive directors: PB Bruzelius, LM Danon, Lord Davies, BD Holden, PG Scott, HT Stitzer, Lord Hollick (retired 19 October 2011) and P Walker (retired 19 October 2011). Lord Davies is the chairman of the remuneration committee. With effect from 1 October 2012, Mr Ho KwonPing will also become a member of the remuneration committee, subject to shareholder approval of his appointment at the company's AGM on 17 October 2012. The chairman of the board and the CEO may, by invitation, attend remuneration committee meetings except when their own remuneration is discussed.

The remuneration committee's principal responsibilities are:

- making recommendations to the board on remuneration policy as applied to the executive directors and the executive committee;
- setting, reviewing and approving individual remuneration arrangements for the chairman of the board, executive directors and executive committee members including terms and conditions of employment;
- determining arrangements in relation to termination of employment of each executive director and other designated senior executives; and
- making recommendations to the board concerning the introduction of any new share incentive plans which require approval by shareholders.

Full terms of reference for the committee are available at www.diageo.com and on request from the company secretary.

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Directors' remuneration report (continued)

What has the remuneration committee done during the year? The remuneration committee met five times during the year to consider and, where applicable, approve key remuneration items including the following:

Governance and forward planning	Pay	Incentive plans
<ul style="list-style-type: none">Reviewed AGM outcomes and feedback from institutional shareholders, giving consideration to implications for future remuneration policy.Reviewed updated United Kingdom governance requirements, including the government consultation on narrative reporting and executive remuneration; assessed Diageo's compliance.Approved shareholder consultation approach and extended invitation to meet with some of Diageo's major shareholders.Reviewed and approved the directors' remuneration report taking into account feedback from shareholder meetings.	<ul style="list-style-type: none">Approved methodology and approach to pay review and identified any benchmarking requirements.Reviewed and approved proposals for salary reviews and any adjustments to other remuneration elements (e.g. levels of share award, pension and benefits).	<ul style="list-style-type: none">Considered and approved plan design, performance measures and targets to be used in short and long term incentive plans to ensure measures are aligned with strategy and that targets are appropriately stretching.Tracked performance for annual bonus and long term incentive measures during the year.Reviewed policy changes for the long term incentives and approved introduction of a clawback condition for future awards.Reviewed year-end business performance and performance linked reward. Determined bonus payouts and vesting of long term incentives.

Further information on meetings held and director attendance is disclosed in the corporate governance report.

Who provides advice to the remuneration committee? During the year ended 30 June 2012, the remuneration committee received advice from the following independent consultants:

- Deloitte LLP – provided advice on remuneration best practice and senior executive remuneration. Deloitte LLP also provided a range of non-related tax, corporate finance and consulting services during the year.
- Kepler Associates – reviewed and confirmed the TSR of Diageo and the peer group companies for the award under the September 2008 Performance Share Plan (for which the performance cycle ended on 30 June 2011) and provided periodic performance updates on all outstanding performance cycles. After 30 June 2012, they also reviewed and confirmed the TSR outcome for the award under the September 2009 Performance Share Plan (for which the performance cycle ended on 30 June 2012). They provided no other services to Diageo during the year.

Additional remuneration survey data published by Aon Hewitt Associates, Towers Watson, and PricewaterhouseCoopers LLP were presented to the remuneration committee during the year.

Diageo's human resources director and director of performance and reward were also invited by the remuneration committee to provide their views and advice. The human resources director is not present when his own remuneration is discussed. The CFO may also attend to provide performance context to the committee during its discussions about target setting.

What was the outcome of the vote on the 2011 directors' remuneration report at the company's AGM? The 2011 directors' remuneration report received a majority 'for' vote of 80% (2010 – 88%).

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Directors' remuneration report (continued)

How has the remuneration committee responded to shareholder feedback during the year? The committee actively considered feedback received from shareholders prior to and following the 2011 AGM and also closely monitored guidance and directional themes emerging from institutional shareholder bodies and the United Kingdom government during the year on the subject of executive remuneration. On the basis of this, the committee has taken the following actions:

- In response to shareholder requests for visibility of targets used in the performance share plan at the start of the performance period, the remuneration committee will disclose targets for future awards in the relevant directors' remuneration report.
- In line with guidance from institutional shareholders, the remuneration committee has introduced a clawback condition in the company's long term incentive plans; this enables the remuneration committee to reduce unvested awards in circumstances that result in performance being materially adversely impacted. Following consultation with shareholders, a clawback condition will also be introduced to the annual bonus arrangements for executive directors.
- In view of the emerging desire for clearer narrative reporting, the remuneration committee has reviewed the structure and content of the directors' remuneration report with a view to improving clarity and understanding. The remuneration committee expects this to be an ongoing evolving process as more details become available from the United Kingdom government on any changes to remuneration disclosure requirements and legislative changes to shareholder voting rights in the United Kingdom following their consultations during the year on these topics.

The remuneration committee also provided the opportunity for some of Diageo's major shareholders and their representative bodies to meet with the remuneration committee chairman during the year to discuss remuneration matters generally.

What will the remuneration committee be focused on for the year ending 30 June 2013?

- Preparing for legislative changes on reporting requirements and shareholder voting rights to be implemented by the United Kingdom government.
- Reviewing and assessing the ongoing appropriateness of current executive remuneration plan design and target stretch.
- Ensuring that remuneration arrangements continue to attract and retain talent, and reward company performance with a focus on maintaining the link between performance and reward.
- Understanding and responding to shareholder feedback and fostering more continuous open dialogue.

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Directors' remuneration report (continued)

What is the philosophy underpinning executive remuneration? The plans in which Diageo's executive directors and senior management participate are designed to reflect the principles detailed below:

What	Why	How
Performance-related compensation	It influences and supports performance and the creation of a high-performing organisation.	<ul style="list-style-type: none"> • Short and long term incentives conditional upon achieving stretching performance targets.
Rewarding sustainable performance	It is at the heart of Diageo's corporate strategy and is vital to meeting stakeholder interests.	<ul style="list-style-type: none"> • A combination of absolute and relative performance measures for short and long term incentives that reflect sustainable profit growth and underlying financial performance. • Shareholding requirements that align the interests of senior executives with those of shareholders and that are a condition of full participation in long term incentive plans.
Measuring performance over three years	It aligns with the time cycle over which management decisions are reflected in the creation of value in this business.	<ul style="list-style-type: none"> • Long term incentives that comprise a combination of share option grants and share awards in each year and vary with three year eps, and TSR, organic net sales and organic operating margin performance, respectively.
Providing a balanced mix of remuneration	It enables focus on long term value creation while avoiding disproportionate risk-taking.	<ul style="list-style-type: none"> • Base salary, benefits, retirement savings, short term cash incentives and long term equity incentives.
Providing a competitive total remuneration opportunity	It helps Diageo attract and retain the best global talent.	<ul style="list-style-type: none"> • Reward levels considered in the context of total remuneration packages paid in relevant global comparators, reflecting the size, complexity and global scope of Diageo's business.
Simplicity and transparency	It allows targets to be motivating and demonstrably linked to company performance.	<ul style="list-style-type: none"> • Targets that are within a sphere of direct influence and that align with the company's short and long term goals.

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Directors' remuneration report (continued)

How does executive remuneration link to business strategy? Diageo's strategy is to drive top line growth and margin improvement in a sustainable and responsible way and to deliver consistent value creation for shareholders over the long term. It will do this through its geographic breadth, its outstanding brands across beverage alcohol categories and the expertise of its people. In support of this objective, the company seeks to accelerate value creation through medium term goals that are centred on delivering faster organic net sales growth, strong organic operating margin improvement and double-digit growth in core earnings per share over the medium term. The remuneration structures and performance measures used in executive incentive plans are designed to support Diageo's business strategy as follows:

Focused on sustainable growth drivers	As a public limited company, Diageo has a fiduciary responsibility to maximise long term value for shareholders. Thus, variable elements of remuneration are dependent upon the achievement of performance measures that are identified as key sustainable growth drivers for the business and that are aligned with the creation of shareholder value.
Variable with performance	A significant proportion of total remuneration for the executive directors is linked to individual and business performance so that remuneration will increase or decrease in line with performance. The fixed versus variable pay mix is illustrated on the following page.
Share ownership	Full participation in incentives is conditional upon building up a significant personal shareholding in Diageo to ensure the company's leaders think and act like owners.
Cost effectiveness	Fixed elements of remuneration are determined by reference to the median of the market, individual experience and performance, and other relevant factors to ensure competitiveness while controlling fixed costs to maximise efficiency.

How do the incentive plan measures link to business strategy? The following table describes the performance measures that are used in the company's short and long term executive incentive plans and the business performance that they drive:

Short term incentive plan measures	Long term incentive plan measures
Net sales – year-on-year organic net sales growth is a key performance measure.	Net sales – sustained year-on-year organic net sales growth is a key performance measure.
Profit before exceptional items and taxation – stretching profit targets drive operational efficiency and influence the level of returns that can be delivered to shareholders through increases in share price and dividend income.	Operating margin – organic operating margin measures the efficiency of the business in delivering top line growth.
Free cash flow – positive cash flow is an indicator of the financial health of the business and critical to enabling infrastructure investment, marketing investment, capital expenditure and acquisition opportunities in line with Diageo's strategy. A proportion of this metric is focused on average cash performance to enhance focus on sustained cash generation throughout the year.	Earnings per share (eps) – reflects profitability and is a key measure for shareholders; an adjusted measure of eps is used in the share option plan.
Individual business objectives – these are measurable deliverables that are specific to the individual and are focused on supporting the delivery of key strategic objectives.	Relative total shareholder return (TSR) – reflects the value of share price growth plus dividends, thus measuring the value returned on shareholder investments; Diageo's performance relative to its selected peer group determines how much reward is delivered to plan participants.





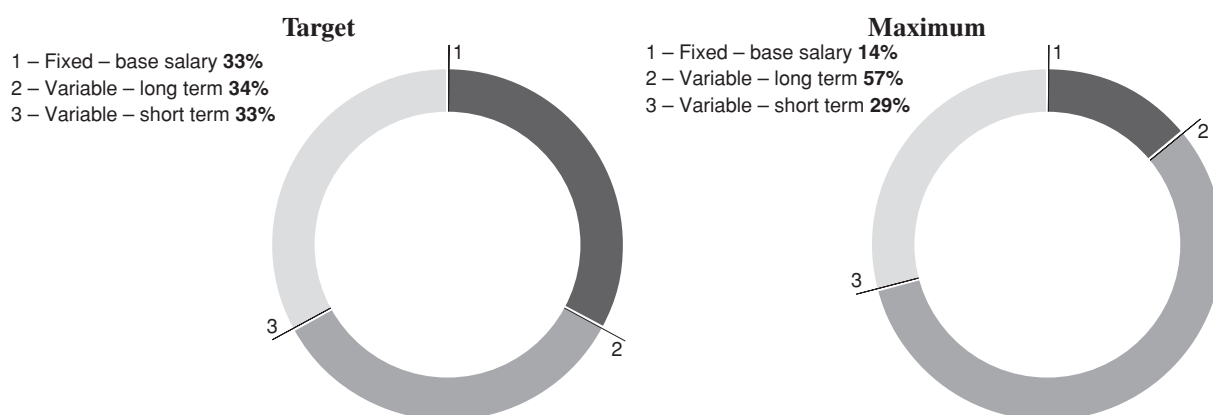
Directors' remuneration report (continued)

How is pay for performance achieved? The board of directors sets stretching performance targets for the business and its leaders. To achieve these targets and deliver performance requires exceptional business management and strategic execution. This approach to target setting reflects the aspirational performance environment that Diageo wishes to create.

The annual incentive plan aims to reward the delivery of short term financial and individual business performance goals with commensurate levels of remuneration. Long term incentive plans aim to reward long term sustained performance and create alignment with the delivery of value for shareholders. Under both sets of plans, if the demanding targets are achieved, high levels of reward may be earned. All incentives are capped in order that inappropriate risk-taking is neither encouraged nor rewarded.

What is the proportion of fixed to variable pay? The balance between fixed and variable elements of remuneration changes with performance. Based on expected values at target and the average of remuneration elements for both executive directors, the mix between fixed and variable remuneration for executive directors is that for £100 of remuneration earned, £33 will be fixed remuneration and £67 will be performance-related remuneration, excluding pensions and other benefits. At maximum, the mix increases the weighting on variable pay (and in particular, long term variable pay) so that for £100 of remuneration earned, £14 will be fixed remuneration and £86 will be performance-related remuneration, excluding pensions and other benefits. This mix is illustrated in the following charts.

Fixed vs variable pay mix



How is risk managed in the incentive plans? The remuneration committee considers the management of risk to be important to the process of designing and implementing sustainable remuneration structures and to setting appropriate performance targets for incentive plans. The members of the remuneration committee also constitute the membership of the audit committee, thus ensuring full oversight of any risk factors that may be relevant to remuneration arrangements and target setting specifically. Before agreeing bonus payments and approving the vesting under long term incentive plans, the remuneration committee, in conjunction with the audit committee, considers the underlying performance of the business during the relevant period to ensure that the level of reward is appropriate and aligned with shareholder interests. A clawback condition has been introduced to future long term incentive plan awards such that outstanding awards may be reduced in the event of a material performance failure.



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Directors' remuneration report (continued)

Summary of current remuneration policy for executive directors

A breakdown of the reward programmes in which Diageo's executive directors participate, the remuneration strategy that they support and the policy governing their execution is detailed in the table below:

What	Why	How
Base salary	Reflects the value of the individual, their skills and experience, and performance.	<ul style="list-style-type: none"> Reviewed annually with changes usually taking effect from 1 October. Benchmarked against the top 30 companies in the FTSE 100 by market capitalisation excluding companies in the financial services sector and Unilever. Generally positioned at the median of the relevant market or, in certain circumstances, positioned above median if justified by the requirement to recruit or retain key executives.
Annual incentive plan	Incentivises year on year delivery of short term performance goals. Provides focus on key financial metrics including profit growth and cash performance.	<ul style="list-style-type: none"> Targets set by reference to the annual operating plan. Level of award determined by Diageo's overall financial performance. Annual incentive plan awards based 80% on financial measures (net sales, profit and cash flow) and 20% on specific individual business objectives related to business strategy and operational targets. Up to 100% of salary earned for on target performance with a maximum of 200% of salary payable for outstanding performance.

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Directors' remuneration report (continued)

<u>What</u>	<u>Why</u>	<u>How</u>
Share options (SESOP 2008)	Incentivises three year earnings growth above a minimum threshold. Provides focus on increasing Diageo's share price over the medium to longer term.	<ul style="list-style-type: none">• A discretionary annual grant of market price share options subject to a performance test based on annual compound growth in adjusted eps over three years.• Stretching growth targets set annually by the remuneration committee.• Maximum annual grant of 375% of salary.• Threshold vesting level of 25% with pro rata vesting up to 100% maximum.

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Directors' remuneration report (continued)

<u>What</u>	<u>Why</u>	<u>How</u>
Performance share awards (PSP 2008)	Incentivises three year total shareholder return relative to a selected peer group of companies and the achievement of organic net sales and organic operating margin targets that support the delivery of the company's medium term growth ambitions. Provides focus on delivering superior returns to shareholders.	<ul style="list-style-type: none">• A discretionary annual award of shares subject to a three year performance test.• Maximum annual award of 375% of salary.• Threshold vesting of 25% up to a maximum of 100%.• Based on three equally weighted measures: TSR performance against a peer group of companies, organic net sales growth (compound annual growth) and total organic operating margin improvement.• Threshold vesting for median TSR performance (ninth position), up to 100% vesting (equivalent to 33.3% of the total award) for achieving third or above in the peer group.• Organic net sales and organic operating margin targets set annually by the remuneration committee for each new award.• Notional dividends accrue on awards, delivered as shares or cash at the discretion of the remuneration committee.
Benefits	Provides market competitive non-cash benefits	<ul style="list-style-type: none">• Provision of benefits such as company car and driver, product allowance, medical insurance and financial counselling.

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Directors' remuneration report (continued)

What	Why	How
Pension	Provides competitive post retirement benefits or cash alternative	<ul style="list-style-type: none">• Provision of market competitive pension arrangements or a cash alternative based on a percentage of base salary.• Bonus and other benefits excluded from calculation of cash supplement.• 'Flexible pension access' allows individuals over the age of 55 to draw their pension early while remaining in employment.

Base salaries

How are base salaries determined? The previous summary table sets out the policy on base salary for the executive directors. In addition to market data, base salaries are determined with reference to individual experience and performance, and the level and structure of remuneration for other employees and the external environment.

How is benchmarking used? Benchmarking is primarily referenced if there is a perceived gap between the individual's base salary positioning and relevant market peers, where there is a known retention risk or where an individual is newly appointed to role. When used, benchmarking data is considered holistically, looking at salary in the context of total package value, and is referenced as a guide to support the committee's judgement taking into account a number of other factors including the importance of the role in delivering the company's strategy, the performance of the individual, and the pay and employment conditions of the general employee population.

The peer group that is referenced comprises the top 30 companies in the FTSE 100 by market capitalisation, excluding companies in the financial services sector and also excluding Unilever, for which PS Walsh is the chairman of the remuneration committee. Benchmarking also makes reference to other relevant global comparators where appropriate recognising the global mobility of the senior talent pool.

What increases have been applied during the year? During the year ended 30 June 2012, the base salaries for the CEO and CFO were increased by 4.5% and 8.7% respectively.

In August 2012, the remuneration committee reviewed base salaries for senior management and agreed new salaries which will apply from 1 October 2012. In determining these salaries, the remuneration committee took into consideration the experience, performance, and the external and internal relative positioning for total reward (taking into account both pay and incentives) of the individuals, and also took into account the pay context for general staff. The overall pay budget for the business in the United Kingdom in the year ending 30 June 2013 is 3.5% of base salary. As a result of these considerations, the remuneration committee, in consultation with the CEO, determined that the base salary for the CEO will not be increased in October 2012.

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Directors' remuneration report (continued)

The CFO was appointed to the board on 1 October 2010. As outlined in the 2011 directors' remuneration report, on her appointment, the CFO's salary was initially set at below typical market levels for comparable roles reflecting her level of experience at the time. In setting this initial salary level, the remuneration committee's intention was to allow scope for future increases to both recognise performance and bring her closer in line with the market with increasing experience. The remuneration committee has awarded an increase that recognises her strong performance since appointment and that provides ongoing progression towards a market-competitive package in line with the company's policy on base salary positioning; with effect from 1 October 2012, the base salary for the CFO will increase by 8.8% to £680,000.

Salary at 1 October (£000)	D Mahlan			PS Walsh		
	2012	2011	2010	2012	2011	2010
Base salary	680	625	575	1,231	1,231	1,178
% increase (over previous year)	8.8%	8.7%	—	0%	4.5%	2.0%

Annual incentive plan

How does the annual incentive plan work? The annual incentive plan is designed to incentivise year on year delivery of short term performance goals that are determined by pre-set stretching targets and measures agreed by the remuneration committee with reference to the annual operating plan. The remuneration committee determines the level of performance achieved based on Diageo's overall financial performance after the end of the financial year. With effect from 1 July 2012, the annual incentive plan will be subject to a clawback arrangement for executive directors. Under this arrangement, the remuneration committee will have discretion to clawback a bonus if exceptional circumstances, such as gross misconduct or gross negligence, are discovered to have occurred during the performance period that applied to the bonus award.

The targets for the year ended 30 June 2012 were a combination of measures including net sales, profit before exceptional items and taxation, and free cash flow. As discussed earlier in the report, these measures focus on key drivers of Diageo's growth strategy while supporting sustainability and the underlying financial health of the company. The executive directors were also measured against a number of individual business objectives (IBOs) that were derived from a set of common goals considered to be key imperatives supporting the delivery of the business plan and that were relevant to their specific area of accountability.

How did the company perform against annual incentive plan targets in the year ended 30 June 2012?

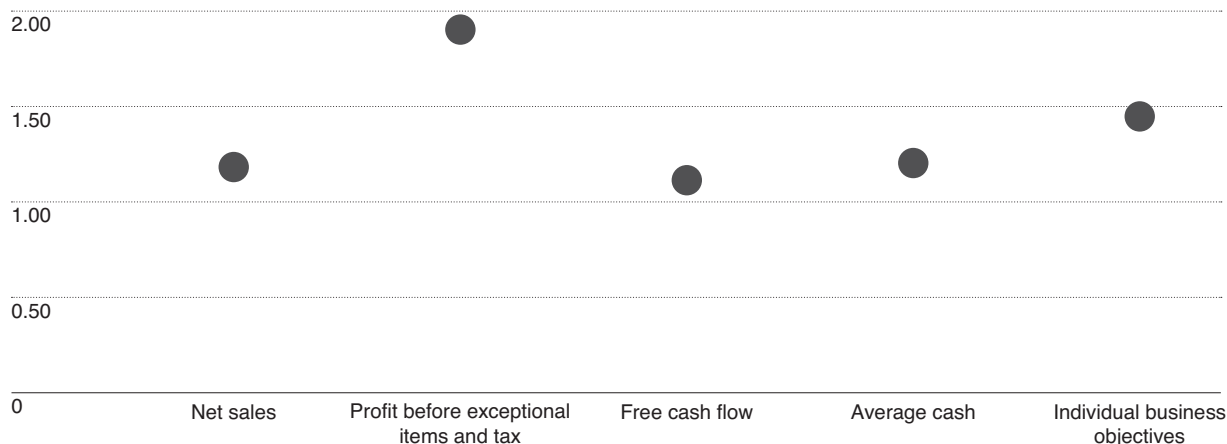
In the year under review, the company has delivered organic top line growth of 6%, operating profit growth of 9% and 60 basis points of operating margin improvement. This is a strong performance that ensures the business is well positioned for the future. The company's performance is reflected in above target outcomes under the net sales and profit measures used in the annual incentive plan, and a strong cash performance also delivered an above target outcome for this measure. The remuneration committee assessed the performance of the CEO and the CFO against this performance context and against their specific IBOs and concluded that, overall, the performance against the IBOs warranted an above target level of payout. The overall level of performance achieved resulted in an annual incentive plan award equating to 148% of base salary for the CEO and 146% of salary for the CFO. The following charts illustrate how the outcomes for the different bonus measures contribute to the overall bonus payout and compare this to the target and maximum potential outcome (based on an average of the IBOs for the executive directors). The actual awards received by the executive directors are shown in this report in the table 'Directors' remuneration for the year ended 30 June 2012'.

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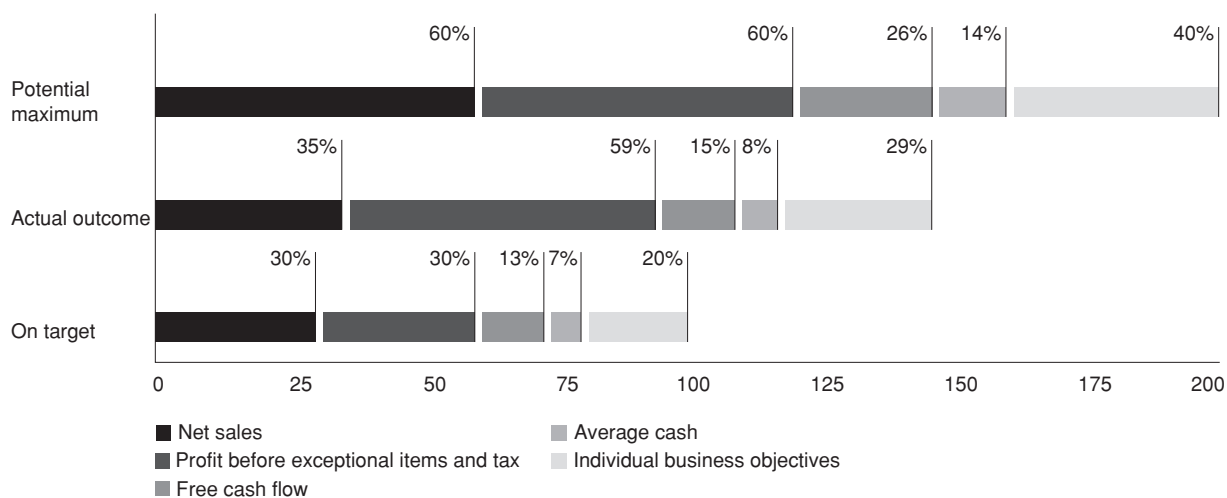


Directors' remuneration report (continued)

Outcome



On target vs actual bonus outcome vs potential maximum as % of target opportunity



The business results for the year ended 30 June 2012 are described in the Business review.

Long term incentive plans (LTIPs)

How do the company's LTIPs work? Long term incentives are a combination of share options under the SESOP and performance share awards under the PSP and are designed to incentivise executive directors and senior managers to strive for long term sustainable performance. These awards are made on an annual basis with the level of award considered each year in light of individual and business performance. Awards made under both sets of plans are subject to performance conditions normally measured over a three year period. The regular review of the performance measures and the vesting schedule used in each plan are designed to ensure that the LTIPs continue to support business



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Directors' remuneration report (continued)

objectives and are in line with current best practice. All of Diageo's share plans operate within the Association of British Insurers' dilution guidelines for share-based remuneration.

Senior executive share option plan 2008 (SESOP 2008)

Options granted under the SESOP 2008 are subject to a performance condition based on compound annual growth in adjusted eps over a three year period, with growth targets set by the company's remuneration committee for each grant. For the purpose of the SESOP, an adjusted measure of eps is used to ensure that items such as exceptional items and the impact of movements in exchange rates are excluded from year on year comparisons of performance. Options will only vest when stretching adjusted eps targets are achieved. Vesting is on a pro rata basis currently ranging from a threshold level of 25% to a maximum level of 100%. The remuneration committee reviewed the targets for the SESOP awards to be made in 2012 and decided to increase their stretch to ensure that they remain aligned with long term shareholder value creation.

What are the targets, award levels and vesting profile for SESOP awards? The adjusted eps growth targets for the current outstanding awards are set out below:

Performance period	Award 2012	Award 2011	Award 2010	Award 2009
	1 Jul 2012 – 30 Jun 2015	1 Jul 2011 – 30 Jun 2014	1 Jul 2010 – 30 Jun 2013	1 Jul 2009 – 30 Jun 2012
	%	%	%	%
Compound annual growth				
Threshold	8	6	3	3
Max	12	10	7	7
Equivalent total over three years				
Threshold	26	19	9	9
Max	40	33	23	23
Percentage of award vesting				
Threshold	25	25	25	25
Max	100	100	100	100

For the 2012 award, 62.5% of the award (the vesting midpoint) will vest for achieving compound annual growth of 10% in adjusted eps.

The maximum annual grant under the plan is 375% of base salary. However, the remuneration committee has the discretion to grant awards in excess of the maximum limit in exceptional circumstances. It is intended that awards equivalent to 375% of base salary will be made to the CEO, COO and CFO in September 2012.

The remuneration committee also has discretion to extend the option exercise period from 12 to 18 months for share options awarded to qualifying leavers. The remuneration committee did not exercise this discretion during the year ended 30 June 2012.

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Directors' remuneration report (continued)

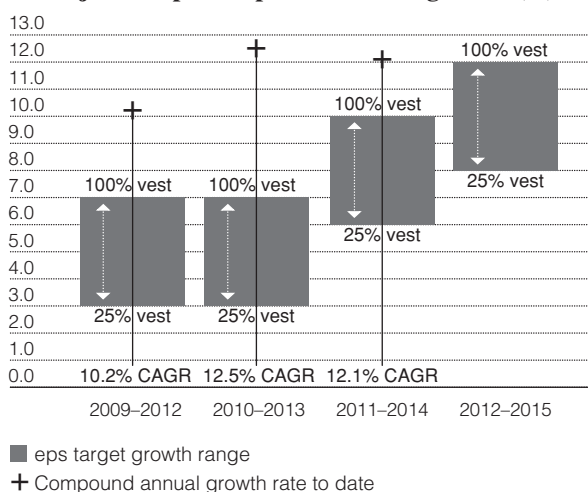
How is adjusted eps performance tracking for outstanding SESOP awards? The following table shows adjusted eps performance for each year that forms all or part of the performance period for outstanding SESOP awards:

Annual adjusted eps performance

<u>Year ended</u>	<u>Adjusted eps growth</u>
30 June 2010	5.9%
30 June 2011	12.9%
30 June 2012	12.1%

The following chart shows the performance targets, minimum and maximum vesting percentages for awards made in 2009, 2010, 2011 and 2012. It also shows the compound annual growth performance for adjusted eps as it is currently tracking for each outstanding award. On the basis of this performance, the 2009 award, which is due to vest in September 2012, has exceeded the performance condition and consequently, the shares under award will vest at 100% of the initial award.

Adjusted eps compound annual growth (%)



Performance share plan (PSP 2008)

Under this plan, participants are granted a discretionary, conditional right to receive shares. All conditional rights awarded vest after a three year period subject to the achievement of specified performance tests. Notional dividends accrue on awards and are paid out either in cash or shares in accordance with the vesting schedule. As discussed in the 2011 directors' remuneration report, the plan was reviewed during the year ended 30 June 2011 resulting in the introduction of two new financial measures to the performance condition for awards made from September 2011 onwards. By introducing these two new financial measures, the remuneration committee has sought to create closer alignment with business strategy, as outlined earlier in this report.



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Directors' remuneration report (continued)

What performance measures are used in the PSP?

For outstanding awards made up to and including September 2010

The primary performance test is a comparison of Diageo's three year TSR – the percentage growth in Diageo's share price (assuming all dividends and capital distributions are reinvested) – with the TSR of a peer group of international drinks and consumer goods companies. TSR calculations are converted to a common currency (US dollars). The second performance test requires that there has been an underlying improvement in Diageo's three year financial performance, typically measured by an adjusted eps measure, for the remuneration committee to recommend the release of awards.

For awards made from September 2011 onwards

The primary performance test is split equally between three performance measures:

- 1) TSR, as defined above;
- 2) growth in organic net sales on a compound annual basis; and
- 3) total organic operating margin improvement.

For any of the award apportioned to the TSR condition to be released, there must be an improvement in the underlying performance of the company. In addition, the remuneration committee requires a minimum level of performance in both organic net sales and organic operating margin before any of the award apportioned to these measures can be released.

In line with shareholder feedback seeking greater visibility of targets at the start of the performance period, the remuneration committee will disclose targets under the two financial measures for future awards. The remuneration committee will also disclose how vesting outcomes relate to performance at the end of the three year performance period in the relevant directors' remuneration report.

What are the targets, award levels and vesting profile for PSP awards?

The targets and vesting profile are shown in the following tables:

	<u>Total shareholder return</u>	<u>Organic net sales (CAGR)</u>	<u>Organic operating margin improvement</u>	<u>Vesting profile</u>
2012 award				
– Threshold	Median ranking (ninth)	5.0%	100bps	25%
– Mid-point	—	6.5%	150bps	62.5%
– Maximum	Upper quintile (third or above)	8.0%	175bps	100%

There is straight line vesting between 25% and 100% for the net sales measure; the operating margin vesting profile is intended to incentivise further outperformance so it will vest in a straight line between threshold and the midpoint for achieving 100bps to 150bps improvement (25% to 62.5% vesting), and

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Directors' remuneration report (continued)

will then vest in a straight line between midpoint and maximum for achieving 150bps to 175bps improvement (62.5% to 100% vesting). The full vesting profile for TSR is shown below:

<u>TSR ranking</u>	<u>From 2011 awards % vesting</u>	<u>From 2008 awards % vesting</u>
1st	100%	100%
2nd	100%	100%
3rd	100%	95%
4th	95%	75%
5th	75%	65%
6th	65%	55%
7th	55%	45%
8th	45%	25%
9th	25%	0%
10th or below	0%	0%

TSR peer group

There are 15 other companies in the peer group for the outstanding 2009 and 2010 awards, and 16 other companies in the peer group for awards made from 2011 onwards:

AB InBev	Kraft Foods
Brown-Forman	Nestlé
Carlsberg	PepsiCo
Coca-Cola	Pernod Ricard
Colgate-Palmolive	Procter & Gamble
Groupe Danone	Reckitt Benckiser (2011 onwards)
Heineken	SABMiller
HJ Heinz	Unilever

The maximum annual award under the plan is 375% of salary. However, the remuneration committee has discretion to grant awards in excess of this maximum in exceptional circumstances. It is intended that awards equivalent to 375% of base salary will be made to the CEO and COO, and an award equivalent to 300% of base salary will be made to the CFO in September 2012.

How does the remuneration committee use discretion to ensure a fair outcome? The remuneration committee will review the vesting outcome of an LTIP award to ensure that it fairly reflects the company's actual underlying performance and may adjust vesting levels if it considers it appropriate. Additionally, for awards made from September 2012 onwards, the plan rules for both SESOP and PSP will provide the remuneration committee with the discretion to apply a clawback condition in order to reduce the number of shares under award in the event of a material performance failure (for example, material restatement to the accounts).

What happens in the event of a change of control? In the event of a change of control and at the remuneration committee's discretion, outstanding PSP awards would be released and outstanding share options would become exercisable based on the extent to which the relevant performance conditions had been met and, if the remuneration committee determines, the time elapsed since the initial award or grant, respectively.

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Directors' remuneration report (continued)

All employee share plans

The executive directors are eligible to participate in the United Kingdom HM Revenue & Customs approved share incentive and sharesave plans that Diageo operates on the same terms as for all eligible employees.

What is the shareholding requirement for the executive directors? Senior executives are currently required to build up significant holdings of shares in Diageo from their own resources over a defined period of time. Full participation in the share option and share award plans is conditional upon meeting this requirement. This policy reflects Diageo's belief that its most senior leaders should also be shareholders. The holding requirement for the CFO and CEO and the status of that requirement as at 30 June 2012 is shown in the following table. Under the company's shareholding requirement policy, D Mahlan has five years from her appointment to the board in which to build up her shareholding to meet and maintain her new requirement.

	<u>D Mahlan</u>	<u>PS Walsh</u>
Value of shareholdings (£000)	1,328	9,083
Minimum shareholding requirement as % of salary	250%	300%
Actual shareholding as % of salary	217%	746%

This information is based on the share interests disclosed in the table 'Share and other interests' in this report, base salary earned in the year ended 30 June 2012, and an average share price for the same period of 1394 pence.

What pension provision is made for executive directors? CEO – PS Walsh was a member of the UK Scheme (the 'Scheme') until 31 March 2011, at which point he stopped accruing pension rights. From 1 May 2011, PS Walsh began to receive his pension benefits under the company's policy of 'flexible pension access'. The rules of the Scheme at the time that PS Walsh began to receive his benefits required pensions in payment to be increased each year in line with increases in the RPI, subject to a maximum of 5% per year and a minimum of 3% per year.

In the event of death in service, a lump sum of four times pensionable pay plus a spouse's pension of two-thirds of the member's pension before commutation would be payable. Upon death after leaving the company, a spouse's pension of two-thirds of the member's pension before commutation is payable.

CFO – Since her appointment to the board, D Mahlan has not been a member of any Diageo group company pension scheme and instead has received a cash supplement in lieu of pension provision equivalent to 40% of base salary. With effect from 1 July 2012, it is proposed that the company contribution is reduced to 35% of base salary and that this benefit is delivered in the form of a contribution into the Diageo North America Inc. Supplemental Executive Retirement Plan (SERP). The SERP is an unfunded, non qualified supplemental retirement programme. Under the plan, accrued company contributions are subject to quarterly interest credits based on the interest rate set out in the US internal revenue code. Under the rules of the SERP, D Mahlan can withdraw the balance of the plan in the form of five equal annual instalments or a lump sum upon reaching age 55 and having left service with Diageo (within six months of separation from service). Upon death in service, a lump sum of four times base salary is payable.

What are the service contracts and terms of employment for the executive directors? The executive directors have rolling service contracts which provide for six months' notice by the director or 12 months' notice by the company and contain non-compete obligations. In the event of early termination by the company without cause, the agreements provide for a termination payment to be

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Directors' remuneration report (continued)

paid (in respect of that part of the notice period not provided to the director by the company) to PS Walsh equivalent to 12 months' base salary for the notice period and an equal amount in respect of all benefits, and to D Mahlan equivalent to 12 months' base salary for the notice period and the cost to the company of providing contractual benefits (excluding incentive plans). Any such payments would be subject to tax and other statutory deductions. The remuneration committee may exercise its discretion to require half of the termination payment to be paid in monthly instalments and, upon the executive commencing new employment, to be subject to mitigation. If the board determines that the executive has failed to perform his or her duties competently, the remuneration committee may exercise its discretion to reduce the termination payment on the grounds of poor performance. PS Walsh's service contract with the company is dated 1 November 2005. D Mahlan's service contract with the company is dated 1 July 2010.

What happens to share awards when executive directors leave? On cessation of employment, outstanding awards under share incentive arrangements will be treated in accordance with the relevant plan rules approved by shareholders in 2008. As set out in last year's remuneration report, in light of the role of the CEO in the delivery of shareholder value, the committee proposes to enable vesting of PSPs granted to the CEO from 2011 to be based entirely on the delivery of that performance. Accordingly, awards will be capable of vesting in full at the end of the performance period, if performance goals are delivered in full, without providing time pro-rating to the point of retirement. Such consideration would be at the sole discretion of the remuneration committee, taking into account all the circumstances it considers relevant at the time.

What external appointments are held by the executive directors? Executive directors may accept external appointments as non-executive directors of other companies and retain any related fees paid to them, subject to the specific approval of the board in each case.

During the year ended 30 June 2012, PS Walsh served as a non-executive director of Unilever NV and PLC, and FedEx Corporation and, with effect from January 2012, was appointed as a non-executive director of Avanti. He retained the fees paid to him for his services. At the government's request, PS Walsh also served as lead non-executive director and deputy chair on the board of the Department of Energy and Climate Change (DECC). PS Walsh has committed to donating all fees that he receives for this directorship to a charitable educational trust. The total amounts of such fees paid in the year ended 30 June 2012 are set out in the table below. D Mahlan did not hold any external appointments during the year ended 30 June 2012. With effect from 1 September 2012, D Mahlan will serve as a non-executive director for Experian Plc.

	<u>PS Walsh</u>
	<u>£000</u>
Unilever(a)	106
FedEx Corporation(a)	65
DECC	20
Avanti (with effect from January 2012)	17
	<u>208</u>

Notes

(a) Fees paid in currencies other than sterling are converted using average exchange rates for the year ended 30 June 2012.

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Directors' remuneration report (continued)

In line with the FedEx Corporation policy for outside directors, PS Walsh is eligible to be granted share options. During the year ended 30 June 2012, he was granted 5,970 options at an option price of \$68.765. He exercised 8,000 FedEx options during the year, which were granted at an option price of \$49.23 and sold at an average price of \$90.27.

Chairman of the board and non-executive directors

What is the policy on chairman of the board and non-executive directors' fees?

- The fees should be sufficient to attract, motivate and retain world-class talent.
- Fee practice should be consistent with recognised best practice standards for such positions.
- The chairman and non-executive directors should not participate in any of the company's incentive plans.
- Part of the chairman's fees should be used for the purchase of Diageo shares.
- Fees for non-executive directors should be within the limits set by the shareholders from time to time, currently £1,000,000, as approved by shareholders at the October 2005 Annual General Meeting. The limit excludes remuneration paid for special services performed by directors.

What terms and conditions apply to the chairman of the board? The chairman of the board, Dr Franz B Humer, commenced his appointment on 1 July 2008. Dr Humer has a letter of appointment for an initial five year term from 1 July 2008. It is terminable on six months' notice by either party or, if terminated by the company, by payment of six months' fees in lieu of notice.

The chairman's fee is normally reviewed every two years and any changes would normally take effect from 1 January. As recommended by the UK Corporate Governance Code, any changes to this fee have to be approved by the remuneration committee. The last scheduled review of fees was undertaken in December 2010 and the next review is anticipated to take place in December 2012 with any changes taking effect on 1 January 2013. Fees are reviewed in the light of market practice in large companies in the United Kingdom and anticipated workload, tasks and potential liabilities. In line with Diageo's policy, a proportion of the chairman's annual fee is used for the monthly purchase of Diageo ordinary shares, which have to be retained until the chairman retires from the company or ceases to be a director for any other reason. The chairman's current fee is shown in the following summary table. No changes were made to the chairman's fee during the year ended 30 June 2012.

What terms and conditions apply to the non-executive directors? All non-executive directors have letters of appointment. A summary of their terms and conditions of appointment is available at www.diageo.com.

The last scheduled review of fees for non-executive directors was undertaken in December 2011. At this time, fees were benchmarked against market practice in large companies in the United Kingdom and reviewed in light of anticipated workload, tasks and potential liabilities. As a result of this review, the base fee paid to non-executive directors was increased by £2,000 from £78,000 to £80,000 per annum and the fee for the chairman of the remuneration committee was increased by £5,000 from £15,000 to £20,000 per annum to reflect market practice in comparable companies. It was decided after this last review that fees for non-executive directors would be reviewed every two years going forward (previously, annually). Therefore, the next review of the non-executive director fees is anticipated to take place in December 2013 with any changes expected to take effect on 1 January

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Directors' remuneration report (continued)

2014. A full summary of the current non-executive directors' fees is shown in the following summary table.

Chairman of the board and non-executive directors' remuneration for the year ended 30 June 2012

<u>Per annum fees effective from</u>	<u>January 2012</u>	<u>January 2011</u>
	£	£
Chairman of the board	500,000	500,000
Non executive directors		
Base fee	80,000	78,000
Senior non executive director	20,000	20,000
Chairman of the audit committee	25,000	25,000
Chairman of the remuneration committee	20,000	15,000

The emoluments received by the chairman of the board and the non-executive directors in the year ended 30 June 2012 are shown in the table 'Directors' remuneration for the year ended 30 June 2012'.

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Directors' remuneration report (continued)

Directors' remuneration for the year ended 30 June 2012

Emoluments						2012	2011
	Base salary £000	Annual incentive plan £000	Share incentive plan £000	Cash in lieu of pension(b) £000	Other benefits(c) £000	Total £000	Total £000
Chairman – fees							
Dr FB Humer(a)	500	—	—	—	7	507	459
Executive directors							
D Mahlan	612	912	3	245	27	1,799	1,353
PS Walsh	1,217	1,821	3	—	58	3,099	3,183
Former executive directors							
NC Rose (retired from the board on 14 October 2010)	—	—	—	—	—	—	732
Sub total	1,829	2,733	6	245	85	4,898	5,268
Non-executive directors – fees							
PB Bruzelius	79	—	—	—	1	80	77
LM Danon	79	—	—	—	1	80	77
Lord Davies	105	—	—	—	1	106	65
BD Holden	79	—	—	—	1	80	77
PG Scott	104	—	—	—	1	105	102
HT Stitzer	79	—	—	—	1	80	77
Former non-executive directors – fees							
Lord Hollick (retired 19 October 2011)	33	—	—	—	—	33	112
PA Walker (retired 19 October 2011) .	23	—	—	—	—	23	77
Sub total	581	—	—	—	6	587	664
Total	2,910	2,733	6	245	98	5,992	6,391

Notes

- (a) £200,000 of Dr Franz B Humer's remuneration in the year ended 30 June 2012 was used for the monthly purchase of Diageo ordinary shares, which must be retained until he retires from the company or ceases to be a director for any other reason.
- (b) D Mahlan does not participate in the company's pension scheme and received a monthly cash supplement equivalent to 40% of base pay during the year ended 30 June 2012.
- (c) Other benefits may include company car and driver, product allowance, financial counselling and medical insurance.

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Directors' remuneration report (continued)

Long term incentive plans

Payments and gains

In the year ended 30 June 2012, the executive directors received payments and made gains under long term incentive plans as follows:

				2012	2011
	Executive share option exercises	September 2008 PSP award	September 2007 DIP award	Total	Total
	£000	£000	£000	£000	£000
Executive directors					
D Mahlan(a)	—	—	126	126	215
PS Walsh	3,208	—	—	3,208	1,225
Total	3,208	—	126	3,334	1,440

Notes

(a) D Mahlan received a release under the Discretionary Incentive Plan (DIP) in September 2011. The award was made in 2007 prior to D Mahlan's appointment to the board, and vested in September 2010 with two equal releases in September 2010 and September 2011. The award was made in the form of American Depository Shares (ADS) and the gain value was converted from US dollars into sterling using the exchange rate as at 30 June 2012. Executive directors are not eligible to participate in the DIP and D Mahlan has no further outstanding DIP awards.

Directors' share options over ordinary shares

The following table shows the number of options held under all executive share option plans and savings-related schemes for the directors who held office during the year.

		30 June 2011	Granted	Exercised	Lapsed	30 June 2012	Option price in pence	Market price at date of exercise in pence	Date from which first exercisable	Expiry date
D Mahlan . . .	DSOP 1999(a),(b)	1,576				1,576	815		20 Sep 2008	20 Sep 2015
	DSOP 1999(a),(b)	45,352				45,352	930		19 Sep 2009	19 Sep 2016
	DSOP 1999(a),(b)	37,560				37,560	1051		18 Sep 2010	18 Sep 2017
	DSOP 1999(a),(b)	52,588				52,588	1035		16 Sep 2011	16 Sep 2018
	SESOP 2008(b),(c)	83,160				83,160	952		17 Sep 2012	17 Sep 2019
	SESOP 2008	199,652				199,652	1080		20 Sep 2013	20 Sep 2020
	SESOP 2008		190,239			190,239	1232		22 Sep 2014	22 Sep 2021
	SAYE(d)		937			937	960		01 Dec 2014	31 May 2015
		<u>419,888</u>	<u>191,176</u>	<u>—</u>	<u>—</u>	<u>611,064</u>				
PS Walsh . . .	SESOP 1999	20,553		(20,553)		—	759	1247	11 Oct 2005	11 Oct 2012
	SESOP 1999	455,521		(150,000)		—	815	1363	20 Sep 2008	20 Sep 2015
				(155,521)		—	815	1383	20 Sep 2008	20 Sep 2015
				(150,000)		—	815	1335	20 Sep 2008	20 Sep 2015
	SESOP 1999	423,387				423,387	930		19 Sep 2009	19 Sep 2016
	SESOP 1999	392,483				392,483	1051		18 Sep 2010	18 Sep 2017
	SESOP 2008	493,871		(100,000)	(207,426)	186,445	877	1500	27 Oct 2011	27 Oct 2018
	SESOP 2008(c)	454,963				454,963	952		17 Sep 2012	17 Sep 2019
	SESOP 2008	409,062				409,062	1080		20 Sep 2013	20 Sep 2020
	SAYE(d)	1,617			1,617	941		01 Dec 2015	31 May 2016	
	SESOP 2008		374,695			374,695	1232		22 Sep 2014	22 Sep 2021
		<u>2,651,457</u>	<u>374,695</u>	<u>(576,074)</u>	<u>(207,426)</u>	<u>2,242,652</u>				

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Directors' remuneration report (continued)

Notes

- (a) Options granted under the Diageo Executive Share Option Plan prior to the executive's appointment to the board.
- (b) US options were granted over ADSs at dollar prices (one ADS is equivalent to four ordinary shares); the option holdings and prices in the table are stated as ordinary share equivalents in pence.
- (c) The performance condition in respect of this SESOP grant was measured after 30 June 2012. The compound annual growth in Diageo's eps over the three years ended 30 June 2012 exceeded the performance condition and 100% of these options will become exercisable in September 2012.
- (d) Options granted under the United Kingdom savings-related share option scheme.
- (e) A summary of the performance criteria in relation to the SESOP 2008 is provided in the 'Summary of current remuneration policy for executive directors' earlier in this report.

The mid-market price for ordinary shares at 30 June 2012 was 1641 pence (2011 – 1273 pence; 13 August 2012 – 1698 pence). The highest mid-market price during the year was 1641 pence and the lowest mid-market price was 1111 pence.

Directors' interests in PSP awards

The following table shows the directors' interests in the PSP. Details of executive share options are shown separately above.

	Performance period	Date of award	Interests at 30 June 2011	Awards made during year	Awards released during year		Market price at date of vesting in pence(c)	Interests at 30 June 2012(d)
			Target award(a)	Target award(a)	Number of shares vested(b)	Number of shares lapsed(b)		
D Mahlan(h)	2008 – 2011	27 Oct 08(g)	27,056		—	(27,056)	1319	—
	2009 – 2012	17 Sep 09(e),(g)	81,380					81,380
	2010 – 2013	20 Sep 10	167,964					167,964
	2011 – 2014	22 Sep 11(f)		159,574				159,574
			276,400	159,574	—	(27,056)		408,918
PS Walsh	2008 – 2011	27 Oct 08	416,867		—	(416,867)	1319	—
	2009 – 2012	17 Sep 09(e)	486,111					486,111
	2010 – 2013	20 Sep 10	430,172					430,172
	2011 – 2014	22 Sep 11(f)		392,872				392,872
			1,333,150	392,872	—	(416,867)		1,309,155

Notes

- (a) This is the number of shares initially awarded. In accordance with the plan rules, the number of shares awarded is determined based on the average of the daily closing price for the preceding financial year. Of this number of shares initially awarded, threshold vesting will release 25% of the initial award and maximum vesting will release 100% of the initial award. The performance conditions and vesting profile that determines the proportion of shares that is eventually released is described in the 'Summary of current remuneration policy for executive directors' earlier in this report.
- (b) The three year performance period for the October 2008 PSP award ended on 30 June 2011. The number of shares released in October 2011 was 0% of the initial award. This was based on a relative TSR ranking of

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Directors' remuneration report (continued)

position 12 in the peer group at the end of the performance period. Kepler Associates independently verified the TSR increase and ranking.

- (c) The price on 27 October 2011, the release date. The market price was 1100 pence when the award was made on 27 October 2008.
- (d) The directors' interests at 13 August 2012 were the same as at 30 June 2012.
- (e) The three year performance period for the September 2009 PSP award ended on 30 June 2012. The number of shares that will be released in September 2012 is 65% of the initial award. This was based on a relative TSR ranking of position fifth in the peer group at the end of the performance period. Kepler Associates independently verified the TSR increase and ranking. In addition to the release of the initial award, notional dividends that have accrued on the award to the extent that it has vested will be settled in the form of shares as soon as practicable after the vesting of the award. The gross value of the accrued notional dividends is equivalent to £428,000 and £79,000 for the CEO and CFO, respectively. The value for the CFO is based on the ADS dividends converted to ordinary shares at a ratio of one ADS to four ordinary shares.
- (f) The market price on 22 September 2011 was 1203 pence.
- (g) US share awards were granted in ADS (one ADS is equivalent to four ordinary shares); the share holdings in the table are stated as ordinary share equivalents.
- (h) D Mahlan also received a release of 2,608 ADS (10,432 ordinary share equivalents) under the Discretionary Incentive Plan on 19 September 2011.

Executive directors' pension benefits

PS Walsh started receiving his pension from the Scheme on 1 May 2011 under the company's policy of flexible pension access and, therefore, has not earned any more pension benefits over the year ended 30 June 2012. The increase in pension shown below is due to the guaranteed standard pension increase awarded on 1 April 2012 in accordance with the rules of the Scheme. PS Walsh has not received any discretionary pension increase since he started receiving his pension.

Although it is a regulatory requirement to calculate the transfer value of a pension, the transfer value has no impact on the level of pension benefit being received by PS Walsh now that he has started to receive his pension. The calculation of the transfer value is based on a prescribed methodology. The assumptions used are reviewed regularly by the trustees of the Scheme and can vary significantly based on prevailing market circumstances. The transfer value is broadly the cost to Diageo if it had to provide the equivalent pension benefit. The transfer value of the annual pension PS Walsh is receiving at 30 June 2011 and 30 June 2012 is shown in the table below. The transfer value as at 30 June 2012 has changed for the reasons set out in note (c) below.

D Mahlan does not participate in the final salary pension scheme, but during the year ended 30 June 2012 received a cash supplement in lieu of pension provision of £245,000 (equivalent to 40% of base pay).

	Age at 30 June 2012	Pensionable service at 30 June 2012	Accrued pension at 30 June 2011	Additional pension accrued in the year(a)	Accrued pension at 30 June 2012(a)(b)	Transfer value at 30 June 2011	Change in transfer value during the year(c)	Transfer value at 30 June 2012(c)
	Years	Years	£000 pa	£000 pa	£000 pa	£000	£000	£000
PS Walsh	57	29	558	20	578	15,796	3,383	19,179

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Directors' remuneration report (continued)

Notes

- (a) All of PS Walsh's Diageo pension is provided from the UK Diageo Pension Scheme, i.e. 0% is provided from the unfunded unregistered retirement benefit scheme (0% in 2011).
- (b) PS Walsh's pension is higher at 30 June 2012 than at 30 June 2011 by £20,000 due to receiving a pro-rated standard pension increase in respect of 11 months of retirement awarded as at 1 April 2012. The pension increase was 3.58% for the 11 months he was retired (3.9% was awarded to members with a full year of retirement) which was in line with the guaranteed pension increase as outlined in the Scheme Rules and which was awarded to all other pensioner members of that section of the Scheme. No discretionary pension increase was awarded to PS Walsh.
- (c) PS Walsh's transfer value is higher at 30 June 2012 than at 30 June 2011 by £3,383,000 for the following reasons:
- £3,257,000 **more** due to allowing for market conditions changing between June 2011 and June 2012 (specifically, the "gap" between the discount rate and pension increases reducing considerably);
 - £689,000 **more** due to allowing for the increase due to interest over the year; and
 - £563,000 **less** due to allowing for the pension payments PS Walsh has received during the year.
- (d) The transfer value at 30 June 2011 was calculated after PS Walsh's retirement on 1 May 2011 when he was aged 56 years, and the transfer value at 30 June 2012 was calculated when he was aged 57 years.
- (e) During the year, PS Walsh made pension contributions of £nil (2011 – £52,668).

Share and other interests

The beneficial interests of the directors in office at 30 June 2012 in the ordinary shares of the company are shown in the table below.

	Ordinary shares		
	13 August 2012	30 June 2012	30 June 2011 or appointment
Chairman			
Dr Franz B Humer	41,517	40,533	32,386
Executive directors			
D Mahlan	95,296	95,275	83,755
PS Walsh	651,602	651,579	667,346
Non-executive directors			
PB Bruzelius	5,000	5,000	5,000
LM Danon	5,000	5,000	5,000
Lord Davies	5,052	5,052	—
BD Holden	17,400	17,400	8,100
PG Scott	10,000	10,000	25,000
HT Stitzer	8,319	8,319	8,319
Total	<u>839,186</u>	<u>838,158</u>	<u>834,906</u>

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Directors' remuneration report (continued)

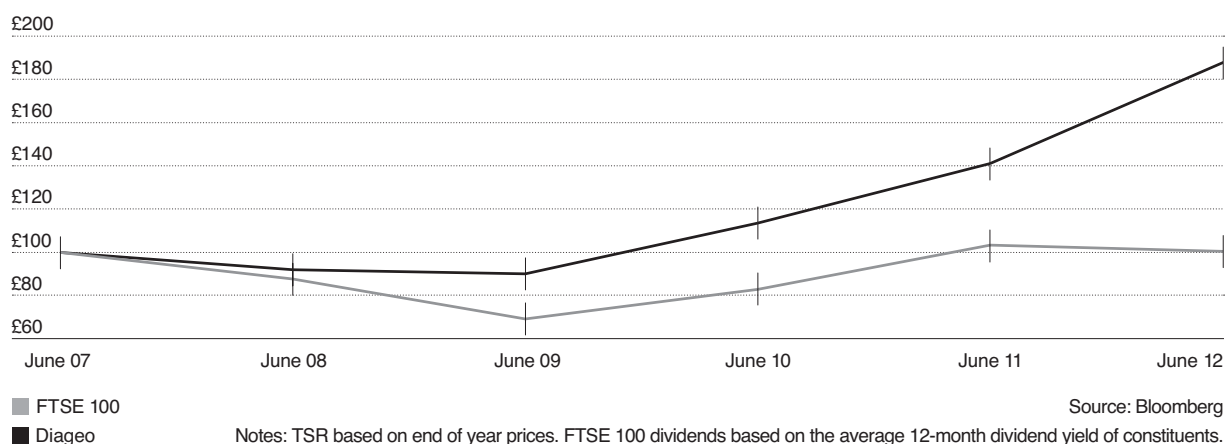
Notes

- (a) At 30 June 2012, there were 7,231,200 shares (30 June 2011 – 9,014,858; 13 August 2012 – 7,082,440) held by trusts to satisfy grants made under Diageo incentive plans and savings-related share option schemes. PS Walsh and D Mahlan are among the potential beneficiaries of these trusts and are deemed to have an interest in all these shares.
- (b) D Mahlan and BD Holden have share interests in ADS (one ADS is equivalent to four ordinary shares); the share interests in the table are stated as ordinary share equivalents.

Performance graph

The graph below shows the total shareholder return for Diageo and the FTSE 100 Index since 30 June 2007. The FTSE 100 Index reflects the 100 largest quoted companies by market capitalisation in the United Kingdom and has been chosen because it is a widely recognised performance benchmark for large companies in the United Kingdom.

Total shareholder return – value of hypothetical £100 holding (based on spot share prices)



Additional information

Emoluments and share interests of senior management The total emoluments for the year ended 30 June 2012 of the executive directors, the executive committee members and the company secretary (together, the senior management) of Diageo comprising base salary, annual incentive plan, share incentive plan, termination payments and other benefits were £17,918,855 (2011 – £21,636,952).

The aggregate amount of gains made by the senior management from the exercise of share options and from the vesting of awards during the year was £12,246,024. In addition, they were granted 1,678,400 options under the SESOP during the year at a weighted average share price of 1230 pence, exercisable by 2021 and 5,564 restricted stock units under the Diageo Executive Long Term Incentive Plan, which will vest in three years. They were also initially awarded 1,556,951 shares under the PSP in September 2011, which will vest in three years subject to the performance tests described above. Five members of the executive committee were also awarded an exceptional grant of 903,312 deferred shares under the Discretionary Incentive Plan (DIP) in September 2011 and March 2012. There are

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Directors' remuneration report (continued)

performance conditions attached to the release of these awards and they will be released, subject to achievement of the performance conditions, in phased tranches between September 2014 and September 2019.

Senior management options over ordinary shares At 13 August 2012, the senior management had an aggregate beneficial interest in 2,127,887 ordinary shares in the company and in the following options over ordinary shares in the company:

	Number of options	Weighted average exercise price in pence	Option period
D Mahlan	611,064	1092	Sep 2008 – Sep 2021
PS Walsh	2,242,652	1029	Sep 2009 – Sep 2021
Other*	5,614,897	1128	Oct 2005 – Sep 2021
	<u>8,468,613</u>		

* Other members of the executive committee and the company secretary.

Key management personnel related party transactions Key management personnel of the group comprises the executive and non-executive directors, the members of the executive committee and the company secretary. As previously disclosed, PS Walsh and G Williams have informed the company that they have purchased seasonal developments at Gleneagles from a subsidiary of the company, Gleneagles Resort Developments Limited. The transactions were priced on the same basis as all the external seasonal development transactions and were at arm's length. The values of the transactions at the date of purchase were as follows: PS Walsh – £43,000 and G Williams – £19,400. Each director continued to hold these seasonal developments at 30 June 2012.

Diageo plc has granted rolling indemnities to the directors and the company secretary, uncapped in amount, in relation to certain losses and liabilities which they may incur in the course of acting as directors or company secretary (as applicable) of Diageo plc or of one or more of its subsidiaries. These indemnities continue to be in place at 30 June 2012.

Other than disclosed in this report, no director had any interest, beneficial or non-beneficial, in the share capital of the company. Save as disclosed above, no director has or has had any interest in any transaction which is or was unusual in its nature, or which is or was significant to the business of the group and which was effected by any member of the group during the financial year, or which having been effected during an earlier financial year, remains in any respect outstanding or unperformed. There have been no material transactions during the last three years to which any director or officer, or 3% or greater shareholder, or any spouse or dependent thereof, was a party. There is no significant outstanding indebtedness to the company from any directors or officer or 3% or greater shareholder.

Statutory and audit requirements This report was approved by a duly authorised committee of the board of directors, on 21 August 2012 and was signed on its behalf by Lord Davies of Abersoch who is senior non-executive director and chairman of the remuneration committee. As required by the Companies Act 2006, a resolution to approve the directors' remuneration report will be proposed at the AGM and will be subject to an advisory shareholder vote.

The board has followed and complied with the requirements of the Companies Act 2006 with reference to Schedules 5 and 8 of the Large and Medium-sized Companies and Groups (Accounts and

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Directors' remuneration report (continued)

Reports) Regulations 2008 and section D of the UK Corporate Governance Code in preparing this report and in designing performance-related remuneration for senior executives.

KPMG Audit Plc has audited the report to the extent required by the Regulations, being the sections headed 'Directors' remuneration for the year ended 30 June 2012', 'Long term incentive plans', 'Directors' share options over ordinary shares', 'Directors' interests in PSP and TSR plan awards' and 'Executive directors' pension benefits'. In addition, the following sections form part of the audited financial statements: 'Share and other interests' and 'Key management personnel related party transactions'.

Terms defined in this remuneration report are used solely herein.

Definitions

Adjusted eps – for the purpose of the SESOP, an underlying measure of eps is used, calculated as reported eps adjusted to exclude exceptional items and the impact of changes in exchange rates, to apply a tax rate before exceptional items for each year and to exclude the impacts of IAS 19, 21 and 39 from net finance charges.

Average cash – for the purpose of the AIP, average cash is a metric where free cash flow delivery in each month is weighted by time.

Organic net sales growth – for the purpose of the PSP, the growth in the group's sales net of excise duties and calculated on a constant currency basis excluding the impact of acquisitions, in the year in which they arise, and disposals.

Organic operating margin improvement – for the purpose of the PSP, the movement in the group's organic operating margin. Organic operating margin is the ratio calculated by dividing organic operating profit by organic net sales expressed as a percentage. Organic operating profit is calculated on a constant currency basis excluding the impact of exceptional items, acquisitions, in the year in which they arise, and disposals.

TSR – for the purpose of the PSP, total shareholder return is the percentage growth in Diageo's share price assuming all dividends and capital distributions are reinvested.

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Corporate governance report

Dear Shareholder

On behalf of the board, I am pleased to present the corporate governance report for the year ended 30 June 2012.

Diversity on boards of directors and elsewhere in corporate life continues to be a significant theme in corporate governance. At Diageo, we have long believed that supporting and respecting all aspects of the diversity of our people is an important contributor to business performance as well as being the right thing to do. There are five nationalities represented on our board and four of the 10 directors are women. In addition to the individual skill sets that each director brings, we continue to believe that this helps to provide an appropriate perspective on business issues and a balance of the skills, experience, independence and knowledge of the company needed to enable the board to: discharge effectively its responsibilities for governance of the company, including setting the company's strategic aims and its values; providing the leadership to put them into effect; supervising and constructively challenging the management who are responsible for the day to day operational running of the business; and reporting to shareholders on their stewardship.

We endeavour in this report to give a sense of how these responsibilities are approached by describing our corporate governance structures and procedures and the work of the board and the executive committee.

The principal corporate governance rules applying to UK companies listed on the London Stock Exchange (LSE) for the year ended 30 June 2012 are contained in The UK Corporate Governance Code as updated and published by the Financial Reporting Council (FRC) in May 2010 (the Code) and the UK Financial Services Authority (FSA) Listing Rules, which require companies listed on the Main Market of the LSE to describe, in their annual report, their corporate governance from two points of view: the first dealing generally with their application of the Code's main principles and the second dealing specifically with non-compliance with any of the Code's provisions. The two descriptions together are designed to give shareholders a picture of governance arrangements in relation to the Code as a criterion of good practice. Diageo has complied with all relevant provisions set out in the Code throughout the year. The Code is publicly available under the heading 'Corporate Governance' at the website of the FRC, www.frc.org.uk.

Diageo must also comply with corporate governance rules contained in the FSA Disclosure and Transparency Rules as well as certain related provisions in the Companies Act 2006 (the Act).

As well as being subject to UK legislation and practice, as a company listed on the New York Stock Exchange (NYSE), Diageo is subject to the listing requirements of the NYSE and the rules of the Securities and Exchange Commission (SEC). Compliance with the provisions of the US Sarbanes-Oxley Act of 2002 (SOX), as it applies to foreign issuers, is continually monitored. Whilst the directors believe that the group's corporate governance policies continue to be robust, changes have been and will continue to be made in light of the rules that are in place at any point in time. Diageo follows UK corporate governance practice; differences from the NYSE corporate governance standards are summarised below within this report and on the company's website at www.diageo.com.

The way in which the Code's principles of good governance and relevant provisions of SOX and applicable laws and regulations are applied is described within this corporate governance report.

PD Tunnacliffe
Company secretary

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Corporate governance report (continued)

Board of directors

Membership of the board and board committees, other directorships and attendance at meetings The chairmen, senior non-executive director and other members of the board, audit committee, nomination committee and remuneration committee are as set out above in the biographies of directors and members of the executive committee. The directors' biographies also show the significant other commitments of the chairman and other directors and whether there have been any changes to them during the year. Directors' attendance during the year at board meetings, meetings of the audit, nomination and remuneration committees and at the annual general meeting was as set out in the table at the end of this report.

The board considers that it is beneficial for the executive directors to hold an external directorship to broaden their experience and normally this would be limited to one company. The chief executive, PS Walsh, holds UK non-executive directorships in Unilever PLC and Avanti Communications Group plc and a US non-executive directorship in FedEx Corporation. The time commitment for these three directorships is not considered to be onerous and the board considers that, given the importance of the United States to the company's business, the FedEx directorship is of benefit to Mr Walsh in terms of market awareness, US business practices and networking. The chief operating officer, IM Menezes, appointed a director on 2 July 2012, holds a US non-executive directorship in Coach, Inc. The chief financial officer, D Mahlan holds a UK non-executive directorship in Experian plc effective 1 September 2012.

There is a clear separation of the roles of the chairman and the chief executive. The chairman, Dr FB Humer, is responsible for the running of the board and for ensuring all directors are fully informed of matters sufficient to make informed judgements. As chief executive, PS Walsh has responsibility for implementing the strategy agreed by the board and for managing the group. He is supported in this role by the executive committee.

The non-executive directors, all of whom the board has determined are independent, are experienced and influential individuals from a range of industries, backgrounds and countries. Their diverse mix of skills and business experience is a major contribution to the proper functioning of the board and its committees, ensuring that matters are fully debated and that no individual or group dominates the board's decision-making processes.

Through the nomination committee, the board ensures that plans are in place for the succession of the executive and non-executive directors.

A summary of the terms and conditions of appointment of the non-executive directors is available at www.diageo.com or on request from the company secretary.

Activities of the board It is the responsibility of the chairman and the company secretary to work closely together in planning the annual programme and agendas for meetings. During the year, six scheduled board meetings were held, five in the United Kingdom and one in Turkey, which incorporated a specific Turkey and Western Europe business focus and involved visits to customers. In addition, an annual strategy conference with the full executive committee was held offsite at which the group's strategy was reviewed in depth.

When directors were unable to attend a meeting, they were advised of the matters to be discussed and took advantage of the opportunity to make their views known to the chairman prior to the meeting. The board manages overall control of the company's affairs with reference to the formal schedule of matters reserved for the board for decision. The schedule was last revised in June 2012.

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Corporate governance report (continued)

The board makes decisions and reviews and approves key policies and decisions of the company, in particular in relation to: group strategy and operating plans; corporate governance; compliance with laws, regulations and the company's code of business conduct; business development, including major investments and disposals; financing and treasury; appointment or removal of directors and the company secretary; risk management; financial reporting and audit; corporate sustainability and responsibility, ethics and the environment; and pensions.

The Act sets out directors' general duties concerning conflicts of interest and related matters. The board has agreed an approach and adopted guidelines for dealing with conflicts of interest and has added responsibility for authorising conflicts of interest to the schedule of matters reserved for the board. The board confirmed that it was aware of no situations that may or did give rise to conflicts with the interests of the company other than those that may arise from directors' other appointments as disclosed in their biographies above. In accordance with the articles, the board authorised the chairman or the company secretary, as appropriate, to receive notifications of conflicts of interest on behalf of the board and to make recommendations as to whether the relevant matters should be authorised by the board. The company has complied with these procedures during the year.

All directors are equally accountable for the proper stewardship of the company's affairs.

The non-executive directors have a particular responsibility for ensuring that the business strategies proposed are fully discussed and critically reviewed. This enables the directors to promote the success of the company for the benefit of its shareholders as a whole, whilst having regard to, among other matters, the interests of employees, the fostering of business relationships with customers, suppliers and others, and the impact of the company's operations on the communities in which the business operates and the environment.

The non-executive directors also oversee the operational performance of the whole group. To do this they have full and timely access to all relevant information, with updates also provided on governance and regulatory matters affecting the company. In addition, executive committee members and other senior executives are invited, as appropriate, to board and strategy meetings to make presentations on their areas of responsibility. The chairman and non-executive directors are also invited to attend the executive committee members' senior leadership meetings to gain further insight into different aspects of the business.

In order to fulfil their duties, procedures are in place for directors to seek both independent advice and the advice and services of the company secretary who is responsible for advising the board, through the chairman, on all governance matters. The non-executive directors meet independently without the chairman present, and also meet with the chairman independently of management, on a regular basis.

The non-executive directors fulfil a key role in corporate accountability. The remits of the audit, the nomination and the remuneration committees of the board are set out below and membership of these committees is as set out above in the 'Board of directors and executive committee' section of this annual report. The company secretary acts as secretary to all of these committees. The terms of reference of the committees are available on the company's website at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Induction, training and business engagement There is a formal induction programme for new directors; they meet with the executive committee members individually and receive orientation training from the relevant senior executive in relation to the group and its business, for example in relation to its assurance processes, environmental and social policies, corporate responsibility policies and practices

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Corporate governance report (continued)

and governance matters. Following this initial induction, appropriate business engagements are arranged for the chairman and the non-executive directors. In addition to those associated with overseas board meetings, during the year these included: visits to the supply operations in Scotland; the chairman of the audit committee's visit to the Nigerian operations; the chairman and senior independent director taking advantage of overseas business commitments to meet with local management; and visits to the customer collaboration centre in the UK.

All directors are provided with the opportunity, and encouraged to attend regular training to ensure they are kept up to date on relevant legal developments or changes and best practice and changing commercial and other risks. Typical training experience for directors includes attendance at seminars, forums, conferences and working groups and, during the year ended 30 June 2012, also included internally led training on compliance, information security and business continuity. Training for directors is kept under review during the year and forms part of the chairman's individual meetings held with each director, with feedback sought from directors on areas and topics that they want to be covered.

Performance evaluation During the year, an evaluation of the board's effectiveness, including the effectiveness of the audit committee, the nomination committee and the remuneration committee was undertaken internally by way of a written questionnaire followed by the chairman of the board meeting individually with all directors.

The board questionnaire focused on the performance of the board throughout the past year in the areas of: strategy, and how effective the board had been in supporting the development of strategy; performance management; management succession, and talent; risk management; ensuring appropriate knowledge of the business and its people; the board's collective judgement; boardroom dynamics; areas in which the board felt it could improve its performance; and external factors that the board should remain particularly alert to.

The questionnaires for the committees focused on the performance of the respective committees throughout the past year; whether the agendas appropriately covered the remits of the committees; how the performance of the respective committees could be enhanced and areas of focus for the forthcoming year.

A report was prepared for the board on its effectiveness and that of its committees. The report concluded that the board and its committees continued to operate effectively, meeting the requirements and spirit of the Code. Processes were seen to have improved to allow a focus and time spent on the most important matters for the company, including the development of strategy, and the climate in the boardroom continued to create the optimum conditions for good decision making and sound guidance. The importance of ensuring appropriate succession to the board to maintain boardroom dynamics and the appropriate balance of skills, knowledge, diversity and experience was recognised in the search for non-executive directors and the appointment, with effect from 1 October 2012, of Ho KwonPing.

Areas identified for the board and committees to maintain the appropriate governance for and development of the business have been integrated into the evolving annual agendas of the board and its committees.

The performance of each director was evaluated by the chairman based on self-analysis and input from the other directors. A report on the individual performance evaluation process was given to the nomination committee. Following the performance evaluation of individual directors, the chairman has confirmed that the non-executive directors standing for re-election at this year's annual general meeting continue to perform effectively and demonstrate commitment to their roles. The chairman's

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Corporate governance report (continued)

performance was evaluated by the directors, using an internally produced questionnaire which was completed and returned to the senior non-executive director, who discussed the feedback in a meeting with the executive and non-executive directors and then privately with the chairman.

It is the board's intention to continue to review annually its performance and that of its committees and individual directors. In respect of the evaluation process in 2013, it is likely that the same method of internal facilitation will be used.

Audit committee

Role of the audit committee The audit committee is responsible for monitoring and reviewing:

- the integrity of the financial statements, including a review of the significant financial reporting judgements contained in them;
- the effectiveness of the group's internal control and risk management and of control over financial reporting;
- the effectiveness of the global audit and risk function, including the programme of work undertaken by that function;
- the group's policies and practices concerning business conduct and ethics, including whistleblowing;
- the group's overall approach to securing compliance with laws, regulations and company policies in areas of risk; and
- the company's relationship with the external auditor, including its independence and management's response to any major external audit recommendations.

For the purposes of the Code and the relevant rule under the US Securities Exchange Act of 1934 (Exchange Act), the board has determined that PG Scott is independent and may be regarded as an audit committee financial expert.

The chairman, the chief financial officer, the group controller, the head of global audit and risk, the group chief accountant and the external auditor are normally invited to attend meetings.

The audit committee met privately with the external auditor and with the head of global audit and risk as appropriate.

Work of the audit committee During the year, the audit committee formally reviewed the annual reports and associated preliminary year-end results announcement, focusing on key areas of judgement, provisioning and complexity, critical accounting policies and any changes required in these areas or policies. In addition, the audit committee reviewed the interim results announcement, which included the interim financial statements and the company's interim management statements. The audit committee also reviewed the work of the filings assurance committee described below and was updated on litigation risks by the group's general counsel.

The audit committee received detailed presentations from certain senior executives on the management of key risk and control issues in their respective business areas, reviewed the effectiveness and findings from internal control and risk management processes described below and reviewed the work of the compliance programme and the work of the audit and risk committee, described below.

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Corporate governance report (continued)

The audit committee had available to it the resources of the global audit and risk function, the activities of which are described below.

During the year, the audit committee reviewed the external audit strategy and the findings of the external auditor from its review of the interim results and its audit of the consolidated financial statements.

The audit committee reviews annually the appointment of the auditor and, on the audit committee's recommendation, the board agreed in August 2012 to recommend to shareholders at the annual general meeting in 2012, the re-appointment of the external auditor for a period of one year. The current overall tenure of the external auditor dates from 1997. Any decision to open the external auditor to tender is taken on the recommendation of the audit committee, based on the results of the effectiveness review described below. There are no contractual obligations that restrict the company's current choice of external auditor.

The audit committee assessed the ongoing effectiveness of the external auditor and audit process on the basis of meetings and a questionnaire-based internal review with finance and global audit and risk staff and other senior executives. In reviewing the independence of the external auditor, the audit committee considered a number of factors. These include: the standing, experience and tenure of the external audit director; the nature and level of services provided by the external auditor; and confirmation from the external auditor that it has complied with relevant UK and US independence standards.

The group has a policy on auditor independence and on the use of the external auditor for non-audit services, which is reviewed annually, most recently in June 2012. Under this policy the provision of any non-audit service must be approved by the audit committee, unless the proposed service is both expected to cost less than £250,000 and also falls within one of a number of service categories which the audit committee has pre-approved. These pre-approved service categories may be summarised as follows:

- accounting advice, employee benefit plan audits, and audit or other attestation services, not otherwise prohibited;
- due diligence and other support in respect of acquisitions, disposals, training and other business initiatives; and
- certain specified tax services, including tax compliance, tax planning and related implementation advice in relation to acquisitions, disposals and other reorganisations.

Fees paid to the auditor for audit, audit related and other services are analysed in note 3(c) to the consolidated financial statements. The main non-audit related services provided by the auditor during the year were in respect of due diligence work for potential acquisitions, a review of internal controls, process review and tax advice. The auditor was considered to be best placed to provide these services and was the provider that offered the best value. The nature and level of all services provided by the external auditor is a factor taken into account by the audit committee when it reviews annually the independence of the external auditor.

Nomination committee

Role of the nomination committee The nomination committee is responsible for keeping under review the composition of the board and succession to it, and succession planning for senior management positions. It makes recommendations to the board concerning appointments to the board, whether of

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Corporate governance report (continued)

executive or non-executive directors, having regard to the balance and structure of the board and the required blend of skills, experience, independence and diversity.

The nomination committee also makes recommendations to the board concerning the re-appointment of any non-executive director at the conclusion of his or her specified term and the re-election of any director by shareholders under the retirement provisions of the company's articles of association. No director is involved in determining his or her own re-appointment or re-election.

Any new directors are appointed by the board and, in accordance with the company's articles of association, they must be elected at the next AGM to continue in office. All existing directors retire by rotation every year, as required by the Code.

Activities of the nomination committee The principal activities of the nomination committee during the year were: the review of individual performance; a review of the executive committee structure, membership and succession planning for it and senior leadership positions; and the consideration of potential non-executive directors.

In respect of the appointment of Ho KwonPing to the board with effect from 1 October 2012, the recruitment process included the development of a candidate profile and the engagement of a professional search agency specialising in the recruitment of high calibre non-executive directors. Reports on potential appointees were provided to the committee, which, after careful consideration, made a recommendation to the board.

In respect of the appointment of IM Menezes to the board and his appointment as chief operating officer, the committee made a recommendation to the board, believing that the appointments strengthened the executive leadership of the business.

Diageo supports diversity within its board of directors, including gender diversity. Currently there are four female directors, out of a total of 10 board members. We believe that all four bring a wealth of international business experience and are an asset to the company and the board.

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.

For similar reasons, Diageo has set itself a goal to increase the number of women in leadership positions in the company. Currently 26% (2011: 27%) fill leadership positions. The aim of the board is to continue to ensure that the company has the right balance of skills, diversity, in all forms, and experience.

This approach has led Diageo to be well represented by women on the board and having fully considered the succession to the executive committee and to leadership positions over the ensuing years, the board is confident it will continue to be able to report progress on the gender diversity agenda.

Remuneration committee

Role of the remuneration committee The role of the remuneration committee and details of how the company applies the principles of the Code in respect of directors' remuneration are set out in the directors' remuneration report.

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Corporate governance report (continued)

The chairman and the chief executive may, by invitation, attend remuneration committee meetings, except when their own remuneration is discussed. No director is involved in determining his or her own remuneration.

Executive direction and control

Executive committee The executive committee, appointed and chaired by the chief executive, consists of the individuals responsible for the key components of the business: the North America, Europe, Africa, Latin America and Caribbean and Asia Pacific markets, global supply and global functions. The members of the committee and their biographies are set out above in the 'Board of directors and executive committee' section of this annual report. During the year, IM Menezes was appointed chief operating officer and L Schwartz was appointed president of North America.

The executive committee met, fully, five times during the year, and spent most of its time discussing strategy, including individual market and brand (and category) strategies, management succession and talent and other people matters, and financial and operational performance. Meetings were held in the US, the UK (three meetings) and India. In addition, scheduled interim update meetings were held by teleconference throughout the year. Responsibility and authority (within the financial limits set by the board) are delegated by the chief executive to individual members of the executive committee who are accountable to him for the performance of their business units.

Executive direction and control procedures include approval of annual strategic plans submitted by each business unit executive and periodic business reviews. These reviews are generally attended by the regional president responsible for the market (and in certain cases additional members of the executive committee) and are held in the relevant market. The reviews focus on business performance management and specific issues around brands, people, key business decisions and risk management.

The chief executive has created several executive working groups to which are delegated particular tasks, generally with specific time spans and success criteria. He has also created committees, intended to have an ongoing remit, including the following.

Audit and risk committee Chaired by the chief executive and responsible for: overseeing the approach to securing effective internal control and risk management in the group; reviewing the adequacy of the group's sources of assurance over the management of key risks; reviewing management's self-assessment process over internal controls; reviewing the effectiveness of the group's compliance programme; and reporting periodically on the above to the audit committee or to the board. In addition, the audit and risk committee is responsible for promoting the culture and processes that support effective compliance with the group's codes of conduct, global policies and business guidelines throughout the business and supports the audit committee, board and executive committee in satisfying its corporate governance responsibilities relating to internal control and risk management within the group.

Corporate citizenship committee Chaired by the chief executive and responsible for making decisions or, where appropriate, recommendations to the board or executive committee concerning policies, issues and measurement and reporting for the following impacts across Diageo's value chain: alcohol in society; water; broader environmental sustainability; community; our people and governance and ethics. Progress in these areas is reported periodically to the board and publicly through a separate Sustainability & Responsibility Report, selected aspects of which are subject to external assurance. This report and the group's social, ethical and environmental policies are published on the Diageo website.

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Corporate governance report (continued)

Two executive working groups (one on alcohol in society, chaired by the corporate relations director, and one on environmental performance, chaired by the president, global supply and global procurement) assist the committee with decisions on specific issues.

Finance committee Chaired by the chief financial officer and including the chief executive, this committee is responsible for making recommendations to the board on funding strategy, capital structure and management of financial risks and the policies and control procedures (including financial issues relating to treasury and taxation) required to implement the company's financial strategy and financial risk management policies. In certain specific circumstances, the board has delegated authority to the finance committee to make decisions in these areas. Treasury activity is managed centrally within tightly defined dealing authorities and procedures recommended by the finance committee and approved by the board.

Filings assurance committee Chaired by the chief financial officer and including the chief executive, this committee is responsible for implementing and monitoring the processes which are designed to ensure that the company complies with relevant UK, US and other regulatory reporting and filing provisions, including those imposed by SOX or derived from it. As at the end of the period covered by this report, the filings assurance committee, with the participation of the chief executive and chief financial officer, carried out an evaluation of the effectiveness of the design and operation of disclosure controls and procedures. These are defined as those controls and procedures that are designed to ensure that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarised and reported within specified time periods. As of the date of the evaluation, the chief executive and the chief financial officer concluded that the design and operation of these disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that the company files or submits under the Exchange Act is accumulated and communicated to the management, including the company's chief executive and chief financial officer, as appropriate, to allow timely decisions regarding disclosure.

Additional information

Internal control and risk management

Diageo's aim is to manage risk and to control its business and financial activities cost-effectively and in a manner that enables it to: exploit profitable business opportunities in a disciplined way; avoid or reduce risks that can cause loss, reputational damage or business failure; support operational effectiveness; and enhance resilience to external events. To achieve this, an ongoing process has been established for identifying, evaluating and managing risks faced by the group. This process, which complies with the requirements of the Code, has been in place for the full financial year and up to the date the financial statements were approved and accords with the guidance issued by the Financial Reporting Council in October 2005, 'Internal Control: Revised Guidance for Directors on the Combined Code', also known as the Turnbull guidance (as amended by the Flint review).

The board acknowledges that it is responsible for the company's systems of internal control and risk management and for reviewing their effectiveness. The board confirms that, through the activities of the audit committee described above, it has reviewed the effectiveness of the company's systems of internal control and risk management described below.

All business units and the executive committee are required to maintain a process to ensure key risks are identified, evaluated and managed appropriately. This process is also applied to major business decisions or initiatives, such as systems implementations, new product development, business

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Corporate governance report (continued)

combination activity or significant business strategy implementation. Additional risk management activity is focused directly towards operational risks within the business, including health and safety, product quality and environmental risk management.

Business unit risk assessments, and the activities planned to manage those risks, are reviewed by relevant executives, for example at periodic business reviews. The oversight of primary level risks, as detailed in the executive committee risk assessment, is allocated as appropriate between the board, board committees and the executive committee. The executive committee risk assessment, and selected key risk assessments, are reviewed by the audit and risk committee and by the audit committee.

In addition, business units are required to self-assess the effectiveness of the design of their internal control framework. Relevant executives review the results of these self-assessments and summary reporting is provided to the audit and risk committee and audit committee. Risk management and internal control processes encompass activity to mitigate financial, operational, compliance and reputational risk. Specific processes are also in place to ensure management maintain adequate internal control over financial reporting, as separately reported below.

A network of risk management committees is in place across the group, which has overall accountability for supporting the audit and risk committee in its corporate governance responsibilities by proactively and effectively identifying and managing risk and monitoring the effectiveness of internal controls.

Processes are in place to ensure appropriate action is taken, where necessary, to remedy any deficiencies identified through the group's internal control and risk management processes.

The global governance and control and global audit and risk functions give the audit committee, board and executive committee visibility and understanding of the group's key risks and risk management capability and provide assurance over the quality of the group's internal control and management of key risks in line with a plan agreed by the audit committee.

The above risk management processes and systems of internal control, together with the filings assurance processes, are designed to manage, rather than eliminate, the risk of failure to achieve the group's strategic objectives. It should be recognised that such systems can only provide reasonable, not absolute, assurance against material misstatement or loss.

During the year, in line with the revised principles of the Code, the board considered the nature and extent of the risks it was willing to take to achieve its strategic goals and reviewed the existing internal statement of risk appetite, which describes existing risk behaviours and identifies a set of high level risk statements underpinning them. The statement of risk appetite serves to complement Diageo's risk policy and was considered and recommended to the board by both the audit and risk committee and the audit committee.

The company has in place internal control and risk management systems in relation to the company's financial reporting process and the group's process for preparation of consolidated accounts. These systems are described above and under the headings 'Filings assurance committee', 'Audit and risk committee' and 'Management's report on internal control over financial reporting'. Diageo's filings assurance committee and audit and risk committee are each responsible for overseeing elements of these internal control and risk management systems. Furthermore, a review of the consolidated financial statements is completed by management to ensure that the financial position and results of the group are appropriately reflected therein.

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Corporate governance report (continued)

Compliance and ethics programme

Diageo is committed to conducting its business responsibly and in accordance with all laws and regulations to which its business activities are subject. The board has a comprehensive training and education programme for both employees and the network of compliance and ethics ambassadors, whose role it is to be the key point of contact for compliance within each market and function. The code of business conduct is also supported by a set of global policies. Work commenced during the year to simplify these policies and to make access and governance of the policies easier.

The Diageo marketing code together with Diageo's digital code of practice remain the principles that Diageo follows in relation to marketing and promotional activities of its brands and products.

In addition, in accordance with the requirements of SOX (and related SEC rules), Diageo has adopted a code of ethics covering its chief executive, chief financial officer, regional presidents and other identifiable persons in the group, including those performing senior accounting and controller functions. No amendments to, or waivers in respect of, the code of ethics were made during the year. The full texts of the code of ethics, code of business conduct, marketing code and other Diageo policies that comprise the compliance programme are available on the company's website at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Compliance and ethics programme guidelines specify the manner in which any potential violations of these codes should be dealt with, including line manager reporting and an independent 'SpeakUp' employee help line. The latter is operated independently and all reports are sent, in confidence, to the global compliance and ethics director and head of corporate security for review, and where appropriate, investigation and escalation to the audit committee as required. There is an annual certification requirement for all management level employees to confirm compliance with the code of business conduct and to identify areas of possible non-compliance to the global compliance and ethics director. To reinforce our stand against bribery or corruption in any form and to create greater simplicity in our guidance in this area, Diageo launched a new global anti-corruption policy during the year.

Both the audit and risk committee and the audit committee review the operation of the compliance programme.

Relations with shareholders

The company values its dialogue with both institutional and private investors. The board's primary contact with institutional shareholders is through the chief executive and chief financial officer.

The chief executive and chief financial officer are supported by the investor relations department, who are in regular contact with institutional shareholders and sell-side analysts. Coverage of the company by sell-side analysts is circulated to the board. The board also ensures that all directors develop an understanding of the views of major institutional shareholders through an independent survey of shareholder opinion. In addition, major shareholders are invited to raise any company matters of interest to them at an annual meeting with the chairman and senior non-executive director. The chairman reports on any meeting to the board. As reported in the remuneration report, shareholder engagement meetings were also held with the chairman of the remuneration committee.

Investor seminars and analyst presentations, including those following the announcement of interim results and preliminary year end results, are webcast and other presentations made to institutional investors are available on the company's website.

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Corporate governance report (continued)

For the year ended 30 June 2012, Diageo produced an annual report, which is available to all shareholders on its website, or in paper form by election or on request. As an alternative to receiving a paper notification through the post, shareholders may elect to receive email notification that the documents are available to be accessed on the company's website. Shareholders can also choose to receive email notification when new company information is published on www.diageo.com. The website also provides private shareholders with the facility to check their shareholdings online and to send any questions they may have to the company. Private shareholders are invited to write to the chairman or any other director and express their views on any issues of concern at any time and the AGM provides an opportunity for private shareholders to put their questions in person.

The chairmen of the audit, nomination and remuneration committees are normally available at the AGM to take any relevant questions and all other directors attend, unless illness or another pressing commitment precludes them from doing so. At general meetings, a schedule of the proxy votes cast is made available to all shareholders and is published on www.diageo.com. The company proposes a separate resolution on each substantially separate issue and does not bundle resolutions together inappropriately. Non-binding resolutions on the receipt of the reports and accounts and the approval of the directors' remuneration report are put to shareholders at the AGM.

Charitable and political donations

During the year, total charitable donations made by the group were £28.7 million (2011 – £28.0 million). UK group companies made donations of £12.0 million (2011 – £10.5 million) to charitable organisations including £1.1 million (2011 – £1.1 million) to the Diageo Foundation and £8.1 million (2011 – £7.7 million) to the Thalidomide Trust. In the rest of the world, group companies made charitable donations of £16.7 million (2011 – £17.5 million) including £1.5 million to the Thalidomide Foundation Ltd in Australia (2011 – £3.0 million).

The group has not given any money for political purposes in the United Kingdom and made no donations to EU political organisations and incurred no EU political expenditure during the year. The group made contributions to non-EU political parties totalling £0.4 million during the year (2011 – £0.6 million). These were all made, consistent with applicable laws, to federal and state candidates and committees in North America, where it is common practice to make political contributions. No particular political persuasion was supported and contributions were made with the aim of promoting a better understanding of the group and its views on commercial matters, as well as a generally improved business environment.

Supplier payment policies and performance

Given the international nature of the group's operations, there is no group standard in respect of payments to suppliers. The group has moved to a standard term of 60 days in respect of payments to the majority of suppliers. Where this standard term does not yet apply, operating companies are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, so that suppliers are aware of the terms of payment and the relevant terms are included in contracts where appropriate. Creditor days for Diageo plc have not been calculated, as the company had no material trade creditors at 30 June 2012. The majority of the company's invoices for goods and services are settled by subsidiaries acting on its behalf.

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Corporate governance report (continued)

Going concern

The group's business activities together with significant risk factors are set out above in the 'Business description' section of this annual report. The liquidity position, capital resources and risk management processes covering exposure to currency, interest rate, credit, liquidity and price risk are described in the notes to the consolidated financial statements.

The group has significant financial resources, strong cash generation from operations and good access to debt markets. Consequently, the directors believe that the group is well placed to manage its business risks despite the current uncertain economic environment.

The directors confirm that, after making appropriate enquiries, they have reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Management's report on internal control over financial reporting

Management, under the supervision of the chief executive and chief financial officer, is responsible for establishing and maintaining adequate control over the group's financial reporting. Diageo's internal control over financial reporting includes policies and procedures that: pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements 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); provide reasonable assurance that receipts and expenditures are made only in accordance with authorisation of management and the directors of the company; and provide reasonable assurance regarding prevention or timely detection of any unauthorised acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Management has assessed the effectiveness of Diageo's internal control over financial reporting (as defined in Rules 13(a)-13(f) and 15(d)-15(f) under the Exchange Act) based on the framework in 'Internal Control – Integrated Framework', issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based on this assessment, management concluded that, as at 30 June 2012, internal control over financial reporting was effective.

Any internal control framework, no matter how well designed, has inherent limitations, including the possibility of human error and the circumvention or overriding of controls and procedures and may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

During the period covered by this report, there were no changes in internal control over financial reporting that have materially affected or are reasonably likely to materially affect the effectiveness of internal control over financial reporting.

KPMG Audit Plc, an independent registered public accounting firm, who also audit the group's consolidated financial statements, has audited the effectiveness of the group's internal control over financial reporting, and has issued an unqualified report thereon, which is included on the page 242 and 243 of this document.

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Corporate governance report (continued)

Directors' responsibilities in respect of the annual report and financial statements

The directors are responsible for preparing the annual report, the information filed with the SEC on Form 20-F and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with IFRS as adopted for use in the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice). The directors have taken responsibility to prepare the group financial statements also in accordance with IFRS as issued by the IASB. The directors have also presented certain additional information required by the SEC for the purposes of the company's Form 20-F.

The group financial statements are required by law and IFRS to present fairly the financial position and the performance of the group; the Act provides in relation to such financial statements that references in the relevant part of the Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRS as adopted for use in the EU and IFRS as issued by the IASB;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006 and, with regard to group consolidated financial statements, Article 4 of the IAS Regulation. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable UK and US law and regulations, the directors are also responsible for preparing a directors' report, a directors' remuneration report and a corporate governance report that comply with that law and those regulations.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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Corporate governance report (continued)

Responsibility statement

Each of the directors, whose names are set out above in the 'Board of directors and executive committee' section of this annual report, confirms that to the best of his or her knowledge:

- the consolidated financial statements contained in the annual report for the year ended 30 June 2012, which have been prepared in accordance with IFRS as issued by the IASB and as endorsed and adopted for use in the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group; and
- the management report represented by the directors' report contained in the annual report for the year ended 30 June 2012 includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that the group faces.

The responsibility statement was approved by the board of directors on 22 August 2012.

New York Stock Exchange corporate governance rules

Under applicable SEC rules and the NYSE's corporate governance rules for listed companies, Diageo must disclose any significant ways in which its corporate governance practices differ from those followed by US companies under NYSE listing standards.

Diageo believes the following to be the significant areas in which there are differences between its corporate governance practices and NYSE corporate governance rules applicable to US companies. This information is also provided on the company's website at www.diageo.com.

- Basis of regulation: UK listed companies are required to include in their annual report a narrative statement of (i) how they have applied the principles of the Code and (ii) whether or not they have complied with the best practice provisions of the Code. NYSE listed companies must adopt and disclose their corporate governance guidelines. Diageo complied throughout the year with the best practice provisions of the Code.
- Director independence: the Code requires at least half the board (excluding the chairman) to be independent non-executive directors, as determined by affirmatively concluding that a director is independent of management and free from any relationship that could materially interfere with the exercise of independent judgement. NYSE rules require a majority of independent directors, according to the NYSE's own 'brightline' tests and an affirmative determination by the board that the director has no material relationship with the listed company. Diageo's board has determined that, in its judgement and without taking into account the NYSE brightline tests, all of the non-executive directors are independent. As such, currently six of Diageo's 10 directors are independent.
- Chairman and chief executive: the Code requires these roles to be separate. There is no corresponding requirement for US companies. Diageo has a separate chairman and chief executive.
- Non-executive director meetings: NYSE rules require non-management directors to meet regularly without management and independent directors to meet separately at least once a year. The Code requires non-executive directors to meet without the chairman present at least annually to appraise the chairman's performance. During the year, Diageo's chairman and

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Corporate governance report (continued)

non-executive directors met four times as a group without executive directors being present, and the independent directors met once without the chairman.

- **Board committees:** Diageo has a number of board committees that are similar in purpose and constitution to those required by NYSE rules. Diageo's audit, remuneration and nomination committees consist entirely of independent non-executive directors (save that the chairman of the nomination committee, Dr FB Humer, is not independent). Under NYSE standards, companies are required to have a nominating/corporate governance committee, which develops and recommends a set of corporate governance principles and is composed entirely of independent directors. The terms of reference for Diageo's nomination committee, which comply with the Code, do not contain such a requirement. In accordance with the requirements of the Code, Diageo discloses in its annual report the results and means of evaluation of the board, its committees and the directors, and it provides extensive information regarding directors' compensation in the directors' remuneration report.
- **Code of ethics:** NYSE rules require a code of business conduct and ethics to be adopted for directors, officers and employees and disclosure of any waivers for executive directors or officers. Diageo has adopted a code of business conduct for all directors, officers and employees, as well as a code of ethics for senior officers in accordance with the requirements of SOX. Currently, no waivers have been granted to directors or executive officers.
- **Compliance certification:** NYSE rules require CEOs to certify to the NYSE their awareness of any NYSE corporate governance violations. Diageo is exempt from this as a foreign private issuer but is required to notify the NYSE if any executive officer becomes aware of any non-compliance with NYSE corporate governance standards. No such notification was necessary during the period covered by this report.

Directors' attendance record at the annual general meeting, board meetings and board committee meetings, for the year ended 30 June 2012 was as set out in the table below. For board and board committee meetings, attendance is expressed as the number of meetings attended out of the number that each director was eligible to attend.

	Annual General Meeting 2011	Board (maximum 6)	Audit committee (maximum 6)	Nomination committee (maximum 5)	Remuneration committee (maximum 5)
Dr FB Humer	✓	6/6	6/6*	5/5	5/5
PS Walsh	✓	6/6	3/6**	5/5*	5/5
D Mahlan	✓	6/6	6/6*	n/a	1/5**
Lord Hollick	✓	2/2	2/2	2/2	1/1
PB Bruzelius	✓	6/6	5/6	5/5	4/5
LM Danon	✓	6/6	5/6	5/5	5/5
Lord Davies	✓	6/6	6/6	5/5	5/5
BD Holden	✓	6/6	6/6	5/5	5/5
PG Scott	✓	6/6	6/6	4/5	5/5
HT Stitzer	✓	6/6	6/6	5/5	5/5
PA Walker	✓	2/2	2/2	2/2	1/1

* Attended by invitation.

** Attended by invitation, for part only.

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Directors' report

The directors have pleasure in submitting their Annual Report for the year ended 30 June 2012.

Annual General Meeting

The AGM will be held at Church House Conference Centre, Dean's Yard, Westminster, London SW1P 3NZ at 2.30pm on Wednesday, 17 October 2012.

Dividends

Diageo paid an interim dividend of 16.60 pence per ordinary share on 10 April 2012. The directors recommend a final dividend of 26.90 pence per ordinary share. Subject to approval by shareholders, the final dividend will be paid on 22 October 2012 to ordinary shareholders on the register on 7 September 2012. Payment to US ADR holders will be made on 26 October 2012. A dividend reinvestment plan, which enables ordinary shareholders to invest their dividends in ordinary shares, is available in respect of the final dividend and the plan notice date is 1 October 2012.

Directors

The directors of the company who served during the year are shown in the section 'Board of directors and company secretary' and 'Executive committee' above.

In accordance with the UK Corporate Governance Code, all the directors retire by rotation at the AGM and offer themselves for re-election. The non-executive directors proposed for re-election do not have service contracts.

Further details of directors' contracts, remuneration and their interests in the shares of the company at 30 June 2012 are given in the directors' remuneration report above.

The directors' powers are determined by UK legislation and Diageo's articles of association. The directors may exercise all the company's powers provided that Diageo's articles of association or applicable legislation do not stipulate that any powers must be exercised by the members.

Auditor

The auditor, KPMG Audit Plc, is willing to continue in office and a resolution for its re-appointment as auditor of the company will be submitted to the AGM.

Disclosure of information to the auditor

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor is unaware; and each director has taken all reasonable steps to ascertain any relevant audit information and to ensure that the company's auditor is aware of that information.

Business review

The review of the business of the company and the description of the principal risks and uncertainties facing the company, prepared in accordance with the Companies Act 2006, comprises the following sections of the Annual Report: the Chief executive's review, the Business description and the Business review.

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Directors' report (continued)

Corporate governance statement

The corporate governance statement, prepared in accordance with rule 7.2 of the FSA's Disclosure and Transparency Rules, comprises the following sections of the Annual Report: the 'Corporate governance report' and the 'Additional information for shareholders.'

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for Diageo's counterparties upon a change of control of the company.

Under the agreement governing the company's 34% investment in Moët Hennessy SNC (MH) and Moët Hennessy International SAS (MHI), if a competitor (as defined therein) directly or indirectly takes control of the company (which, for these purposes, would occur if such competitor acquired more than 34% of the voting rights or equity interests in the company), LVMH Moët Hennessy – Louis Vuitton SA (LVMH) may require the company to sell its shares in MH and MHI to LVMH.

The master agreement governing the operation of the group's regional joint ventures with LVMH states that upon a change of control of the company (being, for these purposes, the acquisition by a third party of 30% or more of the issued share capital having voting rights in the company), LVMH may either appoint and remove the chairman of each joint venture entity governed by such master agreement, who shall be given a casting vote, or require each joint venture entity to be wound up.

Agreements for the distribution of the Jose Cuervo tequila brands allow Casa Cuervo SA de C.V. and certain of its affiliates (jointly, Cuervo) the right to terminate such agreements upon a change of control of the company, if Cuervo's advance written consent to the change of control is not obtained.

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Directors' report (continued)

Other information

Other information relevant to the directors' report may be found in the following sections of the Annual Report:

Information	Location in Annual Report
Amendment of articles of association	Additional information for shareholders – Articles of association
Charitable and political donations	Corporate governance report
Corporate citizenship	Corporate governance report
Directors – appointment and powers	Additional information for shareholders – Articles of association
Directors' indemnities and compensation	Directors' remuneration report
Employment policies	Business description – Business overview – Employees
Events since 30 June 2012	Financial statements – note 35 Post balance sheet events
Financial risk management	Financial statements – note 23 Financial instruments and risk management
Future developments	Business review – Trend information
Purchase of own shares	Business review – Liquidity and capital resources and Financial statements – note 28 Share capital and reserves
Principal activities of the company and its subsidiary undertakings in the course of the year	Financial statements – Principal group companies
Research and development	Business description – Business overview – Research and development
Share capital – structure, voting and other rights	Additional information for shareholders – Share capital and Articles of association
Share capital – employee share plan voting rights	Financial statements – note 34 Employee share compensation
Shareholdings in the company	Additional information for shareholders – Share capital
Supplier payment policies and performance	Corporate governance report

The directors' report of Diageo plc for the year ended 30 June 2012 comprises these pages and the sections of the Annual Report referred to under 'Directors', 'Business review', 'Corporate governance statement' and 'Other information' above, which are incorporated into the directors' report by reference.

The directors' report was approved by a duly appointed and authorised committee of the board of directors on 22 August 2012 and signed on its behalf by PD Tunnacliffe, the company secretary.

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Financial statements – contents

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Report of independent registered public accounting firm

The board of directors and shareholders
Diageo plc:

We have audited the accompanying consolidated balance sheets of Diageo plc and subsidiaries as of 30 June 2012 and 2011, and the related consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the years in the three-year period ended 30 June 2012 on pages 144 to 240, including the disclosures identified as ‘part of the audited financial statements’ within the ‘Critical accounting policies’ section on pages 85 to 86, the ‘Share and other interests’ on page 119 to 120, the ‘Key management personnel related party transactions’ on page 121 and the ‘Principal group companies’ on page 241. These consolidated financial statements are the responsibility of the Diageo plc’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Diageo plc and subsidiaries as of 30 June 2012, and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended 30 June 2012, in conformity with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and IFRS as adopted by the European Union.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Diageo plc’s internal control over financial reporting as of 30 June 2012, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO), and our report dated 22 August 2012 expressed an unqualified opinion on the effectiveness of the company’s internal control over financial reporting.

KPMG Audit Plc
London, England
22 August 2012

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Consolidated income statement

	Notes	Year ended 30 June 2012 £ million	Year ended 30 June 2011 £ million	Year ended 30 June 2010 £ million
Sales	2	14,594	13,232	12,958
Excise duties	3	(3,832)	(3,296)	(3,178)
Net sales	2	10,762	9,936	9,780
Cost of sales	3,5	(4,259)	(4,010)	(4,099)
Gross profit		6,503	5,926	5,681
Marketing	3	(1,691)	(1,538)	(1,419)
Other operating expenses	3,5	(1,654)	(1,793)	(1,688)
Operating profit	2	3,158	2,595	2,574
Sale of businesses	5	147	(14)	(15)
Interest receivable	6	262	278	469
Interest payable	6	(644)	(647)	(844)
Other finance income	6	8	—	4
Other finance charges	6	(23)	(28)	(91)
Share of associates' profits after tax	7	213	176	142
Profit before taxation		3,121	2,360	2,239
Taxation	8	(1,038)	(343)	(477)
Profit from continuing operations		2,083	2,017	1,762
Discontinued operations	9	(11)	—	(19)
Profit for the year		2,072	2,017	1,743
Attributable to:				
Equity shareholders of the parent company		1,942	1,900	1,629
Non-controlling interests		130	117	114
		2,072	2,017	1,743
Basic earnings per share	10			
Continuing operations		78.2p	76.2p	66.3p
Discontinued operations		(0.4)p	—	(0.8)p
		77.8p	76.2p	65.5p
Diluted earnings per share	10			
Continuing operations		77.8p	76.0p	66.2p
Discontinued operations		(0.4)p	—	(0.8)p
		77.4p	76.0p	65.4p

The accompanying notes are an integral part of these consolidated financial statements.

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Consolidated statement of comprehensive income

	Notes	Year ended 30 June 2012 £ million	Year ended 30 June 2011 £ million	Year ended 30 June 2010 £ million
Other comprehensive income				
Exchange differences on translation of foreign operations excluding borrowings				
– group		(74)	(133)	494
– associates and non-controlling interests*		(222)	93	37
Exchange differences on borrowings and derivative net investment hedges		210	(51)	(429)
Effective portion of changes in fair value of cash flow hedges				
– gains/(losses) taken to other comprehensive income		29	25	(27)
– transferred to income statement		(15)	56	(26)
Hyperinflation adjustment		3	6	25
Net actuarial (loss)/gain on post employment plans	4	(495)	272	8
Tax on other comprehensive income	27	103	(65)	(16)
Other comprehensive (loss)/income, net of tax, for the year		(461)	203	66
Profit for the year		2,072	2,017	1,743
Total comprehensive income for the year		1,611	2,220	1,809
Attributable to:				
Equity shareholders of the parent company		1,463	2,167	1,628
Non-controlling interests		148	53	181
Total comprehensive income for the year		1,611	2,220	1,809

* Includes £30 million exchange gain recycled to the consolidated income statement on the acquisition of a majority equity stake in Quanxing and obtaining control of Shuijingfang in the year ended 30 June 2012.

The accompanying notes are an integral part of these consolidated financial statements.

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Consolidated balance sheet

	Notes	30 June 2012		30 June 2011	
		£ million	£ million	£ million	£ million
Non-current assets					
Intangible assets	11	8,821		6,545	
Property, plant and equipment	12	2,972		2,552	
Biological assets	13	34		33	
Investments in associates	14	2,198		2,385	
Other investments	16	97		102	
Other receivables	18	119		118	
Other financial assets	22	505		305	
Deferred tax assets	26	329		516	
Post employment benefit assets	4	22		60	
			15,097		12,616
Current assets					
Inventories	17	3,955		3,473	
Trade and other receivables	18	2,103		1,977	
Assets held for sale	19	77		38	
Other financial assets	22	42		89	
Cash and cash equivalents	20	1,076		1,584	
			7,253		7,161
Total assets			22,350		19,777
Current liabilities					
Borrowings and bank overdrafts	21	(1,230)		(1,447)	
Other financial liabilities	22	(113)		(90)	
Trade and other payables	24	(2,997)		(2,838)	
Liabilities held for sale	19	—		(10)	
Corporate tax payable	8	(317)		(381)	
Provisions	25	(127)		(149)	
			(4,784)		(4,915)
Non-current liabilities					
Borrowings	21	(7,399)		(6,748)	
Other financial liabilities	22	(466)		(147)	
Other payables	24	(85)		(41)	
Provisions	25	(274)		(266)	
Deferred tax liabilities	26	(1,424)		(777)	
Post employment benefit liabilities	4	(1,107)		(898)	
			(10,755)		(8,877)
Total liabilities			(15,539)		(13,792)
Net assets			6,811		5,985
Equity					
Called up share capital	28	797		797	
Share premium		1,344		1,343	
Other reserves		3,213		3,300	
Retained earnings/(deficit)		234		(195)	
Equity attributable to equity shareholders of the parent company			5,588		5,245
Non-controlling interests			1,223		740
Total equity			6,811		5,985

The accompanying notes are an integral part of these consolidated financial statements.

These consolidated financial statements were approved by a duly appointed and authorised committee of the board of directors on 22 August 2012 and were signed on its behalf by PS Walsh and D Mahlan, directors.

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Consolidated statement of changes in equity

	Share capital	Share premium	Capital redemption reserve	Hedging and exchange reserve	Retained earnings/(deficit)			Equity attributable to parent company shareholders	Non- controlling interests	Total equity
					Own shares	Other retained earnings	Total			
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
At 30 June 2009	797	1,342	3,146	133	(2,342)	93	(2,249)	3,169	705	3,874
Total comprehensive income	—	—	—	(34)	—	1,662	1,662	1,628	181	1,809
Employee share schemes	—	—	—	—	89	(3)	86	86	—	86
Share-based incentive plans	—	—	—	—	—	31	31	31	—	31
Share-based incentive plans in respect of associates	—	—	—	—	—	3	3	3	—	3
Tax on share-based incentive plans	—	—	—	—	—	4	4	4	—	4
Dividends paid	—	—	—	—	—	(914)	(914)	(914)	(107)	(1,021)
At 30 June 2010	797	1,342	3,146	99	(2,253)	876	(1,377)	4,007	779	4,786
Total comprehensive income	—	—	—	55	—	2,112	2,112	2,167	53	2,220
Employee share schemes	—	—	—	—	(4)	(5)	(9)	(9)	—	(9)
Share-based incentive plans	—	—	—	—	—	34	34	34	—	34
Share-based incentive plans in respect of associates	—	—	—	—	—	3	3	3	—	3
Tax on share-based incentive plans	—	—	—	—	—	15	15	15	—	15
Shares issued	—	1	—	—	—	—	—	1	—	1
Acquisitions	—	—	—	—	—	—	—	—	20	20
Dividends paid	—	—	—	—	—	(973)	(973)	(973)	(112)	(1,085)
At 30 June 2011	797	1,343	3,146	154	(2,257)	2,062	(195)	5,245	740	5,985
Total comprehensive income	—	—	—	(87)	—	1,550	1,550	1,463	148	1,611
Share-based incentive plans	—	—	—	—	—	35	35	35	—	35
Share-based incentive plans in respect of associates	—	—	—	—	—	2	2	2	—	2
Tax on share-based incentive plans	—	—	—	—	—	29	29	29	—	29
Shares issued	—	1	—	—	—	—	—	1	—	1
Acquisitions	—	—	—	—	—	—	—	—	452	452
Proceeds from non-controlling interests	—	—	—	—	—	—	—	—	11	11
Change in fair value of put option	—	—	—	—	—	(6)	(6)	(6)	—	(6)
Purchase of non-controlling interests	—	—	—	—	—	(145)	(145)	(145)	(10)	(155)
Dividends paid	—	—	—	—	—	(1,036)	(1,036)	(1,036)	(118)	(1,154)
At 30 June 2012	797	1,344	3,146	67	(2,257)	2,491	234	5,588	1,223	6,811

The accompanying notes are an integral part of the consolidated financial statements.

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Consolidated statement of cash flows

	Notes	Year ended		Year ended	
		30 June 2012	30 June 2011	30 June 2011	30 June 2010
		£ million	£ million	(restated)	(restated)
Cash flow from operating activities					
Cash generated from operations	29	3,005	2,859		3,175
Interest received		158	213		307
Interest paid		(549)	(524)		(612)
Taxation paid		(521)	(365)		(474)
Net cash from operating activities		2,093	2,183		2,396
Cash flows from investing activities					
Disposal of property, plant and equipment and computer software		39	47		143
Purchase of property, plant and equipment and computer software		(484)	(419)		(374)
Movements in loans and other investments . . .		(1)	1		(43)
Sale of businesses		51	34		1
Acquisition of businesses	30	(1,420)	(97)		(197)
Net cash outflow from investing activities		(1,815)	(434)		(470)
Cash flows from financing activities					
Proceeds from issue of share capital		1	1		—
Net (purchase)/sale of own shares for share schemes		—	(9)		85
Dividends paid to non-controlling interests . . .		(118)	(112)		(107)
Proceeds from non-controlling interests		11	—		—
Purchase of shares of non-controlling interests		(155)	—		—
Net increase/(decrease) in loans		512	(414)		(422)
Equity dividends paid		(1,036)	(973)		(914)
Net cash outflow from financing activities		(785)	(1,507)		(1,358)
Net (decrease)/increase in net cash and cash equivalents		(507)	242		568
Exchange differences		(27)	(68)		(16)
Net cash and cash equivalents at beginning of the year		1,572	1,398		846
Net cash and cash equivalents at end of the year		1,038	1,572		1,398
Net cash and cash equivalents consist of:					
Cash and cash equivalents	20	1,076	1,584		1,453
Bank overdrafts	21	(38)	(12)		(55)
		1,038	1,572		1,398

The accompanying notes are an integral part of these consolidated financial statements.

Comparatives have been restated following a change in the disclosure of dividends paid to non-controlling interests and transaction costs incurred in respect of business acquisitions. For an explanation of the effect of the restatement see note 1.

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Accounting policies of the group

Basis of preparation

The consolidated financial statements are 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.

The consolidated financial statements are prepared on a going concern basis under the historical cost convention, except that biological assets and certain financial instruments are stated at their fair value.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgement, are set out under 'Critical accounting policies' in the Business review section of this Annual Report.

The information set out in these accounts does not constitute the statutory accounts of the group within the meaning of the Companies Acts for the years ended 30 June 2012, 2011 or 2010. KPMG Audit Plc has reported on those accounts; 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 year ended 30 June 2012, 2011 or 2010. The accounts for 2011 and 2010 have been delivered to the registrar of companies and those for 2012 will be delivered in due course.

Basis for preparation of financial statements on a going concern basis

Information on the business environment that the group operates in, the group's strategy and the principal risk factors that the group faces is contained in the Business review. The financial position of the group, its cash flows, borrowings, borrowing facilities, commitments and the group's policies to manage its financial risks are described in the Business review under 'Liquidity and capital resources', 'Contractual obligations' and notes 21, 22 and 23 to the consolidated financial statements.

At 30 June 2012 the group has cash and cash equivalents of £1,076 million and committed bank facilities of £2,229 million, with borrowings and bank overdrafts due within one year of £1,230 million. The group owns a diverse portfolio of beverage alcohol assets and operates in numerous countries around the world. The group also has a wide diversity of customers and suppliers. The directors believe that the group is well positioned to manage its business and financial risks successfully.

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the consolidated financial statements.

Business combinations

Business combinations are accounted for using the acquisition method. Identifiable assets, liabilities and contingent liabilities acquired are measured at fair value at acquisition date. The consideration

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Accounting policies of the group (continued)

transferred is measured at fair value and includes the fair value of any contingent consideration. The consolidated financial statements include the results of the company and its subsidiaries together with the group's attributable share of the results of associates and joint ventures. The results of subsidiaries sold or acquired are included in the income statement up to, or from, the date that control passes. A subsidiary is an entity controlled, directly or indirectly, by Diageo plc. Control is the power to govern the operating and financial policies of the subsidiary so as to obtain benefits from its activities.

On the acquisition of a business, or of an interest in an associate or joint venture, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets including identifiable intangible assets and contingent liabilities acquired. Adjustments to fair values include those made to bring accounting policies into line with those of the group. Directly attributable acquisition costs are recognised in other external charges as incurred.

The interests of non-controlling interests on the date of acquisition can be measured either at the fair value or at the non-controlling shareholder's proportion of the net fair value of the identifiable assets assumed. This choice is made separately for each acquisition.

Where the group has issued a put option over shares held by a non-controlling interest, the group derecognises the non-controlling interests and instead recognises a contingent deferred consideration liability for the estimated amount likely to be paid to the non-controlling interest on the exercise of those options. Movements in the estimated liability after initial recognition are recognised in reserves.

Transactions with non-controlling interests are recorded directly in equity.

Sales

Sales comprise revenue from the sale of goods, royalties receivable and rents receivable. Revenue from the sale of goods includes excise and other duties which the group pays as principal but excludes amounts collected on behalf of third parties, such as value added tax. Sales are recognised depending upon individual customer terms at the time of despatch, delivery or some other specified point when the risk of loss transfers. Provision is made for returns where appropriate. Sales are stated net of price discounts, allowances for customer loyalty and certain promotional activities and similar items.

Advertising and promotion costs

Advertising costs, point of sale materials and sponsorship payments are charged to marketing in operating profit when the company has a right of access to the goods or services acquired.

Research and development

Research expenditure in respect of new drinks products and package design is written off in the year in which it is incurred. Any subsequent development expenditure in the period leading up to product launch that meets the recognition criteria set out in the relevant standard is capitalised. If capitalised, any intangible asset is amortised on a straight-line basis over the period of the expected benefit.

Share-based payments – employee benefits

The fair value of equity settled share options and share grants is initially measured at grant date based on the binomial or Monte Carlo models and is charged in the income statement over the vesting period. For equity settled shares the credit is included in retained earnings in equity whereas for cash settled share-based payments a liability is recognised in the balance sheet, measured initially at the fair

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Accounting policies of the group (continued)

value of the liability. For cash settled share options and share grants, the fair value of the liability is remeasured at the end of each reporting period until the liability is settled, and at the date of settlement, with any changes in the fair value recognised in the income statement. Cancellations of share options are treated as an acceleration of the vesting period and any outstanding charge is recognised in operating profit immediately. Shares of Diageo plc held by the company for the purpose of fulfilling obligations in respect of various employee share plans around the group are deducted from equity in the consolidated balance sheet. Any surplus or deficit arising on the sale of the Diageo plc shares held by the group is included as a movement in equity.

Pensions and other post employment benefits

The group's principal pension funds are defined benefit plans. In addition, the group has defined contribution plans, unfunded post employment medical benefit liabilities and other unfunded defined benefit post employment liabilities. For post employment plans, other than defined contribution plans, the amount charged in the income statement is the cost of accruing pension benefits promised to employees over the year, plus any fully vested benefit improvements granted to members by the group during the year. The income statement also includes a credit equivalent to the group's expected return on the pension plans' assets over the year, offset by a charge equal to the expected increase in the plans' liabilities over the year. The differences between the fair value of the plans' assets and the present value of the plans' liabilities are disclosed as an asset or liability on the consolidated balance sheet as appropriate. Any differences between the expected return on assets and those actually achieved, and any changes in the liabilities over the year due to changes in assumptions or experience within the plans, are recognised in other comprehensive income. The amount of any pension fund asset recognised on the balance sheet is limited to any future refunds from the plan or the present value of reductions in future contributions to the plan.

Contributions payable by the group in respect of defined contribution plans are charged to operating profit as incurred.

Capitalisation of finance costs

Finance costs directly attributable to the acquisition, construction or production of a qualifying asset, being an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, are added to the cost of that asset. All other finance costs are recognised as charges in the income statement for the period in which they are incurred.

Exceptional items

Exceptional items are those that in management's judgement need to be disclosed by virtue of their size or incidence. Such items are included within the income statement caption to which they relate, and are separately disclosed either in the notes to the consolidated financial statements or on the face of the consolidated income statement.

Foreign currencies

Items included in the financial statements of the group's subsidiaries, associates and joint ventures are measured using the currency of the primary economic environment in which each entity operates (its functional currency). The consolidated financial statements are presented in sterling, which is the functional currency of the parent company.

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Accounting policies of the group (continued)

The income statements and cash flows of overseas entities are translated into sterling at weighted average rates of exchange, other than substantial transactions that are translated at the rate on the date of the transaction. The adjustment to closing rates is taken to the exchange reserve.

Balance sheets are translated at closing rates. Exchange differences arising on the retranslation at closing rates of the opening balance sheets of overseas entities are taken to the exchange reserve, as are exchange differences arising on foreign currency borrowings and financial instruments designated as net investment hedges, to the extent that they are effective. Tax charges and credits arising on such items are also taken to the exchange reserve. Gains and losses accumulated in the exchange reserve are recycled to the income statement when the foreign operation is sold. Other exchange differences are taken to the income statement.

The results of operations in hyperinflationary economies are adjusted to reflect the changes in the purchasing power of the local currency of the entity before being translated to sterling.

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. If hedged, the impact of hedging is recognised, where permitted, under hedge accounting (see accounting policy for derivative financial instruments).

Brands, goodwill and other intangible assets

Goodwill represents the excess of the aggregate of the consideration transferred, the value of any non-controlling interest in the company acquired and the fair value of any previously held equity interest in the subsidiary acquired over the fair value of the identifiable net assets acquired. Goodwill arising on acquisitions prior to 1 July 1998 was eliminated against reserves, and this goodwill has not been restated. Goodwill arising subsequent to 1 July 1998 has been capitalised.

Acquired brands and other intangible assets are recognised when they are controlled through contractual or other legal rights, or are separable from the rest of the business, and the fair value can be reliably measured.

Intangible assets that are regarded as having limited useful economic lives are amortised on a straight-line basis over those lives and reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Goodwill and intangible assets that are regarded as having indefinite useful economic lives are not amortised. These assets are reviewed for impairment at least annually or when there is an indication that the assets may be impaired. To ensure that assets are not carried at above their recoverable amounts, the impairment reviews compare the net carrying value with the recoverable amount, where the recoverable amount is the value in use. Amortisation and any impairment writedowns are charged to other operating expenses in the income statement.

Computer software is amortised on a straight-line basis to estimated residual value over its expected useful life. Residual values and useful lives are reviewed each year. Subject to these reviews, the estimated useful lives are up to five years.

Property, plant and equipment

Land and buildings are stated at cost less depreciation. Freehold land is not depreciated. Leaseholds are depreciated over the unexpired period of the lease. Other property, plant and equipment are depreciated on a straight-line basis to estimated residual values over their expected useful lives, and these values and lives are reviewed each year. Subject to these reviews, the estimated useful lives fall

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Accounting policies of the group (continued)

within the following ranges: buildings – 10 to 50 years; within plant and equipment casks and containers – 15 to 50 years, other plant and equipment – 5 to 10 years; fixtures and fittings – 5 to 10 years; and returnable bottles and crates – 5 to 10 years.

Reviews are carried out if there is some indication that impairment may have occurred, to ensure that property, plant and equipment are not carried at above their recoverable amounts.

Government grants

Government grants are not recognised until there is reasonable assurance that the group will comply with the conditions pursuant to which they have been granted and that the grants will be received. Government grants in respect of property, plant and equipment are deducted from the asset that they relate to and reduce the depreciation expense charged to the income statement.

Leases

Where the group has substantially all the risks and rewards of ownership of an asset subject to a lease, the lease is treated as a finance lease. Assets held under finance leases are recognised as assets of the group at their fair value at the inception of the lease. The corresponding liability to the lessor is included in other financial liabilities on the consolidated balance sheet. Lease payments are apportioned between interest expense and a reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Other leases are treated as operating leases, with payments and receipts taken to the income statement on a straight-line basis over the life of the lease.

Biological assets

Grape cultivation by the group's wine businesses are accounted for as an agricultural activity. Accordingly, the group's biological assets (grape vines and grapes on the vine) are carried at fair value which, in the absence of third party valuations, is computed on the basis of a discounted cash flow calculation. Agricultural produce (harvested grapes) is valued at market value on transfer into inventory.

Associates and joint ventures

An associate is an undertaking in which the group has a long term equity interest and over which it has the power to exercise significant influence. The group's interest in the net assets of associates is included in investments in the consolidated balance sheet and its interest in their results is included in the consolidated income statement below the group's operating profit. Investments in associates are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The impairment review compares the net carrying value with the recoverable amount, where the recoverable amount is the higher of the value in use calculated as the present value of the group's share of the associate's future cash flows and its fair value less cost to sell. Joint ventures, where there is contractual joint control over the entity, are accounted for by including on a line-by-line basis the attributable share of the results, assets and liabilities.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, an appropriate proportion of production and other overheads, but not borrowing

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Accounting policies of the group (continued)

costs. Cost is calculated on the weighted average cost incurred in acquiring inventories. Maturing inventories which are retained for more than one year are classified as current assets.

Assets held for sale

Non-current assets and disposal groups are classified as held for sale if their net book value is expected to be recovered through sale rather than continuing use. This condition is only met when the sale is highly probable and the non-current asset, or disposal group, is available for immediate sale in its present condition. Non-current assets and disposal groups classified as held for sale are measured at the lower of the fair value less selling costs and net book value.

Financial assets

Trade, other receivables and loans are recognised when it is probable that a future economic benefit will flow to the group. Trade, other receivables and loans are carried at original invoice or contract amount less any provisions for discounts and doubtful debts. Provisions are made where there is evidence of a risk of non payment taking into account ageing, previous experience and general economic conditions.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less at acquisition, including money market deposits, commercial paper and investments.

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Financial liabilities

Financial liabilities are initially recognised at fair value less any directly related transaction costs. Certain bonds are designated as being part of a fair value hedge relationship. In these cases, the bond is carried at amortised cost, adjusted for the fair value of the risk being hedged, with changes in value recognised in the income statement. The fair value adjustment is calculated using a discounted cash flow technique based on unadjusted market data applied consistently for similar types of instruments. Other financial liabilities, excluding derivatives, are subsequently carried at amortised cost. The difference between the initial carrying amount of the financial liabilities and their redemption value is recognised in the income statement over the contractual terms using the effective interest rate method.

Derivative financial instruments

Derivative financial instruments are carried at fair value that is calculated using a discounted cash flow technique based on market data applied consistently for similar types of instruments. Gains and losses on derivatives that do not qualify for hedge accounting treatment are taken to the income statement as they arise.

The purpose of hedge accounting is to mitigate the impact of potential volatility in the income statement due to changes in exchange or interest rates, by matching the impact of the hedged item and the hedging instrument in the income statement. To qualify for hedge accounting, the hedging relationship must meet several conditions with respect to documentation, probability of occurrence, hedge effectiveness and reliability of measurement. At the inception of the transaction, the group documents the relationship between hedged items and hedging instruments, as well as its risk

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Accounting policies of the group (continued)

management objective and strategy for undertaking the hedge transaction. This process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The group also documents its assessment, at hedge inception and at least on a quarterly basis, as to whether the derivatives that are used in hedging transactions have been, and are likely to continue to be, effective in offsetting changes in fair value or cash flows of hedged items.

The group designates derivatives which qualify for hedge accounting as either: (a) a hedge of the fair value of a recognised asset or liability (fair value hedge); (b) a hedge of a forecast transaction or the cash flow risk from a change in exchange or interest rates (cash flow hedge); or (c) a hedge of a net investment in foreign operations.

The method of recognising the resulting gains or losses from movements in fair values is dependent on whether the derivative contract is designated to hedge a specific risk and qualifies for hedge accounting.

Fair value hedges are used to manage the currency and/or interest rate risks to which the fair value of certain assets and liabilities are exposed. Changes in the fair value of derivatives that are fair value hedges are recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability. If such a hedge relationship is de-designated, fair value movements on the derivative continue to be taken to the income statement while any fair value adjustments made to the underlying hedged item to that date are amortised through the income statement over its remaining life using the effective interest rate method.

Cash flow hedges are used to hedge the foreign currency risk of highly probable future foreign currency cash flows, as well as the cash flow risk from changes in exchange or interest rates. The effective portion of the gain or loss on the hedges is recognised in other comprehensive income, while any ineffective part is recognised in the income statement. Amounts recorded in other comprehensive income are recycled to the income statement in the same period in which the underlying foreign currency or interest exposure affects the income statement.

Net investment hedges take the form of either foreign currency borrowings or derivatives. All foreign exchange gains or losses arising on translation of net investments are recorded in other comprehensive income and included in the exchange reserve. Liabilities used as hedging instruments in a net investment hedge are revalued at closing exchange rates and the resulting gains or losses are recognised in other comprehensive income to the extent that they are effective, with any ineffectiveness taken to the income statement. Foreign exchange contracts hedging net investments in foreign operations are carried at fair value. Effective fair value movements are recognised in other comprehensive income, with any ineffectiveness taken to the income statement.

Provisions

Provisions are liabilities of uncertain timing or amount. A provision is recognised if, as a result of a past event, the group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are calculated on a discounted basis, where the difference from the original undiscounted provision is material. The carrying amounts of provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

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Accounting policies of the group (continued)

Taxation

Current tax is based on taxable profit for the year. This requires an estimation of the current tax liability together with an assessment of the temporary differences which arise as a consequence of different accounting and tax treatments.

Full provision for deferred tax is made for temporary differences between the carrying value of assets and liabilities in the consolidated financial statements and their tax bases. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the asset will not be realised in the future. No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries where the group is able to control the remittance of earnings and it is probable that such earnings will not be remitted in the foreseeable future, or where no liability would arise on the remittance.

Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, management reviews each material tax benefit to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. Any interest and penalties on tax liabilities are provided for in the tax charge.

Discontinued operations

Discontinued operations comprise disposal groups where they represent a major line of business or geographical area of operations or business activities that the group no longer participates in or did not form part of the group's operations.

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Notes to the consolidated financial statements

1. New accounting policies

(a) Adopted by the group The following accounting standards and amendments, issued by the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC), are effective for the first time in the current financial year and have been adopted by the group with no impact on its consolidated results or financial position:

Amendment to IAS 1 – Presentation of financial statements

IAS 24 (Revised) – Related party disclosures

Amendment to IAS 34 – Interim financial reporting

Amendment to IFRS 7 – Disclosure of the financial effect of the extent to which collateral and other credit enhancements mitigate credit risk

Amendment to IFRS 7 – Transfers of financial assets

Amendment to IFRIC 13 – Customer loyalty programmes

Amendment to IFRIC 14 – IAS 19: The limit on defined benefit assets, minimum funding requirements and their interaction

Statement of cash flows – The group has revised the disclosure of certain prior year amounts in the consolidated statement of cash flows. In the year ended 30 June 2012 directly attributable acquisition transaction costs of £47 million (2011 – £20 million; 2010 – £9 million) have been included in cash flow from operating activities rather than cash flow from investing activities and dividends paid to non-controlling interests of £118 million (2011 – £112 million; 2010 – £107 million) are now disclosed as part of cash flows from financing activities rather than cash flow from operating activities. This revised presentation is considered to be more consistent with the treatment of these items in the consolidated income statement and the consolidated statement of changes in equity. The revision had no impact on prior period increase or decrease in cash and cash equivalents, net assets or net profit.

(b) Not adopted by the group The following standards and amendments, issued by the IASB but not yet endorsed by the EU unless stated otherwise, have not yet been adopted by the group. The standards or interpretations will have to be adopted by the group in the year ending 30 June 2014 unless stated otherwise, though the group may determine to adopt them earlier. The group does not currently believe the adoption of these standards or interpretations will have a material impact on its consolidated results or financial position, unless stated otherwise.

IFRS 9 – Financial instruments (effective in the year ending 30 June 2016) removes the multiple classification and measurement models for financial assets required by *IAS 39* and introduces a model that has only two classification categories: amortised cost and fair value. Classification is determined by the business model used to manage the financial assets and the contractual cash flow characteristics of the financial assets. The accounting and presentation of financial liabilities and for derecognising financial instruments has been transferred from *IAS 39* without any significant changes. The amendment to *IFRS 7 – Financial instruments: Disclosures* requires additional disclosures on transition from *IAS 39* to *IFRS 9*. The group is currently assessing the impact this standard would have on its consolidated results and financial position.

IFRS 10 – Consolidated financial statements replaces the guidance of control and consolidation in *IAS 27* and *SIC-12 – Consolidation – special purpose entities*. The core principle that a consolidated

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Notes to the consolidated financial statements (continued)

1. New accounting policies (continued)

entity presents a parent and its subsidiaries as if they were a single entity remains unchanged, as do the mechanics of consolidation.

IFRS 11 – Joint arrangements requires joint arrangements to be accounted for as a joint operation or as a joint venture depending on the rights and obligations of each party to the arrangement. Proportionate consolidation for joint ventures will be eliminated and equity accounting will be mandatory. It is anticipated that the application of the standard will result in an immaterial decrease in net sales, total assets and total liabilities of the group but have no impact on the group's net profit or net assets.

IFRS 12 – Disclosure of interests in other entities requires enhanced disclosures of the nature, risks and financial effects associated with the group's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

IFRS 13 – Fair value measurement explains how to measure fair value and aims to enhance fair value disclosures. The standard does not materially change the measurement of fair value but codifies it in one place.

Amendments to IAS 19 – Employee benefits (endorsed by the EU in June 2012) changes a number of disclosure requirements for post employment arrangements and restricts the options currently available on how to account for defined benefit pension plans. The most significant change that will impact the group is that the amendment requires the expected returns on pension plan assets, currently calculated based on management's estimate of expected returns, to be replaced by a credit on the pension plan assets calculated at the liability discount rate. The group estimates the adoption of the revised IAS 19 would result in an additional charge to the income statement in the year ended 30 June 2012 of approximately £65 million. The change does not impact the group's net assets.

Amendment to IAS 1 – Presentation of items of other comprehensive income (effective in the year ending 30 June 2013, endorsed by the EU in June 2012)

Amendment to IAS 1 – Clarification of the requirements for comparative information

Limited scope amendment to IAS 12 – Income taxes (effective in the year ending 30 June 2013)

Amendment to IAS 16 – Classification of servicing equipment

IAS 27 (Revised) – Separate financial statements

IAS 28 (Revised) – Investments in associates and joint ventures

Amendment to IAS 32 – Offsetting financial assets and financial liabilities (effective in the year ending 30 June 2015)

Amendment to IAS 32 – Tax effect of distribution to holders of equity instruments

Amendment to IAS 34 – Interim financial reporting

Amendment to IFRS 7 – Disclosures – Offsetting financial assets and financial liabilities

2. Segmental information

Diageo is an international manufacturer and distributor of premium drinks. The group produces, markets and distributes a wide range of premium brands, including Johnnie Walker, Smirnoff, Baileys,

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

Crown Royal, Captain Morgan and Guinness. In addition, Diageo also owns the distribution rights for the Jose Cuervo tequila brands in North America and many other markets.

Diageo also owns a number of investments in unconsolidated associates, the principal investment being a 34% interest in Moët Hennessy, the spirits and wines subsidiary of LVMH Moët Hennessy – Louis Vuitton SA. Moët Hennessy is based in France and is a leading producer and exporter of champagne and cognac.

On 25 May 2011 Diageo announced changes to its regional structure. From 1 July 2011 two autonomous regions, Africa and Latin America and Caribbean, replaced the International region. The Global Travel and duty free operations are now reported within the five geographical regions in which the external sales take place. The Middle East business has become part of Asia Pacific.

As a result of this change Diageo now reports the following operating segments externally: North America, Europe, Africa, Latin America and Caribbean, Asia Pacific and Corporate. In addition, for management reporting for the year ended 30 June 2012, changes have been made to the allocation of specific corporate items reflecting the geographic segments for which they are in respect of. Restated segmental information for the years ended 30 June 2011 and 30 June 2010 has been disclosed in the tables below.

Diageo presents segmental information for the manufacture, distribution and selling of premium drinks in operating segments based on the geographical location of third party customers. The information presented is consistent with management reporting provided to the chief operating decision maker, which has been identified as the executive committee.

The executive committee considers the business principally from a geographical perspective and the business analysis is presented under the operating segments of North America, Europe, Africa, Latin America and Caribbean and Asia Pacific. In addition to these geographical selling segments, a further segment reviewed by the executive committee is Global Supply which manufactures and distributes premium drinks within the group. Continuing operations also include the Corporate function. In view of the focus on the geographical segments in explaining the group's performance in the Business review, the results of the Global Supply segment have been allocated to the geographical segments. Corporate revenues and costs are in respect of central costs, including finance, human resources and legal, as well as certain information systems, facilities and employee costs that do not relate to the geographical segments or to Global Supply and hence are not allocated. They also include rents receivable in respect of properties not used by the group in the manufacture, sale or distribution of premium drinks and the results of Gleneagles Hotel.

The segmental information for net sales and operating profit before exceptional items is reported at budgeted exchange rates in line with management reporting. For management reporting purposes the group measures the current year at, and restates the prior year net sales and operating profit to, the current year's budgeted exchange rates. These exchange rates are set prior to the financial year as part of the financial planning process and provide a consistent exchange rate to measure the performance of the business throughout the year. The adjustments required to retranslate the segmental information to actual exchange rates and to reconcile it to the group's reported results are shown in the tables below. The comparative segmental information, prior to retranslation, has not been restated at the current year's budgeted exchange rates but is presented at the budgeted rates for the years ended 30 June 2011 and 30 June 2010, respectively.

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

In addition, for management reporting purposes Diageo excludes the impact of acquisitions and disposals completed in the current and prior year from the results of the geographical segments in order to provide comparable results. The impact of acquisitions and disposals on net sales and operating profit is allocated to the appropriate geographical segments in the tables below. These acquisitions and disposals are the same as those disclosed in the organic growth reconciliations in the Business review but for management reporting purposes they are disclosed here at budgeted exchange rates.

(a) Segmental information for the consolidated income statement – continuing operations

	North America	Europe	Africa	Latin America and Caribbean	Asia Pacific	Global Supply	Eliminate inter- segment sales	Total operating segments	Corporate and other	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
2012										
Sales	4,094	4,966	1,869	1,491	2,104	2,652	(2,652)	14,524	70	14,594
Net sales										
At budgeted exchange rates* .	3,544	2,648	1,444	1,242	1,451	2,792	(2,665)	10,456	70	10,526
Acquisitions and disposals . . .	1	337	32	—	—	—	—	370	—	370
Global Supply allocation	56	47	3	11	10	(127)	—	—	—	—
Retranslation to actual exchange rates	(45)	(83)	(32)	(14)	40	(13)	13	(134)	—	(134)
Net sales	3,556	2,949	1,447	1,239	1,501	2,652	(2,652)	10,692	70	10,762
Operating profit/(loss)										
At budgeted exchange rates* .	1,311	756	390	386	351	158	—	3,352	(154)	3,198
Acquisitions and disposals . . .	—	119	(3)	(8)	(19)	—	—	89	(19)	70
Global Supply allocation	60	80	3	9	6	(158)	—	—	—	—
Retranslation to actual exchange rates	(17)	(30)	(10)	(4)	4	—	—	(57)	(13)	(70)
Operating profit/(loss) before exceptional items	1,354	925	380	383	342	—	—	3,384	(186)	3,198
Exceptional items	(11)	41	(5)	(2)	(10)	(40)	—	(27)	(13)	(40)
Operating profit/(loss)	1,343	966	375	381	332	(40)	—	3,357	(199)	3,158
Sale of businesses										147
Net finance charges										(397)
Share of associates' profits after tax										
– Moët Hennessy										205
– Other associates										8
Profit before taxation										3,121

* These items represent the IFRS 8 performance measures for the geographical and Global Supply segments.

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

	North America	Europe	Africa	Latin America and Caribbean	Asia Pacific	Global Supply	Eliminate inter- segment sales	Total operating segments	Corporate and other	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
2011 (restated)										
Sales	3,895	4,279	1,764	1,293	1,931	2,678	(2,678)	13,162	70	13,232
Net sales										
At budgeted exchange rates* .	3,330	2,649	1,313	1,119	1,270	2,785	(2,682)	9,784	70	9,854
Acquisitions and disposals . . .	27	3	35	—	1	—	—	66	—	66
Global Supply allocation	31	46	3	12	11	(103)	—	—	—	—
Retranslation to actual exchange rates	(22)	5	6	(68)	95	(4)	4	16	—	16
Net sales	<u>3,366</u>	<u>2,703</u>	<u>1,357</u>	<u>1,063</u>	<u>1,377</u>	<u>2,678</u>	<u>(2,678)</u>	<u>9,866</u>	<u>70</u>	<u>9,936</u>
Operating profit/(loss)										
At budgeted exchange rates* .	1,218	741	349	352	291	146	—	3,097	(157)	2,940
Acquisitions and disposals . . .	4	(8)	(7)	(3)	(8)	—	—	(22)	—	(22)
Global Supply allocation	65	65	4	8	4	(146)	—	—	—	—
Retranslation to actual exchange rates	(12)	(2)	(13)	(39)	12	—	—	(54)	20	(34)
Operating profit/(loss) before exceptional items	<u>1,275</u>	<u>796</u>	<u>333</u>	<u>318</u>	<u>299</u>	<u>—</u>	<u>—</u>	<u>3,021</u>	<u>(137)</u>	<u>2,884</u>
Exceptional items	(23)	(157)	(7)	(6)	(50)	(35)	—	(278)	(11)	(289)
Operating profit/(loss)	<u>1,252</u>	<u>639</u>	<u>326</u>	<u>312</u>	<u>249</u>	<u>(35)</u>	<u>—</u>	<u>2,743</u>	<u>(148)</u>	<u>2,595</u>
Sale of businesses										(14)
Net finance charges										(397)
Share of associates' profits after tax										
– Moët Hennessy										179
– Other associates										(3)
Profit before taxation										<u>2,360</u>

* These items represent the IFRS 8 performance measures for the geographical and Global Supply segments.

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

	North America	Europe	Africa	Latin America and Caribbean	Asia Pacific	Global Supply	Eliminate inter- segment sales	Total operating segments	Corporate and other	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
2010 (restated)										
Sales	3,887	4,460	1,582	1,364	1,595	2,628	(2,628)	12,888	70	12,958
Net sales										
At budgeted exchange rates*	3,012	2,595	1,256	1,028	1,073	2,561	(2,460)	9,065	68	9,133
Acquisitions and disposals	47	9	7	—	—	—	—	63	—	63
Global Supply allocation	18	55	3	13	12	(101)	—	—	—	—
Retranslation to actual exchange rates	263	189	(38)	82	86	167	(167)	582	2	584
Net sales	<u>3,340</u>	<u>2,848</u>	<u>1,228</u>	<u>1,123</u>	<u>1,171</u>	<u>2,627</u>	<u>(2,627)</u>	<u>9,710</u>	<u>70</u>	<u>9,780</u>
Operating profit/(loss)										
At budgeted exchange rates*	1,048	762	313	352	229	142	—	2,846	(147)	2,699
Acquisitions and disposals	(3)	1	(5)	—	(7)	—	—	(14)	—	(14)
Global Supply allocation	59	72	2	8	1	(142)	—	—	—	—
Retranslation to actual exchange rates	80	46	(9)	(24)	17	—	—	110	(44)	66
Operating profit/(loss) before exceptional items	<u>1,184</u>	<u>881</u>	<u>301</u>	<u>336</u>	<u>240</u>	<u>—</u>	<u>—</u>	<u>2,942</u>	<u>(191)</u>	<u>2,751</u>
Exceptional items	(38)	(53)	(3)	(2)	(30)	(39)	—	(165)	(12)	(177)
Operating profit/(loss)	<u>1,146</u>	<u>828</u>	<u>298</u>	<u>334</u>	<u>210</u>	<u>(39)</u>	<u>—</u>	<u>2,777</u>	<u>(203)</u>	<u>2,574</u>
Sale of businesses										(15)
Net finance charges										(462)
Share of associates' profits after tax										
– Moët Hennessy										134
– Other associates										8
Profit before taxation										<u>2,239</u>

* These items represent the IFRS 8 performance measures for the geographical and Global Supply segments.

- (i) The segmental analysis of sales and operating profit/(loss) is based on the location of the third party customers.
- (ii) The net sales figures for Global Supply reported to the executive committee primarily comprise inter-segment sales and these are eliminated in a separate column in the above segmental analysis. Apart from sales by the Global Supply segment to the other operating segments, inter-segmental sales are not material.
- (iii) The group's net finance charges are managed centrally and are not attributable to individual operating segments.

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

(b) Other segmental information

	North America	Europe	Africa	Latin America and Caribbean	Asia Pacific	Global Supply	Corporate and other	Total
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
2012								
Capital expenditure	2	18	137	15	23	211	78	484
Depreciation, intangible asset amortisation and impairment . .	(16)	(23)	(82)	(4)	(22)	(128)	(48)	(323)
Exceptional accelerated depreciation	(2)	—	—	—	—	(27)	—	(29)
Exceptional impairment of intangible assets	—	(59)	—	—	—	—	—	(59)
2011								
Capital expenditure	2	18	126	11	24	176	62	419
Depreciation and intangible asset amortisation	(3)	(16)	(72)	(4)	(22)	(129)	(40)	(286)
Exceptional accelerated depreciation	—	—	—	—	—	(27)	—	(27)
Exceptional impairment of intangible assets	—	(39)	—	—	—	—	—	(39)
2010								
Capital expenditure	1	16	88	3	14	193	59	374
Depreciation and intangible asset amortisation	(3)	(16)	(64)	(4)	(20)	(143)	(41)	(291)
Exceptional accelerated depreciation	—	—	—	—	—	(44)	(2)	(46)
Exceptional impairment of intangible assets	—	(35)	—	—	—	—	—	(35)

(c) Geographical information

	Great Britain	United States	Nether- lands	Rest of World	Total
	£ million	£ million	£ million	£ million	£ million
2012					
Sales	1,666	3,795	57	9,076	14,594
Non-current assets	1,392	3,282	2,228	7,339	14,241
2011					
Sales	1,669	3,581	45	7,937	13,232
Non-current assets	1,226	3,150	2,196	5,163	11,735
2010					
Sales	1,680	3,615	46	7,617	12,958
Non-current assets	1,122	3,348	2,327	4,655	11,452

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Notes to the consolidated financial statements (continued)

2. Segmental information (continued)

- (i) The geographical analysis of sales is based on the location of third party customers.
- (ii) The geographical analysis of non-current assets is based on the geographical location of the assets and comprises intangible assets, property, plant and equipment, biological assets, investments in associates, other investments and non-current other receivables.

(d) Sales by category

	Spirits	Beer	Wine	Ready to drink	Other	Total
	£ million	£ million	£ million	£ million	£ million	£ million
2012	10,051	2,923	507	934	179	14,594
2011	8,742	2,829	561	940	160	13,232
2010	8,475	2,752	642	917	172	12,958

- (e) **Foreign exchange rates** The principal foreign exchange rates used in the translation of financial statements for the three years ended 30 June 2012, expressed in US dollars and euros per £1, were as follows:

	US dollar			Euro		
	2012	2011	2010	2012	2011	2010
	\$	\$	\$	€	€	€
Weighted average rates used to translate income statements . . .	1.58	1.59	1.57	1.18	1.16	1.13
Year end rates used to translate assets and liabilities	1.57	1.61	1.50	1.24	1.11	1.22

The group uses foreign exchange transaction hedges to mitigate the effect of exchange rate movements.

- (f) **Assets and liabilities** The management information provided to the chief operating decision maker does not include an analysis by geographical segment of assets and liabilities and accordingly no analysis by geographical segment of total assets or total liabilities is disclosed.

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Notes to the consolidated financial statements (continued)

3. Operating costs

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Excise duties	3,832	3,296	3,178
Cost of sales	4,259	4,010	4,099
Marketing	1,691	1,538	1,419
Other operating expenses	1,654	1,793	1,688
	<u>11,436</u>	<u>10,637</u>	<u>10,384</u>
Comprising:			
Excise duties – Great Britain	863	839	820
– United States	533	525	542
– Other	2,436	1,932	1,816
Increase in inventories	(431)	(263)	(111)
Raw materials and consumables	2,516	2,227	2,099
Marketing	1,691	1,538	1,419
Other external charges (a)	2,237	2,164	2,165
Staff costs (note 4)	1,224	1,344	1,269
Depreciation, amortisation and impairment	411	352	372
Gains on disposal of properties	(19)	(20)	(89)
Net foreign exchange losses	6	16	127
Other operating income	(31)	(17)	(45)
	<u>11,436</u>	<u>10,637</u>	<u>10,384</u>

(a) **Other external charges** Other external charges include operating lease rentals for plant and equipment of £22 million (2011 – £19 million; 2010 – £16 million), other operating lease rentals (mainly properties) of £92 million (2011 – £87 million; 2010 – £74 million), research and development expenditure of £18 million (2011 – £17 million; 2010 – £13 million) and maintenance and repairs of £90 million (2011 – £106 million; 2010 – £103 million).

(b) **Exceptional operating items** Included in the table above are exceptional operating items as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Other external charges	52	160	100
Staff costs	(88)	64	82
Depreciation, amortisation and impairment – Accelerated depreciation	29	27	46
– Brand impairment	59	39	35
Gains on disposal of properties	(12)	(1)	(86)
Total exceptional operating costs	<u>40</u>	<u>289</u>	<u>177</u>

In the year ended 30 June 2012 exceptional operating items included a credit in staff costs of £115 million (2011 and 2010 – £nil) in respect of changes in the calculation of future pension increases for the group's principal UK and Irish pension schemes. See note 5(f).

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Notes to the consolidated financial statements (continued)

3. Operating costs (continued)

Of the total exceptional operating costs of £40 million (2011 – £289 million; 2010 – £177 million), £31 million (2011 – £27 million; 2010 – £46 million) is included in cost of sales and £9 million (2011 – £262 million; 2010 – £131 million) in other operating expenses.

(c) **Auditor fees** The group has revised the analysis of auditor fees in accordance with Statutory Instrument 2011/2198.

The fees of the principal auditor of the group, KPMG Audit Plc, and its affiliates were as follows:

	United Kingdom	Rest of World	2012	2011 (restated)	2010 (restated)
	£ million	£ million	£ million	£ million	£ million
Audit of these financial statements	2.3	0.8	3.1	3.8	3.4
Audit of financial statements of subsidiaries pursuant to legislation	0.3	2.4	2.7	2.6	2.8
Audit related assurance services(i)	0.4	1.2	1.6	1.8	1.7
Total audit fees	3.0	4.4	7.4	8.2	7.9
Other services relevant to taxation(ii)	0.3	0.8	1.1	0.5	0.6
Other assurance services(iii)	0.5	0.5	1.0	0.5	1.1
All other non-audit fees(iv)	1.7	0.2	1.9	0.9	0.4
	<u>5.5</u>	<u>5.9</u>	<u>11.4</u>	<u>10.1</u>	<u>10.0</u>

- (i) Audit-related assurances services relate principally to reporting required under section 404 of the US Sarbanes-Oxley Act and audit services for the review of the interim financial information.
- (ii) Other services relevant to taxation comprise principally tax advice in respect of transactions.
- (iii) Other assurance services comprise the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements and are not reported under ‘total audit fees’.
- (iv) All other non-audit fees relate principally to advisory services, including services in respect of due diligence and services in relation to acquisitions and disposals.

Under the US disclosure requirements the auditor fees are classified as follows:

	United Kingdom	Rest of World	2012	2011	2010
	£ million	£ million	£ million	£ million	£ million
Audit fees	2.7	4.4	7.1	7.8	7.6
Tax fees(i)	0.3	0.8	1.1	0.5	0.6
Audit related fees(ii)	0.8	0.5	1.3	0.9	1.4
All other fees(iii)	1.7	0.2	1.9	0.9	0.4
	<u>5.5</u>	<u>5.9</u>	<u>11.4</u>	<u>10.1</u>	<u>10.0</u>

- (i) Tax fees comprise principally tax advice in respect of transactions.
- (ii) Audit related fees comprise the aggregate fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the financial statements and are

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Notes to the consolidated financial statements (continued)

3. Operating costs (continued)

not reported under 'audit fees', including audit services for the review of the interim financial information.

(iii) All other fees relate principally to advisory services, including services in respect of due diligence and services in relation to acquisitions and disposals.

In addition to the amounts above, £0.1 million (2011 – £0.1 million; 2010 – £0.2 million) was charged for audit services by firms other than KPMG Audit Plc. KPMG Audit Plc fees for audit services in respect of employee pension plans were £0.4 million (2011 – £0.3 million; 2010 – £0.3 million).

4. Employees

The average number of employees on a full time equivalent basis (all numbers excluding employees of associates) was as follows:

	2012	2011 (restated)	2010 (restated)
North America	1,105	1,229	1,331
Europe	3,802	2,913	2,949
Africa	5,116	4,253	3,674
Latin America and Caribbean	1,631	1,413	1,261
Asia Pacific	2,902	2,639	2,585
Global Supply	8,120	8,202	8,491
Corporate and other	3,022	3,137	2,996
	<u>25,698</u>	<u>23,786</u>	<u>23,287</u>

At 30 June 2012 the group had, on a full time equivalent basis, 27,483 employees. In the year ended 30 June 2012 acquisitions increased the total average headcount by 1,464. The average number of employees of the group, including part time employees, for the year was 26,090 (2011 – 24,020; 2010 – 23,521).

Following changes in the group's regional structure the employee information by segment in the table above for the years ended 30 June 2011 and 2010 has been restated in order to better reflect the segment for which the employees provide the majority of their services. Employees of corporate

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

functions whose costs are charged to the operating segments, such as those in shared service operations, are included in 'Corporate and other' in the table above.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Aggregate remuneration			
Wages and salaries	1,095	1,122	1,070
Share-based incentive plans	36	34	31
Employer's social security	90	85	82
Employer's pension	113	104	91
Exceptional benefit for UK and Irish pension plans	(115)	—	—
Other post employment	5	(1)	(5)
	<u>1,224</u>	<u>1,344</u>	<u>1,269</u>

The costs of post employment benefits, excluding the exceptional benefit for the UK and Irish pension plans, and share-based incentive plans have been included in the consolidated income statement for the year ended 30 June 2012 as follows: cost of sales £61 million (2011 – £60 million; 2010 – £54 million) and other operating expenses £93 million (2011 – £77 million; 2010 – £63 million). Included within aggregate remuneration is a £88 million gain (2011 – £64 million charge; 2010 – £82 million charge) in respect of exceptional operating items.

Employer's pension costs include £13 million (2011 – £7 million; 2010 – £6 million) in respect of defined contribution plans, representing contributions payable to these plans by the group at rates specified in the rules of the plans.

Retirement benefits The group operates a number of pension plans throughout the world, devised in accordance with local conditions and practices.

The larger plans are generally of the defined benefit type and are funded by payments to separately administered trusts or insurance companies. The principal plans are in the United Kingdom, Ireland and the United States where benefits are based on employees' length of service and salary at retirement. All valuations were performed by independent actuaries using the projected unit method to determine pension costs. The most recent full valuations of the significant defined benefit pension plans were carried out as follows: United Kingdom on 31 March 2009; Ireland on 31 December 2009; and United States on 1 January 2012. The triennial valuation of the principal UK plan as at 31 March 2012 is in progress. The results of this valuation are expected to be agreed by Diageo and the trustee later in calendar year 2012. The measurement dates used to calculate the disclosures in the consolidated financial statements are the respective balance sheet dates. In the United Kingdom, the Diageo Pension Scheme (a final salary defined benefit pension plan) (the UK Scheme) closed to new members in November 2005. Employees who have joined Diageo in the United Kingdom thereafter have been eligible to become members of the Diageo Lifestyle Plan (a cash balance defined benefit pension plan).

The assets of the UK and Irish pension plans are held in separate trusts administered by trustees to meet long term pension liabilities to past and present employees. The trustees are required to act in the best interests of the plans' beneficiaries. The two largest pension plans are the UK Scheme in the United Kingdom and the Guinness Ireland Group Pension Scheme in Ireland (the Irish Scheme). For the UK Scheme, the trustee is Diageo Pension Trust Limited. The appointment of the directors to the board is determined by the Scheme's trust documentation. As required by legislation one-third of all

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

directors of the Trust are nominated by members of the UK Scheme. Two member nominated directors have been appointed from the pensioner member community and two from the active member community. For the Irish Scheme, the appointment of trustees is a Diageo Ireland decision. Currently Diageo Ireland makes four nominations and appoints three further candidates nominated by representative groupings.

The group also operates a number of plans, primarily in the United States, which provide employees with post employment benefits in respect of medical costs. These plans are generally unfunded. In addition, there are a number of other plans which provide post employment benefits other than pensions and medical benefits. These plans are also included in the figures presented below.

- (a) The following weighted average assumptions were used to determine the group's deficit/surplus in the main post employment plans at 30 June in the relevant year. The assumptions used to calculate the charge/credit in the consolidated income statement for the year ended 30 June are based on the assumptions disclosed as at the previous 30 June.

	United Kingdom			Ireland			United States		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
	%	%	%	%	%	%	%	%	%
Rate of general increase in salaries	4.0	4.9	4.6	3.7	4.2	4.0	5.9	6.2	5.6
Rate of increase to pensions in payment	3.2	3.8	3.6	1.8	2.3	2.1	—	—	—
Rate of increase to deferred pensions	2.0	3.6	3.3	1.7	2.2	2.0	—	—	—
Medical inflation	n/a	n/a	n/a	n/a	n/a	n/a	8.0	8.5	9.0
Discount rate for plan liabilities	4.5	5.6	5.4	4.1	5.4	4.9	4.1	4.9	4.7
Inflation – CPI	2.0	—	—	1.7	2.2	2.0	1.9	2.2	1.6
Inflation – RPI	2.9	3.6	3.3	—	—	—	—	—	—

For the main plans in the United Kingdom, Ireland and the United States, the salary increase assumptions include an allowance for age related promotional salary increases. For example in the United Kingdom salary increase assumptions comprise one percentage point above RPI inflation and 0.1 of a percentage point (2011 and 2010 – 0.3 of a percentage point) for age related promotional salary increases. The assumption for medical inflation in the United States reduces by 0.5% per year until it reaches 5%.

In assessing the group's post retirement liabilities, the mortality assumption for the UK Scheme is based on the CMI birth year tables with scaling factors based on the experience of the plan and with suitable future improvements. The mortality assumption for the Irish Scheme is also based on the mortality experience of that plan with suitable future improvements. The mortality assumptions for the other plans around the world are based on relevant standard mortality tables and standard mortality improvements in each country.

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

For the main UK and Irish pension funds, the table below illustrates the expected age at death of an average worker who retires currently at the age of 65, and one who is currently aged 45 and subsequently retires at the age of 65:

	United Kingdom			Ireland		
	2012 Age	2011 Age	2010 Age	2012 Age	2011 Age	2010 Age
Retiring currently at age 65						
Male	86.2	86.2	86.0	85.8	85.7	85.6
Female	88.2	87.8	87.7	88.4	88.3	88.2
Currently aged 45, retiring at age 65						
Male	88.3	88.4	88.3	87.6	87.5	87.4
Female	90.5	90.1	90.1	90.2	90.1	90.0

(b) In respect of defined benefit post employment plans, the net amounts charged to the consolidated income statement and consolidated statement of comprehensive income for the three years ended 30 June 2012 are set out below:

	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million
2012				
Operating profit				
Current service cost	(61)	(15)	(34)	(110)
Past service exceptional gain (note 5(f))	86	29	—	115
Gains on curtailment	—	—	3	3
Gains on settlement	—	2	—	2
Total credit/(charge) to operating profit	25	16	(31)	10
Net credit/(charge) to other finance charges (note 6(b))	26	(11)	(8)	7
Credit/(charge) before taxation	51	5	(39)	17
Other comprehensive income				
Actual return on post employment plan assets	313	101	9	423
Expected return on post employment plan assets	(271)	(68)	(33)	(372)
Actual return less expected return on post employment plan assets	42	33	(24)	51
Experience (losses)/gains arising on the plan liabilities	(5)	7	4	6
Changes in assumptions underlying the present value of the plan liabilities	(340)	(188)	(36)	(564)
Actuarial loss recognisable in the reconciliation of the assets and liabilities	(303)	(148)	(56)	(507)
Changes in the recognisable surplus of the plans with a surplus restriction	—	—	12	12
Net actuarial loss recognisable in other comprehensive income	(303)	(148)	(44)	(495)

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

	<u>United Kingdom</u> £ million	<u>Ireland</u> £ million	<u>United States and other</u> £ million	<u>Total</u> £ million
2011				
Operating profit				
Current service cost	(59)	(19)	(32)	(110)
Past service gain	2	—	3	5
Gains on curtailments	2	4	3	9
Total charge to operating profit	<u>(55)</u>	<u>(15)</u>	<u>(26)</u>	<u>(96)</u>
Net credit/(charge) to other finance charges (note 6(b))	14	(4)	(13)	(3)
Charge before taxation	<u>(41)</u>	<u>(19)</u>	<u>(39)</u>	<u>(99)</u>
Other comprehensive income				
Actual return on post employment plan assets	575	37	63	675
Expected return on post employment plan assets	<u>(242)</u>	<u>(70)</u>	<u>(27)</u>	<u>(339)</u>
Actual return less expected return on post employment plan assets	333	(33)	36	336
Experience losses arising on the plan liabilities	(49)	(14)	(11)	(74)
Changes in assumptions underlying the present value of the plan liabilities	<u>(54)</u>	<u>67</u>	<u>7</u>	<u>20</u>
Actuarial gain recognisable in the reconciliation of the assets and liabilities	230	20	32	282
Changes in the recognisable surplus of the plans with a surplus restriction	<u>—</u>	<u>—</u>	<u>(10)</u>	<u>(10)</u>
Net actuarial gain recognisable in other comprehensive income	<u>230</u>	<u>20</u>	<u>22</u>	<u>272</u>

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

	<u>United Kingdom</u> £ million	<u>Ireland</u> £ million	<u>United States and other</u> £ million	<u>Total</u> £ million
2010				
Operating profit				
Current service cost	(49)	(19)	(31)	(99)
Past service gain	13	—	—	13
Gains on curtailments	8	—	1	9
Losses on settlements	—	(3)	—	(3)
Total charge to operating profit	<u>(28)</u>	<u>(22)</u>	<u>(30)</u>	<u>(80)</u>
Net charge to other finance charges (note 6(b))	<u>(21)</u>	<u>(12)</u>	<u>(14)</u>	<u>(47)</u>
Charge before taxation	<u>(49)</u>	<u>(34)</u>	<u>(44)</u>	<u>(127)</u>
Other comprehensive income				
Actual return on post employment plan assets	566	164	18	748
Expected return on post employment plan assets	<u>(217)</u>	<u>(68)</u>	<u>(28)</u>	<u>(313)</u>
Actual return less expected return on post employment plan assets	349	96	(10)	435
Experience gains arising on the plan liabilities	181	32	16	229
Changes in assumptions underlying the present value of the plan liabilities	<u>(447)</u>	<u>(140)</u>	<u>(77)</u>	<u>(664)</u>
Actuarial gain/(loss) recognisable in the reconciliation of the assets and liabilities	83	(12)	(71)	—
Changes in the recognisable surplus of the plans with a surplus restriction	<u>—</u>	<u>2</u>	<u>6</u>	<u>8</u>
Net actuarial gain/(loss) recognisable in other comprehensive income	<u>83</u>	<u>(10)</u>	<u>(65)</u>	<u>8</u>

In the year ended 30 June 2012 the past service exceptional gain is in respect of changes in the inflation index, from RPI to CPI, used for the UK Scheme which affects increases to deferred pensions and the reassessment of pensions in payment for the Irish Scheme. These announcements have reduced

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

the deficit in the schemes and therefore the net liability in the balance sheet. See note 5(f) for further information.

	<u>United Kingdom</u> £ million	<u>Ireland</u> £ million	<u>United States and other</u> £ million	<u>Total</u> £ million
Total cumulative gain/(loss) recognised in other comprehensive income				
At 30 June 2009	(40)	(283)	(150)	(473)
Recognised in the year	83	(10)	(65)	8
At 30 June 2010	43	(293)	(215)	(465)
Recognised in the year	230	20	22	272
At 30 June 2011	273	(273)	(193)	(193)
Recognised in the year	(303)	(148)	(44)	(495)
At 30 June 2012	<u>(30)</u>	<u>(421)</u>	<u>(237)</u>	<u>(688)</u>

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

(c) The expected long term rates of return and fair values of the assets of the defined benefit post employment plans were as follows:

	United Kingdom		Ireland		United States and other		Total	
	Expected long term rates of return	Fair value	Expected long term rates of return	Fair value	Expected long term rates of return	Fair value	Expected long term rates of return	Fair value
	%	£ million	%	£ million	%	£ million	%	£ million
2012								
Fair value of plan assets								
Equities	7.3	1,591	7.3	472	7.2	269	7.3	2,332
Bonds	3.5	1,795	3.2	408	3.4	184	3.4	2,387
Property	7.3	512	7.3	64	7.0	9	7.3	585
Other	3.9	593	3.8	208	3.8	60	3.9	861
		<u>4,491</u>		<u>1,152</u>		<u>522</u>		<u>6,165</u>
Present value of funded plan liabilities . .		(4,747)		(1,552)		(747)		(7,046)
Present value of unfunded plan liabilities		(90)		(7)		(106)		(203)
Deficit in post employment plans		(346)		(407)		(331)		(1,084)
Surplus restriction		—		—		(1)		(1)
Post employment benefit net liabilities . .		<u>(346)</u>		<u>(407)</u>		<u>(332)</u>		<u>(1,085)</u>
2011								
Fair value of plan assets								
Equities	8.3	1,699	8.6	527	8.2	285	8.3	2,511
Bonds	4.8	1,619	4.9	628	4.6	171	4.8	2,418
Property	8.3	495	8.6	75	8.3	10	8.3	580
Other	5.2	489	5.3	(10)	5.1	47	5.2	526
		<u>4,302</u>		<u>1,220</u>		<u>513</u>		<u>6,035</u>
Present value of funded plan liabilities . .		(4,402)		(1,571)		(705)		(6,678)
Present value of unfunded plan liabilities		(81)		—		(100)		(181)
Deficit in post employment plans		(181)		(351)		(292)		(824)
Surplus restriction		—		—		(2)		(2)
Impact of minimum funding requirement		—		—		(12)		(12)
Post employment benefit net liabilities . .		<u>(181)</u>		<u>(351)</u>		<u>(306)</u>		<u>(838)</u>

Included in the post employment plan deficit of £1,084 million (2011 – £824 million) are £191 million (2011 – £166 million) in respect of post employment medical benefit liabilities and £32 million (2011 – £32 million) in respect of other non-pension post employment liabilities.

Within the plan assets above there is no investment in the ordinary shares of Diageo plc. Included in equities in the UK plans at 30 June 2012 are £248 million (2011 – £324 million) invested in hedge funds and £289 million (2011 – £285 million) invested in private equity. Included in other assets at 30 June 2012 are interest rate and inflation swaps and repurchase agreements with a fair value in the UK plans of £329 million gain (2011 – £173 million gain) and in the Irish plans of £73 million gain (2011 – £18 million loss).

The asset classes include some cash holdings that are temporary. This cash is likely to be invested imminently and so has been included in the asset class where it is anticipated to be invested in the long term. UK plan assets include temporary cash of £26 million (2011 – £43 million) in ‘equities’,

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

£102 million (2011 – £74 million) in ‘bonds’ and £7 million (2011 – £5 million) in ‘property’. Irish plan assets include temporary cash of £7 million (2011 – £11 million) in ‘equities’ and £8 million (2011 – £26 million) in ‘bonds’.

Post employment benefit assets and liabilities are recognised in the consolidated balance sheet, depending on whether an individual plan is in surplus or deficit, as follows:

	<u>2012</u>	<u>2011</u>
	£ million	£ million
Non-current assets	22	60
Non-current liabilities	<u>(1,107)</u>	<u>(898)</u>
	<u>(1,085)</u>	<u>(838)</u>

The expected long term rates of return for equities have been determined by reference to government bond rates (minimum risk rates) in the countries in which the plans are based. As at 30 June 2012, to reflect the additional risks associated with equities, expected long term rates of return on equities include a risk premium of 4.5% per year (2011 and 2010 – 4%) in excess of the expected return from government bonds. This risk premium is a long term assumption which is set after taking actuarial advice and considering the assumptions used by other FTSE 100 companies. The expected long term rates of return for other assets are determined in a similar way, by including an appropriate risk premium relative to government bonds in the relevant country.

The investment strategy for the group’s funded post employment plans is decided locally by the trustee of the plan and/or Diageo, as appropriate, and takes account of the relevant statutory requirements. The objective for the investment strategy is to achieve a target rate of return in excess of the movement on the liabilities, while taking an acceptable amount of investment risk relative to the liabilities. This objective is implemented by using specific allocations to a variety of asset classes that are expected over the long term to deliver the target rate of return. Most investment strategies have significant allocations to equities, with the intention that this will result in the ongoing cost to the group of the post employment plans being lower over the long term, within acceptable boundaries of risk. Each investment strategy is also designed to control investment risk by managing allocations to asset classes, geographical exposures and individual equity exposures.

At 30 June 2012, approximately 33% and 57% (2011 – 33% and 37%) of the UK Scheme’s liabilities were hedged against future movements in interest rates and inflation, respectively, through the use of swaps. At 30 June 2012, approximately 37% and 45% (2011 – 37% and 37%) of the Irish Scheme’s liabilities were hedged against future movements in interest rates and inflation, respectively, through the use of swaps.

The discount rate is based on the yields of high quality fixed income investments. For the UK pension plans, which represent approximately 67% of total plan liabilities, the discount rate is determined by reference to the yield curves of AA rated corporate bonds for which the timing and amount of cash outflows are similar to those of the plans. A similar process is used to determine the discount rate for the non-UK plans.

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

The percentages of investments at fair value held by the pension plans at 30 June 2012 and 30 June 2011, analysed by asset class, were as follows:

	<u>United Kingdom</u>	<u>Ireland</u>	<u>United States and other</u>	<u>Total</u>
	%	%	%	%
2012				
Equities	36	41	52	38
Bonds	40	35	35	39
Property	11	6	2	9
Other	13	18	11	14
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
2011				
Equities	39	43	56	41
Bonds	38	51	33	40
Property	12	6	2	10
Other	11	—	9	9
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

(d) Movements in the present value of plan liabilities during the two years ended 30 June 2012:

	United Kingdom	Ireland	United States and other	Total
	£ million	£ million	£ million	£ million
Present value of plan liabilities				
At 30 June 2010	4,279	1,481	809	6,569
Exchange differences	—	144	(27)	117
Current service cost	59	19	32	110
Past service gain	(2)	—	(3)	(5)
Interest cost	228	74	40	342
Actuarial loss/(gain)	103	(53)	4	54
Employee contributions	7	3	1	11
Benefits paid	(189)	(83)	(47)	(319)
Curtailments	(2)	(4)	(3)	(9)
Settlements	—	(10)	(1)	(11)
At 30 June 2011	4,483	1,571	805	6,859
Exchange differences	—	(173)	(1)	(174)
Acquisition of business	—	—	2	2
Current service cost	61	15	34	110
Past service exceptional gain	(86)	(29)	—	(115)
Interest cost	245	79	41	365
Actuarial loss	345	181	32	558
Employee contributions	1	3	1	5
Benefits paid	(212)	(82)	(58)	(352)
Curtailments	—	—	(3)	(3)
Settlements	—	(6)	—	(6)
At 30 June 2012	4,837	1,559	853	7,249

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

(e) Movements in the fair value of plan assets during the two years ended 30 June 2012:

	United Kingdom	Ireland	United States and other	Total
	£ million	£ million	£ million	£ million
Fair value of plan assets				
At 30 June 2010	3,819	1,101	447	5,367
Exchange differences	—	111	(13)	98
Expected return on plan assets	242	70	27	339
Actuarial gain/(loss)	333	(33)	36	336
Contributions by the group	90	61	63	214
Employee contributions	7	3	1	11
Benefits paid	(189)	(83)	(47)	(319)
Settlements	—	(10)	(1)	(11)
At 30 June 2011	<u>4,302</u>	<u>1,220</u>	<u>513</u>	<u>6,035</u>
Exchange differences	—	(132)	—	(132)
Expected return on plan assets	271	68	33	372
Actuarial gain/(loss)	42	33	(24)	51
Contributions by the group	87	46	57	190
Employee contributions	1	3	1	5
Benefits paid	(212)	(82)	(58)	(352)
Settlements	—	(4)	—	(4)
At 30 June 2012	<u>4,491</u>	<u>1,152</u>	<u>522</u>	<u>6,165</u>

(f) History of funded status of plans at 30 June 2012:

	2012	2011	2010	2009	2008
	£ million	£ million	£ million	£ million	£ million
Fair value of plan assets	6,165	6,035	5,367	4,592	5,165
Present value of plan liabilities	(7,249)	(6,859)	(6,569)	(5,965)	(5,559)
Deficit in post employment plans	(1,084)	(824)	(1,202)	(1,373)	(394)
Surplus restriction	(1)	(2)	(2)	(9)	(14)
Impact of minimum funding requirement	—	(12)	(1)	(1)	—
Post employment benefit liabilities	<u>(1,085)</u>	<u>(838)</u>	<u>(1,205)</u>	<u>(1,383)</u>	<u>(408)</u>

In order to address the deficit on the UK Scheme the group established a Pension Funding Partnership. During the year ended 30 June 2011 whisky inventory was transferred into the partnership. The group retains control over the partnership which at 30 June 2012 held inventory with a book value of £565 million (2011 – £535 million). The partnership is fully consolidated in the group financial statements. The UK Scheme acquired a limited interest in the partnership, and as a partner, is entitled to a distribution from the profits of the partnership each year from the date the partnership was established until the year ending 30 June 2024. This profit share was £25 million in the year ended 30 June 2012 and is expected to be approximately the same amount for the next 13 years. In 2024 the group will be required, dependent upon the funding position of the UK Scheme at that time, to pay an amount expected to be no greater than the deficit at that time, up to a maximum of £430 million in

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

cash, to the UK Scheme to buy out the UK Scheme's interest in the partnership. Under *IAS 19 – Employee benefits* the interest in the partnership does not represent a plan asset for group reporting purposes and therefore the UK Scheme's deficit position presented in these financial statements does not reflect the UK Scheme's interest in the partnership. Accordingly, distributions from the partnership to the UK Scheme are reflected in the consolidated group financial statements on a cash basis as distributions are paid. The group has also agreed to make conditional contributions into escrow of up to £338 million if an equivalent reduction in the deficit is not achieved over the 10 year term of the funding plan. The escrow account would be payable to the UK Scheme after the triennial funding trustee valuations. The triennial valuation as at 31 March 2012 is in progress and may result in the payment of up to £127 million in three equal annual instalments, into escrow. In addition to the deficit funding, Diageo continues to make a cash contribution in respect of current service costs based on the UK Scheme trustee's valuation. This contribution is expected to be £45 million to the UK Scheme for the year ending 30 June 2013.

The group has also agreed a deficit funding arrangement with the trustees of the Irish Scheme under which it contributes to the Irish Scheme €21 million (£17 million) per annum until the year ending 30 June 2029. The agreement also provides for additional cash contributions into escrow of up to €188 million (£152 million) if an equivalent reduction in the deficit is not achieved over the 18 year period. As part of this funding plan, Diageo has granted to the Irish Scheme a contingent asset comprising mortgages over certain land and buildings and fixed and floating charges over certain receivables of the group up to a value of €200 million (£161 million). In addition to the deficit funding the group expects to make cash contributions of €29 million (£23 million) to the Irish Scheme in the year ending 30 June 2013.

The group also expects to make cash contributions of £90 million to all other post employment schemes in the year ending 30 June 2013.

(g) History of experience gains and losses:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
	£ million	£ million	£ million	£ million	£ million
Actual return less expected return on post employment plan assets	51	336	435	(946)	(236)
Experience gains/(losses) arising on the plan liabilities	6	(74)	229	60	(54)
Changes in assumptions underlying the present value of the plan liabilities	<u>(564)</u>	<u>20</u>	<u>(664)</u>	<u>(127)</u>	<u>272</u>
Actuarial (loss)/gain recognisable in the reconciliation of the assets and liabilities	<u>(507)</u>	<u>282</u>	<u>—</u>	<u>(1,013)</u>	<u>(18)</u>

(h) Changes in the assumptions used for determining post employment costs and liabilities may have a material impact on the consolidated income statement and balance sheet. For the significant assumptions, the following sensitivity analyses give an estimate of the potential impacts on the

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Notes to the consolidated financial statements (continued)

4. Employees (continued)

consolidated income statement for the year ended 30 June 2012 and on the consolidated balance sheet as at 30 June 2012:

	Estimated impact on consolidated income statement				
	Operating profit	Other finance charges	Profit before taxation	Taxation	Profit for the year
	£ million	£ million	£ million	£ million	£ million
2012					
Effect of 0.5% increase in discount rate:					
Approximate decrease in annual post employment cost . .	8	(8)	—	—	—
Effect of 1% increase in expected rates of return on plan assets:					
Approximate decrease in annual post employment cost . .	—	58	58	(14)	44
Effect of one year increase in life expectancy:					
Approximate increase in annual post employment cost . .	(2)	(11)	(13)	3	(10)
Effect of 0.5% decrease in inflation:					
Approximate decrease in annual post employment cost . .	5	18	23	(5)	18
Effect of 1% increase in medical inflation:					
Approximate increase in annual post employment cost . .	(1)	(1)	(2)	1	(1)
Effect of 1% decrease in medical inflation:					
Approximate decrease in annual post employment cost . .	1	1	2	(1)	1

	Estimated impact on consolidated balance sheet		
	Net post employment benefit liabilities	Net deferred tax assets	Net assets
	£ million	£ million	£ million
2012			
Effect of 0.5% increase in discount rate:			
Approximate decrease in post employment deficit		516	(121)
Effect of one year increase in life expectancy:			
Approximate increase in post employment deficit		(238)	57
Effect of 0.5% decrease in inflation:			
Approximate decrease in post employment deficit		394	(89)
Effect of 1% increase in medical inflation:			
Approximate increase in post employment deficit		(23)	8
Effect of 1% decrease in medical inflation:			
Approximate decrease in post employment deficit		21	(8)

(i) Information on transactions between the group and its pension plans is given in note 32.

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Notes to the consolidated financial statements (continued)

5. Exceptional items

IAS 1 (Revised) – Presentation of financial statements requires material items of income and expense to be disclosed separately. Exceptional items are items 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.

In the three years ended 30 June 2012, the following exceptional items were recorded:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Items included in operating profit			
<i>Restructuring</i>			
Operating model review(a)	(69)	(77)	—
Restructuring of Global Supply operations(b)	(16)	(24)	(93)
Restructuring of Irish brewing operations(c)	(11)	(10)	(12)
Global restructuring programme(d)	—	—	(85)
Restructuring of US wine operations(e)	—	—	48
<i>Other</i>			
Pension changes – past service credits(f)	115	—	—
Brand impairment(g)	(59)	(39)	(35)
Duty settlements(h)	—	(127)	—
SEC settlement(i)	—	(12)	—
	<u>(40)</u>	<u>(289)</u>	<u>(177)</u>
Sale of businesses			
Step acquisition of Quanxing and Shuijingfang(j)	124	—	—
Tanzania Breweries Limited(k)	23	—	—
Wine operations(e)	—	(12)	(26)
Joint venture in India	—	(2)	—
Step acquisition of Nuvo(l)	—	—	11
	<u>147</u>	<u>(14)</u>	<u>(15)</u>
Exceptional items before taxation	107	(303)	(192)
Items included in taxation			
Tax on exceptional operating items	19	51	39
Tax on sale of businesses	—	3	10
Loss of future tax amortisation(m)	(524)	—	—
Settlements with tax authorities (n)	—	66	—
	<u>(505)</u>	<u>120</u>	<u>49</u>
Exceptional items in continuing operations	(398)	(183)	(143)
Discontinued operations net of taxation (note 9)	(11)	—	(19)
Total exceptional items	(409)	(183)	(162)

(a) In the year ended 30 June 2011 the group reviewed its operating model across its businesses and commenced a restructuring programme. The main objective of the programme was to improve the effectiveness and productivity of its operations and to deploy resources closer to the market and in those geographical regions where the potential for growth is greatest. This review resulted in changes to the group's regional structure and the way it organises its central functions. £69 million (2011 –

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Notes to the consolidated financial statements (continued)

5. Exceptional items (continued)

£77 million) was incurred in the year ended 30 June 2012 principally in respect of staff redundancies, early termination of contracts and lease costs primarily in the United Kingdom, Ireland and the United States.

(b) In the year ended 30 June 2010 the group announced a number of initiatives to consolidate and streamline the Global Supply spirits operations in the United Kingdom and North America in order to create greater operating efficiencies.

A restructuring of the group's supply operations in Scotland was announced in the year ended 30 June 2010. This included the consolidation of distilling, packaging and warehousing activities into fewer sites and resulted in the closure of a distillery, two cooperages and a warehouse. The packaging plant at Kilmarnock closed in 2012. New investment has been concentrated in the production sites in Leven in Fife and in Shieldhall near Glasgow. £8 million (2011 – £11 million; 2010 – £81 million) was incurred in the year ended 30 June 2012 primarily in respect of redundancies, additional depreciation and site decommissioning costs.

In the year ended 30 June 2010, the group also announced the closure of the Dorval bottling plant in Quebec, Canada and the restructuring of the Daventry distribution centre and in May 2011 the closure of the Menlo Park bottling plant in California and the specialty product building at the Relay plant in Maryland. The net costs of closing the facilities in the year ended 30 June 2012 was £8 million (2011 – £13 million; 2010 – £12 million).

(c) In the year ended 30 June 2008 Diageo announced the centralisation of the group's brewing activities in Ireland at one site. According to plans finalised in the year ended 30 June 2012, this will result in the closure of the breweries and associated activities at Dundalk and Kilkenny in calendar 2013. The exceptional charge for the three years ended 30 June 2012 was principally in respect of accelerated depreciation.

(d) In February 2009 the group announced a global restructuring programme which was designed to ensure improved routes to market, stronger brand positions and enhanced financial strength. The programme affected all operating segments including Corporate. The majority of the costs were in respect of a reduction in the number of employees and were spread over the two years ended 30 June 2010.

(e) In the year ended 30 June 2010, the group carried out a restructuring of its US wine operations which resulted in a restructuring charge of £41 million in respect of a reduction in the number of employees, early contract terminations and inventory impairment. The group also completed a sale and leaseback transaction of certain land and facilities located in the Napa Valley, California. The lease of land was accounted for as an operating lease and resulted in a gain of £89 million which was accounted for as an exceptional property profit.

In addition, as part of the restructuring of the group's wine operations, it was announced in the year ended 30 June 2010 that a number of non-strategic wine businesses in the United States and the Barton & Guestier wine exporter business in France were to be sold. The loss on sale of these businesses in the year ended 30 June 2011 was £10 million (2010 – £26 million).

In the year ended 30 June 2011 the group also disposed of the Gilbeys wine distribution and wholesale drinks business in Ireland. The loss on sale of the business was £2 million.

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Notes to the consolidated financial statements (continued)

5. Exceptional items (continued)

(f) In July 2010 the UK government announced that the inflation index to be used to derive statutory increases could be changed from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). As the group had a pre existing constructive obligation under the UK Diageo Pension Scheme, and a change from RPI to CPI was notified to the members during the year, a past service credit of £86 million arose and has been accounted for as a change in benefits and recognised as an exceptional credit to operating costs in the income statement. Deferred members who have guaranteed RPI increases will still have their deferred benefits linked to RPI. Pensions in payment are unaffected.

For the Guinness Ireland Group Pension Scheme a decision was made that there would be no increase awarded to pensions in payment for the calendar year 2012 and a review will be carried out of any future pension increases. This decision was notified to members during the year and resulted in a past service credit of £29 million which has been accounted for as an exceptional credit to operating costs in the income statement.

(g) In the year ended 30 June 2012 an impairment loss of £59 million was charged to other operating expenses in respect of the Cacique brand. The principal market for Cacique is Spain where the economy continues to suffer a significant downturn. The forecast and long term growth assumptions in the Spanish market for Cacique were reduced due to a fall in demand which has resulted in an impairment of the brand value.

In the year ended 30 June 2011 and 2010 an impairment loss of £39 million and £35 million, respectively, was charged to other operating expenses in respect of the Ursus brand, resulting in a full impairment of the brand value.

(h) In the year ended 30 June 2011, Diageo Turkey settled its dispute with the Turkish customs authorities regarding duty payable on beverage alcohol products sold in the domestic channel in Turkey between 2001 and 2009. The charge incurred with respect to this settlement (including legal fees and other associated costs) was £92 million which was paid during the year ended 30 June 2011. In addition, in June 2011 Diageo settled a dispute with the Thai customs authorities in respect of the price of imported goods between 2002 and 2005. Diageo paid THB 1.8 billion (£35 million) including legal fees in the year ended 30 June 2011. Legal fees and other associated costs in prior years in respect of these cases were written off to other external charges when incurred. Both charges represent a full and final settlement of these disputes.

(i) In the year ended 30 June 2011 Diageo reached a settlement with the Securities and Exchange Commission (SEC) in the United States which resulted in a charge of \$19 million (£12 million) to exceptional items, including legal fees of \$2 million. The settlement was agreed with the SEC in July 2011 and was in respect of various regulatory and control matters, including the SEC enquiries in respect of activities in Korea, India and Thailand.

(j) On 14 July 2011, Diageo acquired an additional 4% equity stake in Sichuan Chengdu Quanxing Group Company Ltd. (Quanxing) from Chengdu Yingsheng Investment Holding Co., Ltd. The consideration for the additional 4% equity stake was CNY 140 million (£14 million). The acquisition of the 4% equity stake brought Diageo's shareholding in Quanxing to 53%. Quanxing is a holding company controlling a 39.7% equity stake in Sichuan Shuijingfang Co., Ltd. (Shuijingfang), a super premium Chinese white spirits company listed on the Shanghai Stock Exchange which following the appointment of additional directors in June 2012 became a subsidiary of Diageo. Quanxing was accounted for as an associate up to 14 July 2011 but following the acquisition of the additional 4% equity stake it became a subsidiary with a 47% non-controlling interest. Shuijingfang was accounted for

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Notes to the consolidated financial statements (continued)

5. Exceptional items (continued)

as an associate throughout the year ended 30 June 2012 but following the change of control became a subsidiary on 29 June 2012 with a 79% non-controlling interest. As a result of Quanxing and Shuijingfang becoming subsidiaries of the group, a gain of £124 million has arisen on the difference between the book value of the equity owned prior to the transactions and their market value on the completion dates which has been disclosed as a sale of business. The gain includes £30 million of cumulative exchange gains recycled from other comprehensive income less a provision of £16 million for onerous contracts arising on the acquisition.

(k) In January 2012 Diageo sold its 20% equity interest in Tanzania Breweries Limited (TBL) for a consideration of £47 million. The investment in TBL was disclosed as an asset for sale and the gain before tax arising on the disposal was £23 million after transaction costs.

(l) In the year ended 30 June 2010 Diageo acquired an additional equity stake in the London Group, the owner of the Nuvo brand, an ultra-premium vodka-based sparkling liqueur, taking its equity ownership from 42.5% to 71.25%. The London Group was formerly accounted for as an associate and following the acquisition of further shares it became a subsidiary. The difference between the market value of the equity owned prior to the acquisition and the book value of the associate was recognised in the consolidated income statement, resulting in a gain of £11 million which was included in sale of businesses.

(m) The group benefits from the availability of tax amortisation on many of its principal brands and other intangible assets. In the year ended 30 June 2012 negotiations with tax authorities were concluded, the outcome of which was a favourable change in taxation basis that replaces the benefit of future amortisation resulting in a write off the related deferred tax assets of £524 million.

(n) In the year ended 30 June 2011 a number of legacy tax issues were settled in respect of historic restructuring.

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Notes to the consolidated financial statements (continued)

6. Interest and other finance income and charges

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
(a) Net interest			
Interest receivable	107	183	188
Fair value gain on interest rate instruments	155	95	281
Total interest receivable	<u>262</u>	<u>278</u>	<u>469</u>
Interest payable on bank loans and overdrafts	(22)	(21)	(20)
Interest payable on finance leases	(12)	(5)	(1)
Interest payable on all other borrowings	(459)	(514)	(548)
Fair value loss on interest rate instruments	(151)	(107)	(275)
Total interest payable	<u>(644)</u>	<u>(647)</u>	<u>(844)</u>
Net interest	<u>(382)</u>	<u>(369)</u>	<u>(375)</u>
(b) Net other finance income and charges			
Net finance income in respect of post employment plans	7	—	—
Other finance income	1	—	4
Total other finance income	<u>8</u>	<u>—</u>	<u>4</u>
Net finance charge in respect of post employment plans	—	(3)	(47)
Unwinding of discounts	(17)	(16)	(18)
Hyperinflation adjustment	(3)	(9)	(16)
Other finance charges	(3)	—	—
Net exchange movements on short term intercompany loans	—	—	(10)
Total other finance charges	<u>(23)</u>	<u>(28)</u>	<u>(91)</u>
Net other finance charges	<u>(15)</u>	<u>(28)</u>	<u>(87)</u>
Interest on post employment plan liabilities	(365)	(342)	(360)
Expected return on post employment plan assets	372	339	313
Net finance income/(charges) in respect of post employment plans	<u>7</u>	<u>(3)</u>	<u>(47)</u>

The amount of borrowing costs capitalised in the year ended 30 June 2012 was £5 million (2011 – £4 million; 2010 – £5 million).

From December 2009 Venezuela was classified as a hyperinflationary economy. Hyperinflationary accounting requires the restatement of the subsidiary undertaking's income statement to current purchasing power. The impact of applying hyperinflationary accounting to the group's operations in Venezuela resulted in a charge of £3 million (2011 – £9 million; 2010 – £16 million) to other finance charges. The index used to calculate the hyperinflationary adjustment was the Indice Nacional de Precios al Consumidor which changed from 235.3 to 285.5 in the year ended 30 June 2012 (2011 – from 190.4 to 235.3; 2010 – from 145.0 to 190.4), an increase of 21% (2011 – 24%; 2010 – 31%).

7. Associates

The group's share of profit after tax from associates was £213 million (2011 – £176 million; 2010 – £142 million).

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Notes to the consolidated financial statements (continued)

7. Associates (continued)

The group's 34% share of operating profit and of profit for the year of Moët Hennessy was £317 million and £205 million, respectively (2011 – £273 million and £179 million, respectively; 2010 – £229 million and £134 million, respectively).

In the year ended 30 June 2012, the group received dividends from its associates of £166 million (2011 – £138 million; 2010 – £111 million), of which £158 million was received from Moët Hennessy (2011 – £131 million; 2010 – £98 million). These dividends included receipts of £62 million (2011 – £51 million; 2010 – £31 million) from Moët Hennessy in respect of amounts payable to tax authorities.

Information on transactions between the group and its associates is given in note 32. Summarised financial information for the group's investments in associates is presented below:

(a) Moët Hennessy Moët Hennessy prepares its financial statements under IFRS in euros to 31 December each year. Summary information for Moët Hennessy for the three years ended 30 June 2012 after adjustment to align Moët Hennessy's accounting policies and accounting periods with those of the group, translated at £1 = €1.18 (2011 – £1 = €1.16; 2010 – £1 = €1.13), is set out below:

	2012		2011		2010	
	€ million	£ million	€ million	£ million	€ million	£ million
Sales	3,797	3,218	3,353	2,891	2,935	2,597
Profit for the year	711	603	610	526	446	395

Profit for the year is after deducting amounts in respect of non-controlling interests.

(b) Other associates For all of the group's investments in associates other than Moët Hennessy, summarised financial information, aggregating 100% of the sales and results of each associate, is presented below:

	2012	2011	2010
	£ million	£ million	£ million
Sales	1,242	1,228	1,202
Profit for the year	49	32	79

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Notes to the consolidated financial statements (continued)

8. Taxation

(a) Analysis of taxation charge in the year

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Current tax			
Current year	312	450	354
Adjustments in respect of prior years	<u>51</u>	<u>(5)</u>	<u>(80)</u>
	<u>363</u>	<u>445</u>	<u>274</u>
Deferred tax			
Origination and reversal of temporary differences	126	(13)	176
Benefit of previously unrecognised tax losses	—	—	(3)
Changes in tax rates	15	9	1
Adjustments in respect of prior years (note 8(c))	<u>534</u>	<u>(98)</u>	<u>29</u>
	<u>675</u>	<u>(102)</u>	<u>203</u>
Taxation on profit from continuing operations	<u>1,038</u>	<u>343</u>	<u>477</u>

Adjustments in respect of prior years for current tax comprise a UK tax charge of £13 million (2011 – £2 million charge; 2010 – £47 million credit) and an overseas tax charge of £38 million (2011 – £7 million credit; 2010 – £33 million credit).

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Current tax			
United Kingdom	31	94	(57)
Overseas	<u>332</u>	<u>351</u>	<u>331</u>
	<u>363</u>	<u>445</u>	<u>274</u>
Deferred tax			
United Kingdom	16	(141)	29
Overseas	<u>659</u>	<u>39</u>	<u>174</u>
	<u>675</u>	<u>(102)</u>	<u>203</u>
Taxation on profit from continuing operations	<u>1,038</u>	<u>343</u>	<u>477</u>

(b) Exceptional tax charges/(credits)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Tax on exceptional operating items	(19)	(51)	(39)
Tax on sale of businesses	—	(3)	(10)
Loss of future tax amortisation	524	—	—
Settlements agreed with tax authorities	<u>—</u>	<u>(66)</u>	<u>—</u>
	<u>505</u>	<u>(120)</u>	<u>(49)</u>

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Notes to the consolidated financial statements (continued)

8. Taxation (continued)

In the year ended 30 June 2012 a settlement was agreed with tax authorities resulting in a deferred tax asset write off of £524 million. See note 8(c) for further information. In the year ended 30 June 2011 the tax settlement comprised a current tax credit of £66 million.

(c) Factors affecting tax charge for the year

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Profit from continuing operations before taxation	<u>3,121</u>	<u>2,360</u>	<u>2,239</u>
Notional charge at UK corporation tax rate of 25.5% (2011 – 27.5%; 2010 – 28%)	796	649	627
Elimination of notional tax on share of associates' profits after tax	(52)	(48)	(38)
Differences in effective overseas tax rates	(13)	(16)	(3)
Items not chargeable	(393)	(197)	(172)
Items not deductible	100	164	116
Benefit of previously unrecognised tax losses	—	—	(3)
Benefit of previously unrecognised other deferred tax assets	—	(115)	—
Changes in tax rates	15	9	1
Adjustments in respect of prior years	<u>585</u>	<u>(103)</u>	<u>(51)</u>
Tax charge for the year	<u>1,038</u>	<u>343</u>	<u>477</u>

The group benefits from the availability of tax amortisation on many of its principal brands and other intangible assets. During the year ended 30 June 2012 negotiations with tax authorities were concluded, the outcome of which was a favourable change in taxation basis of certain overseas profits that replaces the benefit of future amortisation. This resulted in a write off of deferred tax assets of £524 million. In the year ended 30 June 2011 a combination of strong performance and positive forward outlook led to the recognition of an increase in the deferred tax assets of £115 million in respect of future amortisation.

(d) Factors that may affect future tax charges As a group involved in worldwide operations, Diageo is subject to several factors which may affect future tax charges, principally the levels and mix of profitability in different jurisdictions, transfer pricing policies, tax rates imposed and settlements or agreements with tax authorities.

(e) Corporate tax payable The current corporate tax liability of £317 million (2011 – £381 million) represents the amount of taxes payable in respect of current and prior years that exceed payments made, and includes any interest and penalties payable thereon included in the corporation tax charge.

(f) Material tax liabilities As the group operates throughout the world, it faces potential transfer pricing issues in many jurisdictions relating to goods, services and financing. Acquisitions, disposals and restructuring activities may also give rise to potential tax exposures. The group has a number of tax audits ongoing worldwide but does not currently expect material additional tax exposures to arise, above the amounts provided, as and when audits are concluded.

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Notes to the consolidated financial statements (continued)

9. Discontinued operations

Discontinued operations in the year ended 30 June 2012 comprise a charge of £11 million (£16 million less deferred tax of £5 million) in respect of the discounted value of anticipated future payments to additional thalidomide claimants (2011 – £nil; 2010 – £19 million).

10. Earnings per share

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Profit attributable to equity shareholders			
Continuing operations	1,953	1,900	1,648
Discontinued operations	(11)	—	(19)
	<u>1,942</u>	<u>1,900</u>	<u>1,629</u>
	<u>2012</u>	<u>2011</u>	<u>2010</u>
	million	million	million
Weighted average number of shares			
Shares in issue excluding own shares held	2,495	2,493	2,486
Dilutive potential ordinary shares	14	8	5
	<u>2,509</u>	<u>2,501</u>	<u>2,491</u>
Pence per share			
Continuing operations			
– basic earnings	78.2p	76.2p	66.3p
– diluted earnings	77.8p	76.0p	66.2p
Continuing and discontinued operations			
– basic earnings	77.8p	76.2p	65.5p
– diluted earnings	77.4p	76.0p	65.4p

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Notes to the consolidated financial statements (continued)

11. Intangible assets

	<u>Brands</u> £ million	<u>Goodwill</u> £ million	<u>Other intangibles</u> £ million	<u>Computer software</u> £ million	<u>Total</u> £ million
Cost					
At 30 June 2010	5,005	418	1,267	303	6,993
Exchange differences	(129)	(9)	(81)	—	(219)
Acquisition of businesses	6	31	—	—	37
Other additions	—	—	—	77	77
Disposals	—	(1)	—	(7)	(8)
Transfers to assets held for sale	—	(2)	—	—	(2)
At 30 June 2011	4,882	437	1,186	373	6,878
Exchange differences	33	1	32	(7)	59
Acquisition of businesses	1,358	891	—	1	2,250
Other additions	—	—	4	59	63
Disposals	—	—	(2)	(2)	(4)
At 30 June 2012	6,273	1,329	1,220	424	9,246
Amortisation and impairment loss					
At 30 June 2010	35	18	41	173	267
Exchange differences	3	1	1	(1)	4
Amortisation for the year	—	—	6	24	30
Exceptional impairment	39	—	—	—	39
Disposals	—	—	—	(7)	(7)
At 30 June 2011	77	19	48	189	333
Exchange differences	(9)	(2)	—	(4)	(15)
Amortisation for the year	—	—	5	34	39
Impairment	72	—	—	—	72
Disposals	—	—	(2)	(2)	(4)
At 30 June 2012	140	17	51	217	425
Carrying amount					
At 30 June 2012	6,133	1,312	1,169	207	8,821
At 30 June 2011	4,805	418	1,138	184	6,545
At 30 June 2010	4,970	400	1,226	130	6,726

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Notes to the consolidated financial statements (continued)

11. Intangible assets (continued)

(a) Brands are stated at fair value on acquisition. At 30 June 2012, the principal acquired brands, all of which are regarded as having indefinite useful economic lives, are as follows:

	<u>Principal markets</u>	<u>2012</u> £ million	<u>2011</u> £ million
Carrying amount of acquired brands			
Crown Royal whisky	United States	932	909
Captain Morgan	Global	765	746
Johnnie Walker whisky	Global	625	625
Yeni raki	Turkey	598	—
Shui Jing Fang Chinese white spirit	Greater China	538	—
Smirnoff vodka	Global	525	512
Windsor Premier whisky	Korea	484	506
Bell's whisky	South Africa	179	179
Bushmills whiskey	United States	144	144
Seagram's 7 Crown whiskey	United States	142	139
Zacapa rum	Global	122	—
Seagram's VO whisky	United States	121	118
Gordon's gin	Great Britain	119	119
Old Parr whisky	Venezuela	113	111
Cacique rum	Spain	112	190
Bundaberg rum	Australia	88	90
Tanqueray gin	United States	76	74
Romana Sambuca liqueur	United States	54	53
White Horse whisky	Russia	53	53
Meta beer	Ethiopia	52	—
Other brands		291	237
		<u>6,133</u>	<u>4,805</u>

Capitalised brands are regarded as having indefinite useful economic lives and are therefore not amortised. These brands are protected by trademarks, which are renewable indefinitely, in all of the major markets where they are sold. There are not believed to be any legal, regulatory or contractual provisions that limit the useful lives of these brands. The nature of the premium drinks industry is that obsolescence is not a common issue, with indefinite brand lives being commonplace, and Diageo has a number of brands that were originally created more than 100 years ago. Accordingly, the directors believe that it is appropriate that the brands are treated as having indefinite lives for accounting purposes.

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Notes to the consolidated financial statements (continued)

11. Intangible assets (continued)

(b) For the purposes of impairment testing, goodwill has been attributed to cash-generating units as follows:

	2012	2011
	£ million	(restated) £ million
North America – United States	223	204
Europe – Western Europe	163	117
– Turkey	607	—
– Russia and Eastern Europe	41	43
Africa – East Africa	34	32
– Africa Regional Markets	97	3
Asia Pacific – Greater China	105	—
Other cash-generating units	42	19
	<u>1,312</u>	<u>418</u>

Comparatives have been restated following a revision of the group's reporting segments. For an explanation of the change in regional structure see note 2.

Goodwill has arisen on acquisitions of businesses and distribution rights and includes synergies arising from cost savings and the opportunity to utilise the group's distribution network to leverage marketing of the acquired products and the extension of the group's portfolio of brands in other markets around the world.

The fair values of the net assets (including brands) acquired in the Shuijingfang and Meta business combinations in Greater China and Africa Regional Markets, respectively, will be finalised in the year ending 30 June 2013 and as a result the goodwill and its allocation disclosed at 30 June 2012 is provisional.

(c) Other intangibles comprise principally distribution rights. In the year ended 30 June 2008, Diageo acquired the global distribution rights in perpetuity for Ketel One vodka products, and the directors believe that it is appropriate to treat these rights as having an indefinite life for accounting purposes. The carrying value at 30 June 2012 was £1,146 million (2011 – £1,118 million). All other distribution rights are amortised on a straight-line basis over the length of the distribution arrangements, generally between 10 and 20 years, unless there is an indication that the asset may be impaired, in which case, if necessary, the asset is written down or the amortisation period is reassessed and changed. Amortisation of other intangible assets is recognised in other operating expenses in the income statement.

(d) Computer software includes £51 million (2011 – £71 million) in respect of projects in the course of development. Amortisation of computer software is recognised in other operating expenses in the income statement.

Net book value of computer software includes £9 million (2011 – £nil) in respect of assets held under finance leases; depreciation for the year on these assets was £nil (2011 – £ nil).

Impairment testing To ensure that brands, goodwill and other intangibles with indefinite useful lives are not carried at above their recoverable amount, impairment reviews are performed comparing the net carrying value with the recoverable amount using value in use calculations. For goodwill the recoverable amount is calculated in respect of the cash-generating unit including the attributed

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Notes to the consolidated financial statements (continued)

11. Intangible assets (continued)

goodwill. These calculations are performed annually, or more frequently if events or circumstances indicate that the carrying amount may not be recoverable. The value in use calculations are based on discounted forecast cash flows and terminal values calculated on the assumption that cash flows continue in perpetuity at the long term growth rate of each country or region.

The methodology to determine the discount factors and establish the long term growth rates applied in the calculation of the terminal recoverable amount has been revised following a review of best practice. Values calculated under the former and the revised methodology are not materially different.

Cash flows are forecast for each brand, other intangible and cash-generating unit for the financial year, which is approved by management and reflects expectations of sales growth, operating costs and margin, based on past experience and external sources of information.

The discount rates used are the weighted average cost of capital which reflect the returns on government bonds issued by triple 'A' rated countries with a maturity of 10 years, and an equity risk premium adjusted for specific industry and country risks. Further risk premiums are applied according to management's assessment of the risks in respect of the individual cash flows. The group applies post-tax discount rates to post-tax cash flows as the valuation calculated using this method closely approximates to applying pre-tax discount rates to pre-tax cash flows. The long term growth rates applied at the end of the forecast period are the long-term annual inflation rate of the country obtained from external sources. For goodwill, these assumptions are based on the cash-generating unit or group of units to which the goodwill is attributed. For brands, they are based on a weighted average taking into account the country or countries where sales are made.

For some intangible assets, management expects to achieve growth, driven by Diageo's sales, marketing and distribution expertise, which is significantly in excess of the long term growth rates for the applicable countries or regions. In these circumstances, the recoverable amount is calculated based on a five year detailed plan and extended by up to an additional five to ten years using the annual growth rate of the real gross domestic product (GDP) of the country or region aggregated with its inflation rate, adjusted to take into account circumstances specific to the group. In the calculation of the terminal recoverable amount, the long-term annual inflation rate of the country is used as the growth rate.

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Notes to the consolidated financial statements (continued)

11. Intangible assets (continued)

The pre-tax discount rates and long term growth rates used for impairment testing are as follows:

	Pre-tax discount rate	Long term growth rate
	%	%
North America – United States	9	2
Europe – Western Europe	12	2
– Great Britain	8	2
– Spain	13	2
– Russia and Eastern Europe	12	5
– Turkey	17	5
Africa – East Africa	20	5
– Africa Regional Markets	21	5
– South Africa	13	5
Asia Pacific – South-East Asia	11	3
– Korea	10	3
– Australia	10	3
– Greater China	10	3

Any impairment writedowns identified are charged to other operating expenses in the income statement. Included in the total impairment charge of £72 million in the year ended 30 June 2012, an exceptional impairment charge of £59 million is in respect of the Cacique brand. The principal market for Cacique is Spain where the economy continued to suffer a significant downturn. The forecast and long term growth assumptions in the Spanish market for Cacique were reduced due to a fall in demand which has resulted in an impairment of the brand value. The exceptional impairment charge of £39 million in the year ended 30 June 2011 (2010 – £35 million) was in respect of Ursus.

Sensitivity to change in key assumptions Impairment testing is dependent on management’s estimates and judgements, in particular in relation to the forecasting of future cash flows, the discount rates applied to those cash flows and the expected long term growth rates.

The Cacique brand would be impaired in case of an increase in discount rate of 1ppt, a decrease in long term growth rate of 1ppt and a decrease in annual cash flows of 5% by £10 million, £6 million and £6 million against its current carrying value, respectively. It remains possible that changes in assumptions could arise in excess of those indicated above.

For all intangibles with an indefinite life, other than the Cacique brand, management has concluded that no reasonable possible change in the key assumptions on which it has determined the recoverable amounts would cause their carrying values to exceed their recoverable amounts.

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Notes to the consolidated financial statements (continued)

12. Property, plant and equipment

	Land and buildings	Plant and equipment	Fixtures and fittings	Returnable bottles and crates	Under construction	Total
	£ million	£ million	£ million	£ million	£ million	£ million
Cost						
At 30 June 2010	1,060	2,244	202	351	280	4,137
Exchange differences	3	4	(3)	—	(8)	(4)
Acquisition of businesses	10	26	1	5	22	64
Other additions	19	82	17	47	244	409
Disposals	(14)	(28)	(26)	(11)	(1)	(80)
Transfers	15	205	(7)	10	(223)	—
At 30 June 2011	1,093	2,533	184	402	314	4,526
Exchange differences	(21)	(86)	(4)	(25)	(4)	(140)
Acquisition of businesses	100	67	3	—	16	186
Other additions	21	100	10	30	454	615
Disposals	(45)	(134)	(17)	(20)	(3)	(219)
Transfers	75	305	(50)	21	(351)	—
At 30 June 2012	1,223	2,785	126	408	426	4,968
Depreciation						
At 30 June 2010	314	1,078	127	214	—	1,733
Exchange differences	2	17	(2)	4	—	21
Depreciation charge for the year	37	166	22	31	—	256
Exceptional accelerated depreciation	4	23	—	—	—	27
Disposals	(11)	(27)	(22)	(3)	—	(63)
Transfers	13	(13)	—	—	—	—
At 30 June 2011	359	1,244	125	246	—	1,974
Exchange differences	(11)	(58)	(4)	(17)	—	(90)
Depreciation charge for the year	36	188	11	36	—	271
Exceptional accelerated depreciation	8	21	—	—	—	29
Disposals	(43)	(114)	(17)	(14)	—	(188)
Transfers	(3)	33	(31)	1	—	—
At 30 June 2012	346	1,314	84	252	—	1,996
Carrying amount						
At 30 June 2012	877	1,471	42	156	426	2,972
At 30 June 2011	734	1,289	59	156	314	2,552
At 30 June 2010	746	1,166	75	137	280	2,404

(a) The net book value of land and buildings comprises freeholds of £780 million (2011 – £664 million), long leaseholds of £47 million (2011 – £25 million) and short leaseholds of £50 million (2011 – £45 million). Depreciation was not charged on £118 million (2011 – £101 million) of land.

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Notes to the consolidated financial statements (continued)

12. Property, plant and equipment (continued)

(b) Included in the net book value of property, plant and equipment are the following amounts held under finance leases:

	2012	2011
	£ million	£ million
Land and buildings	33	34
Plant and equipment	92	27
Fixtures and fittings	3	4
Assets under construction	95	16
	<u>223</u>	<u>81</u>

Depreciation for the year on these assets was £9 million (2011 – £6 million).

(c) Transfers primarily represent assets brought into use during the year.

(d) As at 30 June 2012 the group has received government grants from the United States Virgin Islands government of £116 million (2011 – £110 million) which have been netted against the capital expenditure incurred on the construction of a new rum distillery in the United States Virgin Islands.

13. Biological assets

	£ million
Fair value	
At 30 June 2010	30
Exchange differences	(2)
Harvested grapes transferred to inventories	(27)
Transfer from assets held for sale	5
Changes in fair value	27
At 30 June 2011	33
Exchange differences	1
Harvested grapes transferred to inventories	(27)
Changes in fair value	27
At 30 June 2012	<u>34</u>

Biological assets comprise grape vines and grapes on the vine. At 30 June 2012, these assets comprise approximately 2,004 hectares (2011 – 1,878 hectares) of vineyards, ranging from newly established vineyards to vineyards that are 93 years old.

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Notes to the consolidated financial statements (continued)

14. Investments in associates

	Moët Hennessy	Other associates	Total
	£ million	£ million	£ million
Cost less provisions			
At 30 June 2010	1,814	246	2,060
Exchange differences	150	7	157
Additions	—	58	58
Share of retained profits/(losses)	99	(10)	89
Share of movements in other comprehensive income	21	—	21
At 30 June 2011	2,084	301	2,385
Exchange differences	(199)	(11)	(210)
Additions	—	48	48
Share of retained profits	109	—	109
Share of movements in other comprehensive income	(9)	—	(9)
Step acquisition of Quanxing and Shuijingfang	—	(125)	(125)
At 30 June 2012	<u>1,985</u>	<u>213</u>	<u>2,198</u>

Investments in associates comprise the cost of shares, less goodwill written off on acquisitions prior to 1 July 1998 of £1,238 million (2011 – £1,410 million), plus the group's share of post acquisition reserves of £960 million (2011 – £975 million).

The movements in the year ended 30 June 2011 in respect of Moët Hennessy have been reclassified to be consistent with the disclosure in the year ended 30 June 2012.

(a) **Moët Hennessy** Moët Hennessy prepares its financial statements under IFRS in euros to 31 December each year. A summary of Moët Hennessy's consolidated balance sheet as at 30 June 2012 and 30 June 2011, including acquisition fair value adjustments principally in respect of Moët Hennessy's brands and translated at £1 = €1.24 (2011 – £1 = €1.11), is set out below:

	2012		2011	
	€ million	£ million	€ million	£ million
Non-current assets	4,247	3,425	4,109	3,702
Current assets	5,860	4,726	5,522	4,975
Total assets	10,107	8,151	9,631	8,677
Current liabilities	(1,586)	(1,279)	(1,490)	(1,343)
Non-current liabilities	(1,281)	(1,033)	(1,338)	(1,205)
Total liabilities	(2,867)	(2,312)	(2,828)	(2,548)
Net assets	<u>7,240</u>	<u>5,839</u>	<u>6,803</u>	<u>6,129</u>

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Notes to the consolidated financial statements (continued)

14. Investments in associates (continued)

(b) **Other associates** For all of the group's investments in associates other than Moët Hennessy, summarised financial information, aggregating 100% of the assets and liabilities of each associate, including acquisition fair value adjustments, is presented below:

	2012	2011
	£ million	£ million
Non-current assets	566	715
Current assets	411	546
Total assets	<u>977</u>	<u>1,261</u>
Current liabilities	(219)	(259)
Non-current liabilities	(282)	(296)
Total liabilities	<u>(501)</u>	<u>(555)</u>
Net assets	<u><u>476</u></u>	<u><u>706</u></u>

15. Investments in joint ventures

The group consolidates its share of the results and net assets of joint ventures that are attributable to the group's brands on a line-by-line basis or on a different proportional basis measured according to the terms of the arrangements. The group's principal joint ventures are as follows:

	Country of incorporation	Country of operation	Percentage of equity owned	Principal activities
Don Julio BV	Netherlands	Mexico	50%	Production, marketing and distribution of premium drinks
Diageo Moët Hennessy (Thailand) Ltd.	Thailand	Thailand	53.6%	Marketing and distribution of premium drinks
Guinness Anchor Berhad	Malaysia	Malaysia	50%	Production, marketing and distribution of premium drinks
Moët Hennessy Diageo (China) Co. Ltd.	China	China	50%	Marketing and distribution of premium drinks
North British Distillery Co. Ltd.	Scotland	Scotland	50%	Production of premium grain spirit and warehousing

The group's joint ventures are involved in the production, marketing and distribution of premium drinks in Europe, South Africa, Central America and the Far East.

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Notes to the consolidated financial statements (continued)

15. Investments in joint ventures

Included in the consolidated financial statements are the following amounts that represent the group's interest in the results and assets and liabilities of joint ventures:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Sales	660	615	568
Operating costs	(597)	(624)	(495)
Profit/(loss) before tax	<u>63</u>	<u>(9)</u>	<u>73</u>

In the year ended 30 June 2011, operating costs included the impact of the settlement with the Thai customs authorities (see note 5(h)).

	<u>2012</u>	<u>2011</u>
	£ million	£ million
Non-current assets	110	147
Current assets	283	278
Total assets	393	425
Current liabilities	(207)	(218)
Non-current liabilities	(45)	(25)
Total liabilities	(252)	(243)
Net assets	<u>141</u>	<u>182</u>

16. Other investments

	<u>Loans</u>	<u>Other</u>	<u>Total</u>
	£ million	£ million	£ million
Cost less provisions or fair value			
At 30 June 2010	107	10	117
Exchange differences	3	—	3
Additions	22	—	22
Repayments	(23)	—	(23)
Fair value adjustments and provisions	(17)	—	(17)
At 30 June 2011	92	10	102
Exchange differences	(13)	—	(13)
Acquisition of businesses	8	—	8
Additions	27	—	27
Repayments	(27)	—	(27)
At 30 June 2012	<u>87</u>	<u>10</u>	<u>97</u>

Loans include £57 million (2011 – £63 million; 2010 – £56 million) of loans to associates in South Africa and £30 million (2011 – £29 million; 2010 – £51 million) of loans to customers and other third parties. Provision against loans was £28 million (2011 – £28 million; 2010 – £11 million).

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Notes to the consolidated financial statements (continued)

17. Inventories

	2012	2011
	£ million	£ million
Raw materials and consumables	334	258
Work in progress	66	25
Maturing inventories	2,953	2,681
Finished goods and goods for resale	602	509
	<u>3,955</u>	<u>3,473</u>

Maturing inventories include whisky, rum, wines and Chinese white spirit. The following amounts of inventories are expected to be utilised after more than one year:

	2012	2011
	£ million	£ million
Raw materials and consumables	49	35
Maturing inventories	2,479	2,246
	<u>2,528</u>	<u>2,281</u>

Inventories are disclosed net of provisions for obsolescence, an analysis of which is as follows:

	2012	2011
	£ million	£ million
Balance at beginning of the year	57	97
Exchange differences	(1)	(2)
Income statement charge	4	10
Utilised	(8)	(48)
	<u>52</u>	<u>57</u>

18. Trade and other receivables

	2012		2011	
	Current assets	Non-current assets	Current assets	Non-current assets
	£ million	£ million	£ million	£ million
Trade receivables	1,749	—	1,501	—
Interest receivable	19	—	45	—
Other receivables	165	108	270	108
Prepayments	142	11	130	10
Accrued income	28	—	31	—
	<u>2,103</u>	<u>119</u>	<u>1,977</u>	<u>118</u>

As at 30 June 2012 non-current other receivables includes £84 million (2011 – £97 million) in respect of the assessment of excise duties made by the Korean customs authorities (see note 31(c)).

At 30 June 2012, approximately 12% and 22% of the group's trade receivables of £1,749 million are due from counterparties based in the United Kingdom and in the United States, respectively.

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Notes to the consolidated financial statements (continued)

18. Trade and other receivables (continued)

The aged analysis of trade receivables, net of provisions, is as follows:

	2012	2011
	£ million	£ million
Not overdue	1,681	1,446
Overdue 1 – 30 days	34	21
Overdue 31 – 60 days	8	7
Overdue 61 – 90 days	8	3
Overdue 91 – 180 days	11	9
Overdue more than 180 days	7	15
	<u>1,749</u>	<u>1,501</u>

Trade and other receivables are disclosed net of provisions for bad and doubtful debts, an analysis of which is as follows:

	2012	2011
	£ million	£ million
Balance at beginning of the year	61	61
Exchange differences	(4)	2
Income statement charge	12	10
Written off	(11)	(12)
	<u>58</u>	<u>61</u>

19. Assets and disposal groups held for sale

	2012	2011
	£ million	£ million
Non-current assets	58	19
Current assets	19	19
Assets held for sale	<u>77</u>	<u>38</u>
Current liabilities	—	(10)
Liabilities held for sale	<u>—</u>	<u>(10)</u>

Assets and disposal groups held for sale at 30 June 2012 comprise a development property in China and land held in the United Kingdom.

20. Cash and cash equivalents

	2012	2011
	£ million	£ million
Cash at bank	548	563
Cash equivalents	528	1,021
	<u>1,076</u>	<u>1,584</u>

Cash and cash equivalents comprise cash in hand, money market and term deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less.

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Notes to the consolidated financial statements (continued)

21. Borrowings and bank overdrafts

	Repayment date	Currency	Year end interest rates %	2012 £ million	2011 £ million
Bank overdrafts	On demand	Various	Various	38	12
Commercial paper	—	US dollar	0.47-0.55	23	—
Bank and other loans	Various	Various	Various	165	103
Credit support obligations	2012	Various	Various	130	91
Guaranteed debentures 2011	2011	US dollar	9.0	—	186
Guaranteed bonds 2012	2012	US dollar	5.125	—	373
Guaranteed bonds 2012	2012	Euro	1.271	—	675
Guaranteed bonds 2013	2013	US dollar	5.2	478	—
Guaranteed bonds 2013	2013	US dollar	5.5	382	—
Fair value adjustment to borrowings	—	—	—	14	7
Borrowings due within one year and bank overdrafts				1,230	1,447
Guaranteed bonds 2013	2013	US dollar	5.2	—	466
Guaranteed bonds 2013	2013	US dollar	5.5	—	373
Guaranteed bonds 2013	2013	Euro	5.5	926	1,035
Guaranteed bonds 2014	2014	US dollar	7.375	514	502
Guaranteed bonds 2014	2014	Euro	6.625	805	899
Guaranteed bonds 2015	2015	US dollar	5.3	477	465
Guaranteed bonds 2015	2015	US dollar	3.25	318	310
Guaranteed bonds 2016	2016	US dollar	5.5	381	372
Guaranteed bonds 2017	2017	US dollar	5.75	794	775
Guaranteed bond 2017	2017	US dollar	1.5	633	—
Guaranteed bonds 2020	2020	US dollar	4.828	379	362
Guaranteed bond 2022	2022	US dollar	2.875	631	—
Guaranteed bonds 2035	2035	US dollar	7.45	255	248
Guaranteed bonds 2036	2036	US dollar	5.875	377	369
Guaranteed bond 2042	2042	US dollar	4.25	314	—
Guaranteed debentures 2022	2022	US dollar	8.0	189	185
Medium term notes	2018	US dollar	4.85	127	124
Bank and other loans	Various	Various	Various	44	49
Fair value adjustment to borrowings	—	—	—	235	214
Borrowings due after one year				7,399	6,748
Total borrowings before derivative financial instruments				8,629	8,195
Fair value of foreign currency forwards and swaps	—	—	—	(210)	(182)
Fair value of interest rate hedging instruments	—	—	—	(3)	(58)
Total borrowings after derivative financial instruments				8,416	7,955

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Notes to the consolidated financial statements (continued)

21. Borrowings and bank overdrafts (continued)

Bank overdrafts form an integral part of the group's cash management and are included as a component of net cash and cash equivalents in the consolidated statement of cash flows. All bonds, medium term notes, debentures and commercial paper are fully and unconditionally guaranteed by Diageo plc.

Included in borrowings due within one year are credit support obligations. When derivative transactions are undertaken with bank counterparties, the group may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the benefit of the other if the net valuations of the derivatives are above a pre-determined threshold. At 30 June 2012, the collateral held under these agreements amounted to \$135 million (£86 million) and €54 million (£44 million) (2011 – \$84 million (£52 million) and €44 million (£39 million)).

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate hedges (see note 23). The average monthly net borrowings for the year were £8,293 million (2011 – £7,227 million). Based on average monthly net borrowings and net interest charge, taking into account interest rate hedges, the effective interest rate for the year was 4.7% (2011 – 4.9%). For this calculation, 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. The loans above are stated net of unamortised finance costs of £92 million (2011 – £78 million; 2010 – £84 million).

The weighted average interest rate, before interest rate hedges, for short term borrowings at 30 June 2012 was 6.1% (2011 – 4.3%; 2010 – 5.6%). The weighted average interest rate, before interest rate hedges, for bonds, medium term notes and bank loans included within borrowings due after one year at 30 June 2012 was 5.1% (2011 – 5.8%; 2010 – 5.5%).

Certain borrowings are reported in the table above at amortised cost with a fair value adjustment shown separately.

(a) Analysis of net borrowings

	2012	2011
	£ million	£ million
Borrowings due within one year and bank overdrafts	(1,230)	(1,447)
Borrowings due after one year	(7,399)	(6,748)
Fair value of foreign currency forwards and swaps(i)	210	182
Fair value of interest rate hedging instruments	3	58
Finance lease liabilities	(230)	(79)
Gross borrowings	(8,646)	(8,034)
Offset by:		
Cash and cash equivalents	1,076	1,584
Net borrowings	(7,570)	(6,450)

(i) Includes derivative financial instruments designated in net investment hedges or designated to hedge the foreign currency risk associated with certain foreign currency denominated borrowings.

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Notes to the consolidated financial statements (continued)

21. Borrowings and bank overdrafts (continued)

Foreign currency forwards and swaps, interest rate hedging instruments and finance lease liabilities are included as appropriate in other financial assets and other financial liabilities.

(b) Reconciliation of movement in net borrowings

	<u>2012</u>	<u>2011</u>
	<u>£ million</u>	<u>£ million</u>
Net borrowings at beginning of the year	(6,450)	(6,954)
Net (decrease)/increase in cash and cash equivalents before exchange	(507)	242
Net (increase)/decrease in loans	(512)	414
Change in net borrowings from cash flows	(1,019)	656
Exchange differences on net borrowings	152	(17)
Borrowings acquired through purchase of businesses	(5)	(22)
Other non-cash items	(248)	(113)
Net borrowings at end of the year	(7,570)	(6,450)

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Notes to the consolidated financial statements (continued)

22. Other financial assets and liabilities

	Non-current assets	Current assets	Current liabilities	Non-current liabilities	Total
	£ million	£ million	£ million	£ million	£ million
2012					
Derivative assets/(liabilities)					
Designated in a cash flow hedge	235	28	(32)	(8)	223
Designated in a fair value hedge	—	3	—	—	3
Designated in a net investment hedge	—	1	(23)	—	(22)
Not designated in a hedge relationship	<u>270</u>	<u>10</u>	<u>(18)</u>	<u>(148)</u>	<u>114</u>
	<u>505</u>	<u>42</u>	<u>(73)</u>	<u>(156)</u>	<u>318</u>
Non-derivative liabilities					
Deferred consideration payable	—	—	(17)	(103)	(120)
Finance lease liabilities	—	—	(23)	(207)	(230)
	—	—	(40)	(310)	(350)
Total other financial assets/(liabilities)	<u>505</u>	<u>42</u>	<u>(113)</u>	<u>(466)</u>	<u>(32)</u>
2011					
Derivative assets/(liabilities)					
Designated in a cash flow hedge	177	44	(31)	(11)	179
Designated in a fair value hedge	66	2	—	(10)	58
Designated in a net investment hedge	—	13	(17)	—	(4)
Not designated in a hedge relationship	<u>62</u>	<u>30</u>	<u>(31)</u>	<u>(33)</u>	<u>28</u>
	<u>305</u>	<u>89</u>	<u>(79)</u>	<u>(54)</u>	<u>261</u>
Non-derivative liabilities					
Deferred consideration payable	—	—	(4)	(21)	(25)
Finance lease liabilities	—	—	(7)	(72)	(79)
	—	—	(11)	(93)	(104)
Total other financial assets/(liabilities)	<u>305</u>	<u>89</u>	<u>(90)</u>	<u>(147)</u>	<u>157</u>

Finance lease liabilities are payable as follows:

	2012			2011		
	Future minimum lease payments	Future finance charges	Present value of minimum lease payments	Future minimum lease payments	Future finance charges	Present value of minimum lease payments
	£ million	£ million	£ million	£ million	£ million	£ million
Less than one year	(39)	16	(23)	(12)	5	(7)
Between one and five years	(129)	45	(84)	(38)	16	(22)
More than five years	<u>(165)</u>	<u>42</u>	<u>(123)</u>	<u>(76)</u>	<u>26</u>	<u>(50)</u>
	<u>(333)</u>	<u>103</u>	<u>(230)</u>	<u>(126)</u>	<u>47</u>	<u>(79)</u>

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management

Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates, interest rates and commodity price movements that arise in the normal course of the group's business.

The group's funding, liquidity and exposure to foreign currency and interest rate risks are managed by the group's treasury department. The treasury department uses a range of financial instruments to manage these underlying risks.

Treasury operations are conducted within a framework of board-approved policies and guidelines, which are recommended and subsequently monitored by the finance committee. This committee is described in the Corporate governance report. The policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk. The benchmarks, hedge cover levels and overall appropriateness of Diageo's risk management policies are reviewed by the board following, for example, significant business, strategic or accounting changes. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board-approved strategies. Transactions arising on the application of this flexibility may give rise to exposures different from the defined benchmark levels that are separately monitored on a daily basis using value at risk analysis. These transactions are carried at fair value and gains or losses are taken to the income statement as they arise. In the year ended 30 June 2012 gains and losses on these transactions were not material.

The group purchases insurance for commercial or, where required, for legal or contractual reasons. In addition, the group retains insurable risk where external insurance is not considered an economic means of mitigating these risks.

The finance committee receives monthly reports on the activities of the treasury department, including any exposures different from the defined benchmarks.

(a) Currency risk The group presents its consolidated financial statements in sterling and conducts business in many foreign currencies. As a result, it is subject to foreign currency risk due to exchange rate movements, which will affect the group's transactions and the translation of the results and underlying net assets of its foreign operations. To manage the foreign currency risk the group uses certain financial instruments. Where hedge accounting is applied, hedges are documented and tested for hedge effectiveness on an ongoing basis. Diageo expects hedges entered into to continue to be effective and therefore does not expect the impact of ineffectiveness on the consolidated income statement to be material.

Hedge of net investment in foreign operations The group hedges a substantial portion of its exposure to fluctuations in the sterling value of its foreign operations by designating net borrowings held in foreign currencies and using foreign currency spots, forwards, swaps and other financial derivatives. The board reviewed and approved a revised policy, applicable from 20 June 2012, to manage hedging of foreign exchange risk arising from net investment in foreign operations. The group's revised policy is to maintain total net investment Value at Risk below £1 billion with additional limits for individual currencies, where Value at Risk is defined as the maximum amount of loss not exceeded over a one year period with a 95% probability confidence level. The group's previous policy was to seek to hedge currency exposure on its net investment in foreign operations by using gross debt in foreign currencies and foreign currency spots, forwards, swaps and other financial derivatives within the following percentage bands: 80% to 100% for US dollars and euros and, at management's discretion, 0% to 100% for other currencies.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

Exchange differences arising on the retranslation of foreign currency borrowings (including foreign currency forwards, swaps and other financial derivatives), to the extent that they are in an effective hedge relationship, are recognised in other comprehensive income to offset exchange differences on net investments in foreign operations. Exchange differences on foreign currency borrowings not in a hedge relationship and any ineffectiveness are taken to the income statement.

Transaction exposure hedging The group's policy is to hedge up to 24 months forecasted transactional foreign currency risk in the three major currency pairs (US dollar/sterling, euro/sterling and euro/US dollar) targeting 75% coverage of the current financial year when the annual plan is approved, and up to 18 months for other currency pairs. The effective portion of the gain or loss on the hedge is recognised in other comprehensive income and recycled into the income statement at the same time as the underlying hedged transaction affects the income statement. Any ineffectiveness is taken to the income statement.

Hedge of foreign currency debt The group uses cross currency interest rate swaps to hedge the foreign currency risk associated with certain foreign currency denominated borrowings. The effective portion of the gain or loss on the hedge is recognised in other comprehensive income and recycled into the income statement at the same time as the underlying hedged transaction affects the income statement. Any ineffectiveness is taken to the income statement.

(b) Interest rate risk The group has an exposure to interest rate risk, arising principally on changes in US dollar, euro and sterling interest rates. To manage interest rate risk, the group manages its proportion of fixed to floating rate borrowings within limits approved by the board, primarily through issuing fixed and floating rate borrowing and commercial paper, and by utilising interest rate derivatives. These practices aim to minimise the group's net finance charges with acceptable year on year volatility. To facilitate operational efficiency and effective hedge accounting, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of forecast net borrowings. Due to the exceptionally low interest rate environment experienced during 2012, the board has approved an exception to this policy, permitting fixed rate debt to reach up to 100% of forecast net debt. For these calculations, net borrowings exclude interest rate related fair value adjustments. The majority of Diageo's existing interest rate derivatives are legacy fair value hedges that have locked in positive market values. These instruments are no longer involved in hedge relationships and the fair value change is recognised in the income statement which is partially offset by the net interest earned on these derivatives.

(c) Commodity price risk The group is exposed to commodity price risk. Commodity price risk is managed in line with principles approved by the board either through long term purchase contracts with suppliers or, where appropriate, derivative contracts. Where derivative contracts are used the group manages exposures principally through exchange-traded futures, forwards, swaps and options.

(d) Market risk sensitivity analysis The group is using a sensitivity analysis technique that measures the estimated impacts on the consolidated income statement and other comprehensive income of either an instantaneous increase or decrease of 0.5% (50 basis points) in market interest rates or a 10% strengthening or weakening in sterling against all other currencies, from the rates applicable at 30 June 2012 and 30 June 2011, for each class of financial instruments with all other variables remaining constant. The sensitivity analysis excludes the impact of market risks on the net post employment benefit liability and corporate tax payable. This analysis is for illustrative purposes only, as in practice interest and foreign exchange rates rarely change in isolation.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

The sensitivity analysis is based on the following:

- Financial instruments are valued at the balance sheet date using discounted cash flow techniques.
- Changes in interest rates affect the interest income or expense of variable interest financial instruments.
- Changes in interest rates only affect interest income or expense in relation to financial instruments with fixed interest rates if these are recognised at fair value.
- Changes in interest rates affect the fair value of derivative financial instruments designated as hedging instruments.
- Changes in the fair values of derivative financial instruments and other financial assets and liabilities are estimated by discounting the future cash flows to net present values using rates prevailing at the year end.
- All interest rate, net investment and foreign currency cash flow hedges are expected to be highly effective.

The sensitivity analysis estimates the impact of changes in interest and foreign exchange rates. Actual results in the future may differ from these results materially due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the following table, which therefore should not be considered as projections of likely future events, gains or losses.

Reasonably possible hypothetical changes in other risk variables would not significantly affect the fair value of financial instruments at 30 June 2012 and 30 June 2011.

Analysis of sensitivities

	0.5% decrease in interest rates £ million	0.5% increase in interest rates £ million	10% weakening of sterling £ million	10% strengthening of sterling £ million
2012				
Impact on income statement – gain/(loss)	5	(5)	(26)	21
Impact on the consolidated statement of comprehensive income – gain/(loss)(i)(ii)	19	(18)	(786)	643
2011				
Impact on income statement – gain/(loss)	13	(13)	(29)	24
Impact on the consolidated statement of comprehensive income – gain/(loss)(i)(ii)	22	(22)	(731)	598

- (i) The group's foreign currency debt is used to hedge the net investments in foreign operations and as such the translation of foreign net investments mainly offsets the foreign currency gains or losses on financial instruments recognised in other comprehensive income.
- (ii) Impact on the consolidated statement of comprehensive income includes the impact on the income statement.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

The above analysis considers the impact of all financial instruments including financial derivatives, cash and cash equivalents, borrowings and other financial assets and liabilities.

(e) **Credit risk** Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the group. Credit risk arises from cash balances (including bank deposits and cash and cash equivalents), derivative financial instruments and credit exposures to customers, including outstanding loans, trade and other receivables, financial guarantees and committed transactions. Credit risk is managed separately for financial and business related credit exposures.

Financial credit risk

Diageo aims to minimise its financial credit risk through the application of risk management policies approved and monitored by the board. Counterparties are limited to major banks and financial institutions, primarily with a long term credit rating within the A band or better, and the policy restricts the exposure to any one counterparty by setting credit limits taking into account the credit quality of the counterparty. The group's policy is designed to ensure that individual counterparty limits are adhered to and that there are no significant concentrations of credit risk. The board also defines the types of financial instruments which may be transacted. The credit risk arising through the use of financial instruments for currency and interest rate risk management is estimated with reference to the fair value of contracts with a positive value, rather than the notional amount of the instruments themselves.

When derivative transactions are undertaken with bank counterparties, the group may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the benefit of the other if the net valuations of the derivatives are above a pre-determined threshold.

Diageo annually reviews the credit limits applied and regularly monitors the counterparties' credit quality reflecting market credit conditions.

Business related credit risk

Loan, trade and other receivables exposures are managed locally in the operating units where they arise and credit limits are set as deemed appropriate for the customer. There is no concentration of credit risk with respect to loans, trade and other receivables as the group has a large number of customers which are internationally dispersed.

The carrying amount of financial assets represents the group's exposure to credit risk at the reporting date as disclosed in note 23(i), excluding the impact of any collateral held or other credit enhancements.

(f) **Liquidity risk** Liquidity risk is the risk that Diageo may encounter in meeting its obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The group's policy with regard to the expected maturity profile of borrowings is to limit the amount of such borrowings maturing within 12 months to 50% of gross borrowings less money market demand deposits, and the level of commercial paper to 30% of gross borrowings less money market demand deposits. In addition, it is group policy to maintain backstop facilities with relationship banks to support commercial paper obligations.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

The following table provides an analysis of the anticipated contractual cash flows including interest payable for the group's non-derivative financial liabilities on an undiscounted basis. Where interest payments are on a floating rate basis, rates of each cash flow until maturity of the instruments are calculated based on the forward yield curve prevailing at 30 June 2012 and 30 June 2011.

	Borrowings(i) £ million	Interest on borrowings(i)(iii) £ million	Finance lease capital repayments(i) £ million	Finance lease interest(i) £ million	Other(ii) £ million	Total £ million
2012						
After five years	(3,155)	(1,399)	(123)	(42)	(9)	(4,728)
From four to five years .	(1,027)	(184)	(11)	(8)	(13)	(1,243)
From three to four years	(484)	(208)	(27)	(11)	(133)	(863)
From two to three years	(1,142)	(287)	(22)	(12)	(21)	(1,484)
From one to two years . .	(1,448)	(376)	(24)	(14)	(25)	(1,887)
Due after one year	(7,256)	(2,454)	(207)	(87)	(201)	(10,205)
Due within one year . . .	(1,216)	(442)	(23)	(16)	(2,128)	(3,825)
Total gross contractual cash flows	<u>(8,472)</u>	<u>(2,896)</u>	<u>(230)</u>	<u>(103)</u>	<u>(2,329)</u>	<u>(14,030)</u>
Net carrying amount(iii)	<u>(8,629)</u>	<u>(168)</u>	<u>(230)</u>	<u>—</u>	<u>(2,290)</u>	<u>(11,317)</u>
2011						
After five years	(2,512)	(1,081)	(50)	(26)	(9)	(3,678)
From four to five years .	(475)	(161)	(4)	(3)	—	(643)
From three to four years	(1,221)	(244)	(4)	(4)	(1)	(1,474)
From two to three years	(1,543)	(338)	(7)	(4)	(4)	(1,896)
From one to two years . .	(861)	(385)	(7)	(5)	(37)	(1,295)
Due after one year	(6,612)	(2,209)	(72)	(42)	(51)	(8,986)
Due within one year . . .	(1,440)	(438)	(7)	(5)	(2,069)	(3,959)
Total gross contractual cash flows	<u>(8,052)</u>	<u>(2,647)</u>	<u>(79)</u>	<u>(47)</u>	<u>(2,120)</u>	<u>(12,945)</u>
Net carrying amount(iii)	<u>(8,195)</u>	<u>(186)</u>	<u>(79)</u>	<u>—</u>	<u>(2,118)</u>	<u>(10,578)</u>

(i) For the purpose of these tables above, borrowings are defined as total borrowings before derivative financial instruments as presented in note 21.

(ii) This category primarily consists of trade and other payables that meet the definition of financial liabilities under IAS 32.

(iii) Carrying amount of interest on borrowings is included within accruals in note 24.

The following table provides an analysis of the anticipated contractual cash flows in respect of the group's derivative instruments, using undiscounted cash flows. Where interest payments are on a floating rate basis, rates of each cash flow until maturity of the instrument are calculated based on the

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

forward yield curve prevailing at 30 June 2012 and 30 June 2011. Cash flows are presented on a net or gross basis in accordance with the settlement arrangements of the instruments.

<u>Derivative liabilities</u>	2012		2011	
	<u>Inflow</u> £ million	<u>Outflow</u> £ million	<u>Inflow</u> £ million	<u>Outflow</u> £ million
After five years	139	(136)	9	—
From four to five years	4	(4)	—	(5)
From three to four years	5	(4)	—	(7)
From two to three years	6	(4)	—	(14)
From one to two years	4	(14)	—	(17)
Due after one year	158	(162)	9	(43)
Due within one year	4	(71)	—	(84)
Total gross contractual cash flows	<u>162</u>	<u>(233)</u>	<u>9</u>	<u>(127)</u>

<u>Derivative assets</u>	2012		2011	
	<u>Inflow</u> £ million	<u>Outflow</u> £ million	<u>Inflow</u> £ million	<u>Outflow</u> £ million
After five years	700	(520)	1,204	(1,033)
From four to five years	432	(348)	42	(37)
From three to four years	52	(30)	60	(34)
From two to three years	56	(31)	72	(34)
From one to two years	61	(31)	115	(34)
Due after one year	1,301	(960)	1,493	(1,172)
Due within one year	98	(31)	213	(34)
Total gross contractual cash flows	<u>1,399</u>	<u>(991)</u>	<u>1,706</u>	<u>(1,206)</u>

The group had available undrawn committed bank facilities as follows:

	2012 £ million
Expiring within one year	745
Expiring between one and two years	—
Expiring after two years	1,484
	<u>2,229</u>

Commitment fees are paid on the undrawn portion of these facilities and accounted for on an accruals basis. Borrowings under these facilities will be at prevailing LIBOR rates (dependent on the period of drawdown) plus an agreed margin. 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 short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

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 associates' profits after tax, 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.

(g) Hedging instruments The group designates derivatives which qualify for hedge accounting as either: (i) a hedge of the fair value of a recognised asset or liability (fair value hedge); (ii) a hedge of a forecast transaction or the cash flow risk from a change in foreign exchange or interest rates (cash flow hedge); or (iii) a hedge of a net investment in foreign operations. The accounting treatment for hedges is disclosed in 'Accounting policies of the group'.

The group tests effectiveness on a prospective and retrospective basis. Methods for testing effectiveness include dollar offset, critical terms, regression analysis and hypothetical derivative method.

Gain on fair value hedging instruments for the year was £84 million (2011 – £8 million loss; 2010 – £163 million gain) and the loss on the hedged items attributable to the hedged risks was £86 million (2011 – £19 million gain; 2010 – £163 million loss).

In respect of cash flow hedging instruments, gains of £29 million (2011 – £25 million gain; 2010 – £27 million loss) have been recognised in other comprehensive income due to changes in fair value. A gain of £4 million and a loss of £19 million have been transferred out of other comprehensive income to other operating expenses and to other finance charges, respectively, in the year (2011 – £2 million loss and a loss of £54 million; 2010 – £47 million loss and a gain of £73 million, respectively).

For cash flow hedges of forecast transactions at 30 June 2012, based on year end interest and foreign exchange rates, there is expected to be a charge to the income statement of £6 million in 2013 and £4 million in 2014. With respect to hedges of the cash flow risk from a change in forward foreign exchange rates using cross currency interest rate swaps, the retranslation of the related bond principal to closing foreign exchange rates and recognition of interest on the related bonds will affect the income statement in each year until the related bonds mature in 2016 and 2036. Foreign exchange retranslation and the interest on the hedged bonds in the income statement are expected to offset those on the cross currency swaps in each of the years.

(h) Fair value measurements Fair value measurements of financial instruments are presented through the use of a three-level fair value hierarchy that prioritises the valuation techniques used in fair value calculations. The levels can be broadly described as follows:

- Level 1 – use of unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – use of observable inputs other than quoted prices included within level 1, such as quoted prices for similar assets or liabilities in active markets; and
- Level 3 – use of inputs not based on observable market data but reflecting management's own assumptions about pricing the asset or liability.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

The group maintains policies and procedures to value instruments using the most relevant data available. If multiple inputs that fall into different levels of the hierarchy are used in the valuation of an instrument, the instrument is categorised on the basis of the most subjective input.

Derivatives and other financial liabilities at fair value

Foreign currency forwards and swaps, cross currency swaps and interest rate swaps are valued using discounted cash flow techniques. These techniques incorporate inputs at levels 1 and 2, such as foreign exchange rates and interest rates. These market inputs are used in the discounted cash flow calculation incorporating the instrument's term, notional amount and discount rate, and taking credit risk into account. As significant inputs to the valuation are observable in active markets, these instruments are categorised as level 2 in the hierarchy.

The Nolet Group's option to sell the remaining 50% equity stake in Ketel One Worldwide BV to Diageo is classified as a derivative financial liability with changes in fair value included in operating profit. Industrias Licoreras de Guatemala's option to sell the remaining 50% equity stake in Rum Creations Products Inc, the owner of the Zacapa rum brand, to Diageo is classified as a financial liability with changes in fair value included in retained earnings (see note 30). As the valuation of these options uses assumptions not observable in the market, they are categorised as level 3 in the hierarchy.

The group's financial assets and liabilities, excluding finance lease liabilities, measured at fair value are categorised as follows:

	2012				2011			
	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total £ million
Assets								
Derivative assets	—	547	—	547	—	394	—	394
Total assets	—	547	—	547	—	394	—	394
Liabilities								
Derivative liabilities . . .	—	(221)	(8)	(229)	—	(118)	(15)	(133)
Other financial liabilities	—	—	(120)	(120)	—	—	(25)	(25)
Total liabilities	—	(221)	(128)	(349)	—	(118)	(40)	(158)

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

The movements in level 3 instruments, measured on a recurring basis, are as follows:

	<u>Derivative liabilities</u> £ million	<u>Other financial liabilities</u> £ million	<u>Total level 3 instruments</u> £ million
At 30 June 2010	(23)	(28)	(51)
Net gains included in the consolidated statement of comprehensive income(i)	<u>8</u>	<u>3</u>	<u>11</u>
At 30 June 2011	(15)	(25)	(40)
Financial liabilities arising on acquisitions	—	(97)	(97)
Net gains included in the consolidated statement of comprehensive income(i)	7	6	13
Net losses included in retained earnings	—	(6)	(6)
Settlement of liabilities	<u>—</u>	<u>2</u>	<u>2</u>
At 30 June 2012	<u>(8)</u>	<u>(120)</u>	<u>(128)</u>

(i) Including gains/(losses) included in the income statement.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

(i) **Total financial assets and liabilities** The table below sets out the group's accounting classification of each class of financial assets and liabilities, and their fair values.

	2012		2011	
	Total carrying value	Fair value	Total carrying value	Fair value
	£ million	£ million	£ million	£ million
Financial assets				
Cash and cash equivalents	1,076	1,076	1,584	1,584
Available-for-sale investments	4	4	4	4
Trade receivables	1,749	1,749	1,501	1,501
Interest receivable	19	19	45	45
Accrued income	28	28	32	32
Other receivables(ii)	87	87	196	196
Other investments	93	93	98	98
Loans and receivables	1,976	1,976	1,872	1,872
Derivatives in a hedge relationship	267	267	302	302
Other instruments at fair value	280	280	92	92
Financial assets at fair value through profit or loss	547	547	394	394
Total financial assets	<u>3,603</u>	<u>3,603</u>	<u>3,854</u>	<u>3,854</u>
Financial liabilities				
Finance leases	230	230	79	79
Borrowings not in a hedge relationship(i)	8,308	9,131	4,812	5,164
Borrowings in a hedge relationship(i)	321	327	3,383	3,631
Trade payables	1,078	1,078	986	986
Interest payable	177	177	191	191
Other payables(ii)	217	217	260	260
Accruals	875	875	847	847
Financial liabilities at amortised cost	10,976	11,805	10,479	11,079
Derivatives in a hedge relationship	63	63	69	69
Other instruments at fair value	286	286	89	89
Financial liabilities at fair value through profit or loss	349	349	158	158
Total financial liabilities	<u>11,555</u>	<u>12,384</u>	<u>10,716</u>	<u>11,316</u>

(i) For the purpose of this table, borrowings are defined as total borrowings before derivative financial instruments as presented in note 21.

(ii) Only receivables and payables that meet the definition of financial instruments under IAS 32 are included in this line.

All derivative financial instruments not in a hedge relationship are classified as trading derivatives with fair value changes recorded in the income statement. The group does not use derivatives for

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

speculative purposes. All transactions in derivative financial instruments are initially undertaken to manage the risks arising from underlying business activities.

The fair values of borrowings are based on market data. The fair values of derivatives and financial instruments are estimated by discounting the future contractual cash flows using the appropriate yield curves prevailing at 30 June each year. At 30 June 2012 and 30 June 2011, the carrying values of cash and cash equivalents, bank overdrafts, other financial assets and liabilities were considered to approximate fair values.

(j) Analysis of cash and cash equivalents by currency

	2012		2011	
	£ million	%	£ million	%
US dollar	551	52	1,058	67
Euro	46	4	56	4
Sterling	23	2	123	8
Korean won	111	10	67	4
Chinese yuan	88	8	21	1
Other	257	24	259	16
Cash and cash equivalents	1,076	100	1,584	100

(k) Analysis of gross borrowings by currency

	2012		2011	
	£ million	%	£ million	%
US dollar	(3,524)	41	(3,689)	46
Euro	(1,951)	23	(1,990)	25
Sterling	(2,893)	33	(1,776)	22
Other	(278)	3	(579)	7
Gross borrowings	(8,646)	100	(8,034)	100

The analysis of group's gross borrowings above includes the impact of foreign currency forwards and swaps.

(l) Analysis of net borrowings by interest rate profile

	2012		2011	
	£ million	%	£ million	%
Fixed rate	(7,528)	99	(3,638)	57
Floating rate	127	(2)	(2,722)	42
Interest free	—	—	5	—
Impact of financial derivatives and fair value adjustments	(169)	3	(95)	1
Net borrowings	(7,570)	100	(6,450)	100

The analysis above includes the impact of interest rate hedging instruments.

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Notes to the consolidated financial statements (continued)

23. Financial instruments and risk management (continued)

(m) **Capital management** Diageo considers the following components of its balance sheet to be capital: borrowings, banks overdrafts and equity.

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 improve the return on investment and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, maximise flexibility and give the appropriate level of access to debt markets at attractive cost levels. This is achieved by targeting a range of ratios which are currently broadly consistent with an A band credit rating. Diageo would consider modifying these ratios in the medium term in order to effect strategic initiatives within its stated goals, which could have an impact on its rating.

The group regularly assesses its debt and equity capital levels against its stated policy for capital structure.

Where appropriate, comparative figures were reclassified to ensure a consistent presentation with current year information.

24. Trade and other payables

	2012		2011	
	Current liabilities	Non-current liabilities	Current liabilities	Non-current liabilities
	£ million	£ million	£ million	£ million
Trade payables	1,078	—	986	—
Interest payable	177	—	191	—
Tax and social security excluding income tax	496	—	408	—
Other payables	354	72	387	29
Accruals	875	—	847	—
Deferred income	17	13	19	12
	<u>2,997</u>	<u>85</u>	<u>2,838</u>	<u>41</u>

Interest payable at 30 June 2012 included interest on non-derivative financial instruments of £168 million (2011 – £186 million).

25. Provisions

	Thalidomide	Restructuring	Other	Total
	£ million	£ million	£ million	£ million
At 30 June 2011	168	109	138	415
Exchange differences	—	(2)	—	(2)
Acquisition of businesses	—	—	17	17
Provisions charged during the year	16	13	21	50
Provisions used during the year	(16)	(40)	(34)	(90)
Unwinding of discounts	10	—	1	11
At 30 June 2012	<u>178</u>	<u>80</u>	<u>143</u>	<u>401</u>
Included in current liabilities	27	43	57	127
Included in non-current liabilities	151	37	86	274
	<u>178</u>	<u>80</u>	<u>143</u>	<u>401</u>

Provisions by their nature are subject to uncertainties with respect to the timing and outcomes of future events.

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Notes to the consolidated financial statements (continued)

25. Provisions (continued)

(a) A provision was established in the year ended 30 June 2005 in respect of the discounted value of the group's commitment to the UK Thalidomide Trust, and will be utilised over the period of the commitment up to 2037. Additional provisions were made in the years ended 30 June 2012 and 30 June 2010 in respect of anticipated future payments to additional thalidomide claimants and these will be utilised up to 2030.

(b) The group is engaged in a number of restructuring programmes, which involve the rationalisation of certain operations around the world. Employee charges, incremental costs in respect of service contract and information systems infrastructure charges in connection with the programmes are recognised in the restructuring provision, which is expected to be substantially utilised by 30 June 2014 (see note 5(a)-(e)).

(c) The largest item in other provisions is £46 million (2011 – £42 million) in respect of employee deferred compensation plans which will be utilised when employees leave the company.

26. Deferred tax assets and liabilities

The amounts of deferred tax accounted for in the consolidated balance sheet comprise the following net deferred tax assets/(liabilities):

	Property, plant and equipment	Intangible assets	Post employment plans	Tax losses	Other temporary differences	Total
	£ million	£ million	£ million	£ million	£ million	£ million
At 30 June 2010	(189)	(603)	305	12	260	(215)
Exchange differences	10	45	(2)	—	(13)	40
Recognised in income – continuing operations	32	(58)	(28)	170	(14)	102
Recognised in other comprehensive income	—	5	(113)	(69)	(1)	(178)
Acquisition of businesses	(9)	(2)	—	—	1	(10)
At 30 June 2011	(156)	(613)	162	113	233	(261)
Exchange differences	3	(16)	(4)	(3)	(2)	(22)
Recognised in income – continuing operations	1	(542)	(45)	17	(106)	(675)
Recognised in income – discontinued operations	—	—	—	—	5	5
Recognised in other comprehensive income	—	—	74	34	33	141
Acquisition of businesses	(14)	(278)	—	—	9	(283)
At 30 June 2012	(166)	(1,449)	187	161	172	(1,095)

Deferred tax on other temporary differences includes items such as the thalidomide provision, restructuring provisions, share-based payments and intra group sales of products.

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Notes to the consolidated financial statements (continued)

26. Deferred tax assets and liabilities (continued)

After offsetting deferred tax assets and liabilities where appropriate within territories, the net deferred tax liability comprises:

	<u>2012</u>	<u>2011</u>
	<u>£ million</u>	<u>£ million</u>
Deferred tax assets	329	516
Deferred tax liabilities	<u>(1,424)</u>	<u>(777)</u>
	<u>(1,095)</u>	<u>(261)</u>

The net deferred tax liability of £1,449 million (2011 – £613 million) in respect of intangible assets comprises deferred tax assets of £39 million (2011 – £590 million) less deferred tax liabilities of £1,488 million (2011 – £1,203 million). The group benefits from the availability of tax amortisation on some of its principal brands and other intangible assets. During the year ended 30 June 2012 negotiations with tax authorities were concluded, the outcome of which was a favourable change in taxation basis of certain overseas profits that replaced the benefit of some future amortisation. This resulted in a write off of the related deferred tax assets of £524 million. This has been accounted for as an exceptional item. Deferred tax assets of £153 million (2011 – £107 million) have been recognised in jurisdictions with prior year taxable losses. It is considered more likely than not that there will be sufficient future taxable profits to support recognition of these deferred tax assets.

Unrecognised deferred tax assets Deferred tax assets have been recognised to the extent that it is considered more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Where this is not the case, deferred tax assets have not been recognised, as set out below:

	<u>2012</u>		<u>2011</u>	
	<u>Tax losses</u>	<u>Other</u>	<u>Tax losses</u>	<u>Other</u>
	<u>£ million</u>	<u>£ million</u>	<u>£ million</u>	<u>£ million</u>
Gross deferred tax assets	319	39	317	623
Amounts not recognised	<u>(158)</u>	<u>—</u>	<u>(204)</u>	<u>(33)</u>
	<u>161</u>	<u>39</u>	<u>113</u>	<u>590</u>

Of the amounts recognised in respect of tax losses, £19 million has expiration dates through to 2022 (2011 – £16 million through to 2021) and £142 million can be carried forward indefinitely (2011 – £97 million). Of the amounts unrecognised in respect of tax losses, £7 million has expiration dates through to 2022 (2011 – £7 million through to 2021) and £151 million (2011 – £197 million) can be carried forward indefinitely.

Unrecognised deferred tax liabilities No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries where the group is able to control the remittance of earnings and it is probable that such earnings will not be remitted in the foreseeable future, or where no liability would arise on the remittance. It is not practicable to estimate the amount of unrecognised deferred tax liabilities in respect of these unremitted earnings.

The aggregate amount of temporary difference associated with investments in subsidiaries, branches interests in joint ventures and associates for which deferred tax liabilities have not been recognised is £16.6 billion (2011 – £15.2 billion). This has been calculated based upon the temporary differences arising between the carrying value in the consolidated financial statements and the tax basis of each investment.

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Notes to the consolidated financial statements (continued)

27. Other comprehensive income

	Hedging reserve	Exchange reserve	Retained earnings/ (deficit)	Total attributable to parent company shareholders	Non-controlling interests	Total
	£ million	£ million	£ million	£ million	£ million	£ million
2012						
Exchange differences on translation of foreign operations excluding borrowings						
– group	—	(74)	—	(74)	—	(74)
– associates and non-controlling interests*	—	(240)	—	(240)	18	(222)
Exchange differences on borrowings and derivative net investment hedges	—	210	—	210	—	210
Effective portion of changes in fair value of cash flow hedges						
– taken to other comprehensive income	29	—	—	29	—	29
– transferred to income statement	(15)	—	—	(15)	—	(15)
Hyperinflation adjustment	—	—	3	3	—	3
Net actuarial loss on post employment plans	—	—	(495)	(495)	—	(495)
Other comprehensive income/(loss) before taxation	<u>14</u>	<u>(104)</u>	<u>(492)</u>	<u>(582)</u>	<u>18</u>	<u>(564)</u>
Tax on exchange differences	—	7	—	7	—	7
Tax on effective portion of changes in fair value of cash flow hedges	(4)	—	—	(4)	—	(4)
Tax on net actuarial loss on post employment plans	—	—	100	100	—	100
Tax on other comprehensive income/(loss)	<u>(4)</u>	<u>7</u>	<u>100</u>	<u>103</u>	<u>—</u>	<u>103</u>
Other comprehensive income/(loss) for the year	<u>10</u>	<u>(97)</u>	<u>(392)</u>	<u>(479)</u>	<u>18</u>	<u>(461)</u>
2011						
Exchange differences on translation of foreign operations excluding borrowings						
– group	—	(133)	—	(133)	—	(133)
– associates and non-controlling interests	—	157	—	157	(64)	93
Exchange differences on borrowings and derivative net investment hedges	—	(51)	—	(51)	—	(51)
Effective portion of changes in fair value of cash flow hedges						
– taken to other comprehensive income	25	—	—	25	—	25
– transferred to income statement	56	—	—	56	—	56
Hyperinflation adjustment	—	—	6	6	—	6
Net actuarial gain on post employment plans	—	—	272	272	—	272

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Notes to the consolidated financial statements (continued)

27. Other comprehensive income (continued)

	Hedging reserve	Exchange reserve	Retained earnings/ (deficit)	Total attributable to parent company shareholders	Non-controlling interests	Total
	£ million	£ million	£ million	£ million	£ million	£ million
Other comprehensive income/(loss) before taxation	81	(27)	278	332	(64)	268
Tax on exchange differences	—	8	—	8	—	8
Tax on effective portion of changes in fair value of cash flow hedges	(7)	—	—	(7)	—	(7)
Tax on net actuarial gain on post employment plans	—	—	(66)	(66)	—	(66)
Tax on other comprehensive income/(loss) .	(7)	8	(66)	(65)	—	(65)
Other comprehensive income/(loss) for the year	<u>74</u>	<u>(19)</u>	<u>212</u>	<u>267</u>	<u>(64)</u>	<u>203</u>
2010						
Exchange differences on translation of foreign operations excluding borrowings – group	—	494	—	494	—	494
– associates and non-controlling interests . .	—	(30)	—	(30)	67	37
Exchange differences on borrowings and derivative net investment hedges	—	(429)	—	(429)	—	(429)
Effective portion of changes in fair value of cash flow hedges						
– taken to other comprehensive income . . .	(27)	—	—	(27)	—	(27)
– transferred to income statement	(26)	—	—	(26)	—	(26)
Hyperinflation adjustment	—	—	25	25	—	25
Net actuarial gain on post employment plans	—	—	8	8	—	8
Other comprehensive (loss)/income before taxation	(53)	35	33	15	67	82
Tax on exchange differences	—	(17)	—	(17)	—	(17)
Tax on effective portion of changes in fair value of cash flow hedges	1	—	—	1	—	1
Tax on other comprehensive (loss)/income .	1	(17)	—	(16)	—	(16)
Other comprehensive (loss)/income for the year	<u>(52)</u>	<u>18</u>	<u>33</u>	<u>(1)</u>	<u>67</u>	<u>66</u>

* Includes £30 million exchange gain recycled to the consolidated income statement on the acquisition of a majority equity stake in Quanxing and obtaining control of Shuijingfang in the year ended 30 June 2012.

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Notes to the consolidated financial statements (continued)

28. Share capital and reserves

(a) Allotted and fully paid share capital – ordinary shares of 28¹⁰¹/₁₀₈ pence each

	Number of shares	Nominal value
	million	£ million
At 30 June 2012, 30 June 2011 and 30 June 2010	<u>2,754</u>	<u>797</u>

(b) **Share premium** During the year, 0.1 million ordinary shares with an aggregate nominal value of less than £0.1 million were allotted under employee share option schemes for a total consideration of £1 million (2011 – 0.1 million shares, nominal value less than £0.1 million, consideration £0.4 million; 2010 – 0.1 million shares, nominal value less than £0.1 million, consideration £0.4 million).

(c) **Hedging and exchange reserve** At 30 June 2012 the hedging reserve and exchange reserve comprised a credit of £74 million and a deficit of £7 million, respectively (2011 – £64 million credit and £90 million credit, respectively; 2010 – a deficit of £10 million and a credit of £109 million, respectively).

(d) **Own shares** Own shares comprise shares in the company held by employee share trusts, shares repurchased as part of the company's share buyback programmes and held as treasury shares, shares held as treasury shares and call options held for hedging share scheme grants provided to employees. Movements in own shares are as follows:

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Notes to the consolidated financial statements (continued)

28. Share capital and reserves (continued)

	Own shares and options held by employee share trusts		Treasury shares repurchased under buyback programmes		Treasury shares for hedging share scheme grants to employees		Total own shares	
	Number of shares	Purchase consideration	Number of shares	Purchase consideration	Number of shares	Purchase/(sale) consideration	Number of shares	Purchase consideration
	million	£ million	million	£ million	million	£ million	million	£ million
At 30 June 2009	23	188	223	1,841	32	313	278	2,342
Share trust arrangements	(8)	(58)	—	—	—	—	(8)	(58)
Share call options purchased	—	23	—	—	—	—	—	23
Shares sold to fund call options	—	—	—	—	(3)	(24)	(3)	(24)
Shares used to satisfy options	—	—	—	—	(3)	(30)	(3)	(30)
At 30 June 2010	15	153	223	1,841	26	259	264	2,253
Share trust arrangements	(4)	(24)	—	—	—	—	(4)	(24)
Shares purchased	—	—	—	—	6	67	6	67
Shares used to satisfy options	—	—	—	—	(4)	(39)	(4)	(39)
At 30 June 2011	11	129	223	1,841	28	287	262	2,257
Share trust arrangements	(4)	(26)	—	—	—	—	(4)	(26)
Shares transferred	2	23	—	—	(2)	(23)	—	—
Shares purchased	—	—	—	—	9	114	9	114
Shares sold to employees	—	—	—	—	—	(2)	—	(2)
Shares used to satisfy options	—	—	—	—	(8)	(86)	(8)	(86)
At 30 June 2012	9	126	223	1,841	27	290	259	2,257

At 30 June 2012, employee share trusts funded by the group held 9 million ordinary shares in the company with a market value of £153 million (2011 – 11 million shares, market value £144 million; 2010 – 15 million shares, market value £159 million). Dividends are waived on all shares in the company owned by the employee share trusts.

During the year ended 30 June 2012, 2 million ordinary shares, with a nominal value of £0.6 million (2011 and 2010 – nil) were transferred from treasury shares to share trusts to ensure that sufficient level of shares are held within the share trusts to satisfy grants and awards made under the group's employee share schemes.

During the year ended 30 June 2012, the company purchased 9 million ordinary shares (2011 – 6 million), with an aggregate nominal value of £3 million (2011 – £2 million), representing approximately 0.4% (2011 – 0.3%) of the issued ordinary share capital (excluding treasury shares), to be held as treasury shares. These shares have not been cancelled but are deducted from shareholders' equity. Dividends are waived on these shares.

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Notes to the consolidated financial statements (continued)

28. Share capital and reserves (continued)

During the year ended 30 June 2012 the company sold 0.1 million ordinary shares held as treasury shares with an aggregate nominal value of less than £0.1 million, to employees under the International sharematch plan (2011 and 2010 – nil).

The company utilised 8 million ordinary shares held as treasury shares, with an aggregate nominal value of £2 million, to satisfy options exercised by employees during the year (2011 – 4 million shares, nominal value of £1 million; 2010 – 3 million shares, nominal value of £1 million).

During the year ended 30 June 2010 the company sold 3 million ordinary shares held as treasury shares, with an aggregate nominal value of £1 million, to purchase call options over 8 million shares at a cost of £24 million to hedge share option grants. These options are held by the employee share trust. Call options denominated in US dollars with a value of £1 million were included in other financial assets.

(e) Dividends

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Amounts recognised as distributions to equity shareholders in the year			
Final dividend for the year ended 30 June 2011			
24.9 pence per share (2010 – 23.5 pence; 2009 – 22.2 pence)	621	586	551
Interim dividend for the year ended 30 June 2012			
16.6 pence per share (2011 – 15.5 pence; 2010 – 14.6 pence)	415	387	363
	<u>1,036</u>	<u>973</u>	<u>914</u>
Proposed final dividend for the year ended 30 June 2012			
26.9 pence per share (2011 – 24.9 pence; 2010 – 23.5 pence)	<u>671</u>	<u>621</u>	<u>586</u>

The proposed final dividend was approved by the board of directors on 22 August 2012. As this was after the balance sheet date and the dividend is subject to approval by shareholders at the Annual General Meeting, this dividend has not been included as a liability in these consolidated financial statements. There are no corporate tax consequences arising from this treatment.

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Notes to the consolidated financial statements (continued)

29. Cash generated from operations

	2012		2011 (restated)		2010 (restated)	
	£ million	£ million	£ million	£ million	£ million	£ million
Profit for the year	2,072		2,017		1,743	
Discontinued operations	11		—		19	
Taxation	1,038		343		477	
Share of associates' profits after tax	(213)		(176)		(142)	
Net interest and net other finance charges . .	397		397		462	
(Gain)/loss on sale of businesses	(147)		14		15	
Operating profit		3,158		2,595		2,574
Increase in inventories	(338)		(204)		(104)	
(Increase)/decrease in trade and other receivables	(218)		62		69	
Increase in trade and other payables and provisions	27		32		364	
Net movement in working capital		(529)		(110)		329
Depreciation, amortisation and impairment .	411		352		372	
Dividend income	166		138		111	
Other items	(201)		(116)		(211)	
Cash generated from operations		3,005		2,859		3,175

Comparatives have been restated following a change in the disclosure of dividends paid to non-controlling interests and transaction costs incurred in respect of business acquisitions (see note 1).

Cash generated from operations is stated after £158 million (2011 – £259 million; 2010 – £145 million) of cash outflows in respect of exceptional operating items.

Other items include £200 million of cash contributions to post employment schemes in excess of the income statement impact (2011 – £119 million; 2010 – £114 million) and gains on sale of property of £19 million (2011 – £20 million; 2010 – £89 million) partly offset by the fair value charge in respect of share-based incentive plans of £36 million (2011 – £34 million; 2010 – £31 million).

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Notes to the consolidated financial statements (continued)

30. Acquisition of businesses and purchase of shares of non-controlling interests

	Net assets acquired and consideration							
	Mey İcki	Zacapa	Meta	Shuijingfang	Other	2012 Total	2011	2010
	£ million	£ million	£ million	£ million	£ million	£ million	£ million	£ million
Brands and computer software	647	119	55	538	—	1,359	6	62
Property, plant and equipment	117	10	13	46	—	186	64	2
Investments	—	—	—	8	28	36	40	—
Inventories	44	19	6	66	—	135	3	—
Assets and liabilities held for sale	—	—	—	58	—	58	—	—
Other working capital	12	—	(2)	(59)	—	(49)	(14)	(1)
Taxation	(147)	—	(18)	(135)	—	(300)	(10)	(2)
Cash	38	2	—	57	—	97	—	4
Borrowings	—	—	(5)	—	—	(5)	(22)	—
Post employment benefit liabilities	(2)	—	—	—	—	(2)	—	—
Fair value of assets and liabilities	709	150	49	579	28	1,515	67	65
Goodwill arising on acquisition	590	97	99	105	—	891	31	19
Step acquisition	—	—	—	(219)	—	(219)	—	(21)
Non-controlling interests	(1)	—	—	(451)	—	(452)	(20)	—
Consideration payable	1,298	247	148	14	28	1,735	78	63
Satisfied by:								
Cash consideration paid	1,298	120	145	14	28	1,605	73	37
Financial liabilities	—	97	—	—	—	97	(1)	—
Deferred/contingent consideration payable	—	30	3	—	—	33	6	26
	<u>1,298</u>	<u>247</u>	<u>148</u>	<u>14</u>	<u>28</u>	<u>1,735</u>	<u>78</u>	<u>63</u>
Cash consideration paid for investments in subsidiaries	1,298	120	145	14	—	1,577	33	37
Cash consideration paid for investments in associates	—	—	—	—	48	48	58	41
Cash acquired	(38)	(2)	—	(57)	—	(97)	—	(4)
Purchase consideration paid in respect of prior year acquisitions	—	—	—	—	7	7	6	—
Deposit (received)/paid	—	—	—	(115)	—	(115)	—	123
Net cash outflow/(inflow) on acquisition of businesses*	1,260	118	145	(158)	55	1,420	97	197

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Notes to the consolidated financial statements (continued)

30. Acquisition of businesses and purchase of shares of non-controlling interests (continued)

Purchase of shares of non-controlling interests

	2012
	£ million
Kenya Breweries	140
Philippines	15
	<u>155</u>

* The group has revised the disclosure of the directly attributable acquisition costs in the consolidated statement of cash flow. In the year ended 30 June 2012 these costs of £47 million (2011 – £20 million; 2010 – £9 million) have been included in cash flow from operating activities rather than cash flow from investing activities.

2012 acquisitions

Mey İçki On 23 August 2011, Diageo completed the acquisition of 100% of Mey İçki Sanayi ve Ticaret A.Ş. (Mey İçki) from TPG Capital and the Actera group for \$2,129 million (£1,298 million). Mey İçki is the leading producer and distributor of raki in Turkey and also owns vodka and wine brands. Mey İçki has been consolidated from 23 August 2011. Directly attributable transaction and integration costs of £11 million have been charged to other external charges in the year. Since acquisition Mey İçki has contributed £705 million to sales, £291 million to net sales and £95 million to operating profit (net of £11 million transaction and integration costs).

Zacapa On 5 July 2011, Diageo completed the acquisition of a 50% equity controlling stake in Rum Creations Products Inc (RCP), the owner of the Zacapa rum brand, from Industrias Licoreras de Guatemala (ILG), for a cash consideration of \$240 million (£150 million) (including deferred and contingent consideration of \$48 million (£30 million)). ILG has a put option to sell the remaining 50% equity stake exercisable from 2016 calculated on a profit multiple. The net present value of this financial liability was \$155 million (£97 million) at acquisition. In addition, the transaction provided Diageo with perpetual global distribution rights for Zacapa rum, excluding those for Guatemala and the domestic markets of El Salvador, Honduras, Nicaragua, Costa Rica, Belize and Panama. Diageo consolidates the results of RCP. Directly attributable transaction costs of £1 million have been charged to other external charges in the year. In the period since acquisition the additional contribution of the Zacapa brand to operating profit was £8 million (net of £1 million transaction costs).

Quanxing and Shuijingfang On 14 July 2011, Diageo acquired an additional 4% equity stake in Sichuan Chengdu Quanxing Group Company Ltd. (Quanxing) from Chengdu Yingsheng Investment Holding Co., Ltd. The consideration for the additional 4% equity stake was CNY 140 million (£14 million). The acquisition of the 4% equity stake brought Diageo's shareholding in Quanxing to 53%. Quanxing was accounted for as an associate up to 14 July 2011 but following the acquisition of the additional 4% equity stake it became a subsidiary with a 47% non-controlling interest. Quanxing is primarily a holding company controlling a 39.7% equity stake in Sichuan Shuijingfang Co., Ltd. (Shuijingfang), a super premium Chinese white spirits company listed on the Shanghai Stock Exchange. During the year ended 30 June 2010 £123 million was deposited with China's securities depository and clearing agency in respect of the tender offer to all other shareholders of Shuijingfang. During the year ended 30 June 2012, Diageo received approval from the Chinese Securities Regulatory Commission to launch, and Diageo did launch and settle, the mandatory tender offer to all the other shareholders of

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Notes to the consolidated financial statements (continued)

30. Acquisition of businesses and purchase of shares of non-controlling interests (continued)

Shuijingfang. A nominal amount of shares of Shuijingfang were tendered into the offer and the deposit was returned to Diageo.

On 29 June 2012 at the annual general meeting additional Diageo directors were appointed to the board of Shuijingfang which gave Diageo control over the board and the operating and financial policies of the company. Up to 29 June 2012 Diageo accounted for Shuijingfang as an associate and following the change in control on 29 June 2012 it became a subsidiary. As a result of Quanxing and Shuijingfang becoming subsidiaries of the group, a gain of £124 million arose on the difference between the book value of the equity owned prior to the transactions and the market values on the completion dates which has been disclosed as a sale of businesses in the consolidated income statement. The non-controlling interest in Shuijingfang has been calculated as 79% of the fair value of the net assets of the company and the non-controlling interest in Quanxing has been valued at 47% of the fair value of its net assets. The fair values of the net assets disclosed are provisional and have been estimated by Diageo based on information obtained in accordance with all relevant Chinese laws and regulations. The fair values will be finalised in the year ending 30 June 2013.

The goodwill arising on the transaction represents the strategic premium in respect of entering the Chinese white spirits market and the synergies arising from combining operations. Directly attributable transaction and integration costs of £16 million have been charged to other external charges in the year.

Meta On 9 January 2012, Diageo completed the acquisition of Meta Abo Brewery Share Company SC (Meta) from the government of Ethiopia for a cash consideration of \$225 million (£148 million). Meta produces and distributes the Meta beer brand. Directly attributable transaction and integration costs of £3 million have been charged to other external charges in the year. In the period since acquisition the contribution (net of transaction and integration costs) to sales, net sales and operating profit was £16 million, £13 million and £nil, respectively. The fair values will be finalised in the year ending 30 June 2013.

Halico During the year Diageo completed in tranches the acquisition of an additional 20.6% (2011 – 24.9%) equity stake in Hanoi Joint Stock Company (Halico), the largest domestic branded spirits producer in Vietnam for a consideration of £28 million (2011 – £32 million). As a consequence Diageo owns 45.5% of the equity of Halico and equity accounts for this investment. Transaction costs on the acquisition were not material (2011 – £2 million).

The goodwill acquired in respect of the above acquisitions represents synergies arising from combining operations, intangible assets that do not qualify for separate recognition and the extension of the group's portfolio in other markets around the world. None of the goodwill recognised is expected to be deductible for income tax purposes. If the acquisitions had been completed on 1 July 2011 the group's sales, net sales and operating profit for the year would have increased by £293 million, £207 million and £73 million, respectively.

Purchase of shares of non-controlling interests

Kenya Breweries On 25 November 2011, Diageo completed the acquisition of SABMiller Africa BV's 20% non-controlling equity stake in Kenya Breweries Limited (Kenya Breweries), through its subsidiary undertaking, East African Breweries Limited, of which Diageo owns 50.03%, for a cash consideration of 19.5 billion Kenyan shillings (£134 million). Transaction costs of £6 million have been incurred and charged to other retained earnings. As a result, Diageo owns 100% of Kenya Breweries. Kenya

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Notes to the consolidated financial statements (continued)

30. Acquisition of businesses and purchase of shares of non-controlling interests (continued)

Breweries terminated a brewing and distribution agreement with SABMiller International BV on 31 May 2011 and has ceased to distribute SABMiller's brands in Kenya.

Philippines In December 2011, Diageo completed the acquisition of Carlos Palanca Group's 49% non-controlling equity stake in Diageo Philippines Inc (DPI) for £15 million and became the sole shareholder. DPI produces, imports, exports and distributes Diageo's brands throughout the Philippines. Transaction costs were not material.

2011 acquisitions

Serengeti Breweries On 22 October 2010, Diageo completed the acquisition of a 51% equity stake in Serengeti Breweries Limited (SBL), a beer business based in Tanzania, through its subsidiary undertaking, East African Breweries Limited of which Diageo owns 50.03%. The fair value of purchase consideration payable was £60 million, including borrowings acquired of £22 million. Transaction costs of £2 million (2010 – £5 million) in respect of the acquisition were charged to operating profit. Diageo consolidates 100% of SBL with a 75% non-controlling interest and has a call option for the remaining 49% of equity exercisable in 2013, calculated on a profit multiple of SBL. None of the goodwill recognised is expected to be deductible for income tax purposes.

22 Marquis On 30 September 2010, Diageo acquired a 20% equity stake in LNJ Group, LLC, owner of the 22 Marquis brand, a sparkling liqueur, for a consideration of £6 million. Depending on the performance of the brand in the first three years following the acquisition Diageo has a contractual right to increase its ownership to 50% without additional consideration. Diageo also has an option to purchase the remaining 50% equity stake in 2014 at a pre-agreed profit multiple reflecting fair value. Diageo equity accounts for this investment.

2010 acquisitions

Nuvo On 29 June 2010 Diageo acquired an additional 28.75% equity stake in the London Group, the owner of the Nuvo brand, an ultra-premium vodka-based sparkling liqueur, for a consideration of £29 million. The London Group was formerly accounted for as an associate and following the acquisition of further shares became a subsidiary.

For all of the above acquisitions the non-controlling interests were recognised at the proportionate share of net assets acquired.

Acquisitions after 30 June 2012

Ypióca On 9 August 2012, Diageo completed the acquisition of 100% of the equity of Ypióca Bebidas S.A. (Ypióca) from Ypióca Agroindustrial Limitada for a cash consideration of BRL 900 million (£284 million). Ypióca is a leading producer and distributor of a cachaça brand, Ypióca in Brazil. Ypióca will be consolidated and for the year ended 31 December 2011 had net sales of BRL 177 million (£56 million). The fair value assessment has not been completed and an analysis of the net assets acquired is not disclosed as the acquisition was completed only two weeks prior to the financial statements being signed. Directly attributable transaction costs of £7 million have been charged to other external charges in the year.

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Notes to the consolidated financial statements (continued)

31. Contingent liabilities and legal proceedings

(a) **Guarantees** As of 30 June 2012 the group has no material performance guarantees or indemnities to third parties.

(b) **Colombian litigation** An action was filed on 8 October 2004 in the United States District Court for the Eastern District of New York by the Republic of Colombia and a number of its local government entities against Diageo and other spirits companies. The complaint alleges several causes of action. Included among the causes of action is a claim that the defendants allegedly violated the Federal RICO Act by facilitating money laundering in Colombia through their supposed involvement in the contraband trade to the detriment of government owned spirits production and distribution businesses. Diageo is unable to quantify meaningfully the possible loss or range of loss to which the lawsuit may give rise. Diageo intends to defend itself vigorously against this lawsuit.

(c) **Korean customs dispute** Litigation is ongoing in Korea in connection with the application of the methodology used in transfer pricing on spirits imports since 2004. In December 2009, Diageo Korea received a final customs audit assessment notice from the Korean customs authorities, covering the period from 1 February 2004 to 30 June 2007, for Korean won 194 billion or £108 million (including £13 million of value added tax), which was paid in full and appealed to the Korean Tax Tribunal.

On 18 May 2011, the Tax Tribunal made a determination that the statute of limitations had run for part of the assessment period, ordered a partial penalty refund and instructed the Korean customs authorities to reinvestigate the remaining assessments. Accordingly, a refund of Korean won 43 billion or £24 million (including £2 million of value added tax) was made to Diageo Korea.

However, post the completion of the reinvestigation, the Korean customs authorities have concluded that they will continue to pursue the application of the same methodology and on 18 October 2011 a further final imposition notice was issued for Korean won 217 billion or £120 million (including £13 million of value added tax) in respect of the period from 29 February 2008 to 31 October 2010.

In response Diageo Korea filed a claim with the Seoul Administrative Court along with a petition for preliminary injunction to stay the final imposition notice. The Seoul Administrative Court granted Diageo Korea's request for preliminary injunction and stayed the final imposition until 30 September 2012.

The underlying matter is currently in progress with the Seoul Administrative Court and Diageo Korea is unable to quantify meaningfully the possible loss or range of loss to which these claims may give rise. Diageo Korea continues to defend its position vigorously.

(d) **Ketel One vodka put option** The Nolet Group has an option exercisable from 9 June 2011 to 9 June 2013 to sell its 50% equity stake in Ketel One Worldwide BV to Diageo for a total consideration of \$900 million (£573 million) plus 5.5% annual interest calculated from the date of the original acquisition on 9 June 2008. If the Nolet Group exercises this option but Diageo chooses not to buy the stake, Diageo will then have to pay \$100 million (£64 million) to the Nolet Group and the Nolet Group may then pursue a sale of its stake to a third party, subject to rights of first offer and last refusal on Diageo's part.

(e) **Thalidomide litigation** In Australia, a class action claim alleging product liability and negligence for injuries arising from the consumption of the drug thalidomide has been filed in the Supreme Court of Victoria against Distillers Company (Biochemicals) Limited, its parent Diageo Scotland Limited (formerly Distillers Company Limited), as well as against Grünenthal GmbH, the developer of the

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Notes to the consolidated financial statements (continued)

31. Contingent liabilities and legal proceedings (continued)

drug. The size of the class is not yet known. On 18 July 2012 Diageo settled the claim of the lead claimant Lynette Rowe and agreed a process to consider the remaining claimants in the class. To enable this process to occur, Lynette Rowe and her legal representatives have agreed not to take any step towards a trial of any issue in the litigation before 31 August 2013. In the United Kingdom, proceedings have twice been commenced but lapsed for lack of service. Distillers Company (Biochemicals) Limited distributed the drug in Australia and the United Kingdom for a period in the late 1950s and early 1960s. Diageo is unable to quantify meaningfully the possible loss or range of loss to which these lawsuits may give rise. The company has worked voluntarily for many years with various thalidomide organisations and has provided significant financial support.

(f) Other The group has extensive international operations and is defendant in a number of legal, customs and tax proceedings incidental to these operations. There are a number of legal, customs and tax claims against the group, the outcome of which cannot at present be foreseen.

Save as disclosed above, neither Diageo, nor any member of the Diageo group, is or has been engaged in, nor (so far as Diageo is aware) is there pending or threatened by or against it, any legal or arbitration proceedings which may have a significant effect on the financial position of the Diageo group.

32. Related party transactions

Transactions between the group and its related parties are made on terms equivalent to those that prevail in arm's length transactions.

Subsidiaries Transactions between the company and its subsidiaries are eliminated on consolidation and therefore are not disclosed. Details of the principal group companies are given after these financial statements.

Associates and joint ventures Sales and purchases to and from associates and joint ventures are principally in respect of premium drinks products but also include the provision of management services. All transactions are on terms equivalent to those in an arm's length transaction.

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Notes to the consolidated financial statements (continued)

32. Related party transactions (continued)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Income statement items			
Sales to associates	37	46	74
Purchases from associates*	22	26	27
Sales to joint ventures	5	5	5
Purchases from joint ventures	<u>41</u>	<u>21</u>	<u>17</u>
Balance sheet items			
Group payables to associates	1	8	9
Group receivables from associates	2	—	2
Loans receivable from associates	57	63	57
Group payables to joint ventures	1	3	2
Group receivables from joint ventures	<u>3</u>	<u>7</u>	<u>7</u>
Cash flow items			
Loans and equity contribution to associates	<u>27</u>	<u>22</u>	<u>64</u>

* Including purchase of maturing inventories from Moët Hennessy of £9 million (2011 – £9 million; 2010 – £8 million).

Other disclosures in respect of associates are included in note 7 and note 14.

Key management personnel The key management of the group comprises the executive and non-executive directors, the members of the executive committee and the company secretary. They are listed under ‘Board of directors and executive committee’.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Salaries and short term employee benefits	18	20	21
Non-executive directors’ fees	1	1	1
Share-based payments	9	10	10
Post employment benefits	1	4	4
Termination benefits	<u>—</u>	<u>1</u>	<u>—</u>
	<u>29</u>	<u>36</u>	<u>36</u>

Non-executive directors do not receive share-based payments or post employment benefits.

Details are given in the directors’ remuneration report of the individual directors’ remuneration and transactions between the group and key management personnel.

Pension plans The Diageo pension plans are recharged with the cost of administration services provided by the company to the pension plans and with professional fees paid by the company on behalf of the pension plans. The total amount recharged for the year was £10 million (2011 – £18 million; 2010 – £28 million).

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Notes to the consolidated financial statements (continued)

33. Commitments

Capital expenditure Commitments for expenditure on intangibles and property, plant and equipment not provided for in these consolidated financial statements are estimated at £145 million (2011 – £148 million).

Operating lease commitments The minimum lease rentals to be paid under non-cancellable leases, principally in respect of properties, are as follows:

	<u>2012</u>	<u>2011</u>
	£ million	£ million
Payments falling due:		
Within one year	94	104
Between one and two years	86	84
Between two and three years	70	74
Between three and four years	53	57
Between four and five years	47	49
After five years	<u>325</u>	<u>354</u>
	<u>675</u>	<u>722</u>

There are no significant leases for which contingent rent is payable, nor any that have purchase options, escalation clauses or restrictions. A number of the operating leases have renewal clauses that are all at fair market value. In respect of property not currently utilised, the group has entered into sub-leases for which the minimum amount receivable is £39 million (2011 – £44 million), of which £7 million (2011 – £9 million) falls due within one year of the balance sheet date. The amount received under these leases is included in sales in the income statement.

34. Employee share compensation

The group uses a number of equity settled and cash settled share plans to grant options and share awards to its directors and employees.

The annual fair value charge for the three years ended 30 June 2012 by principal plan is as follows:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
	£ million	£ million	£ million
Executive share option plans			
Diageo executive long term incentive plan	3	2	1
Diageo senior executive share option plan	2	2	3
Diageo executive share option plan	2	4	7
Savings plans	4	4	5
Executive share award plans			
Diageo executive long term incentive plan	9	7	1
Performance share plan	11	11	10
Discretionary incentive plan	4	4	4
Cash settled	1	—	—
	<u>36</u>	<u>34</u>	<u>31</u>

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

The fair value charge in the year ended 30 June 2011 includes operating exceptional items of £4 million (2010 – £1 million).

The principal plans are as follows:

Executive share option plans

(a) **Diageo executive long term incentive plan (DELTIP)** This scheme was introduced in the year ended 30 June 2010 to replace the Diageo executive share option plan. Awards made to executives under the plan are in the form of shares and share options at the market value at the time of grant. Executives are given the opportunity to elect to have their awards in the form of share options or shares or a combination of both. Share awards vest/are released on the third anniversary of the grant date. Share options granted under this scheme may normally be exercised between three and ten years after the grant date. There are no performance conditions to be satisfied, although the top 70 senior executives are required to hold a minimum number of shares in Diageo plc. US executives are granted awards over the company's ADSs (one ADS is equivalent to four ordinary shares).

(b) **Diageo senior executive share option plan 2008 (SESOP 2008)** This scheme was introduced in October 2008 and grants options to senior executives at market value at the time of grant. Options granted under this scheme may normally be exercised between three and ten years after the grant date but only to the extent that a performance condition is satisfied. The current performance condition is based on the increase in Diageo's adjusted earnings per share (eps) over a three-year period. Growth targets are set annually by the remuneration committee. For the 2011 grant, targets were set at 6% to 10% and for the 2012 grant at 7% to 11% compound annual growth in adjusted eps. The proportion of options that can be exercised depends on the extent to which the adjusted eps growth targets have been met. For the 2011 and 2012 grants, the exercise range is 25% for threshold performance up to 100% for achieving 10% and 11% or more compound annual growth in adjusted eps, respectively. Re-testing of the performance condition is not permitted. US executives are granted options over the company's ADSs.

(c) **Diageo executive share option plan (DSOP)** This scheme was introduced in December 1999 and granted options to executives at the market value at the time of grant. The last grant made under this scheme was in September 2009. Options granted under this scheme may normally be exercised between three and ten years after the date granted.

(d) **Diageo associated companies share incentive plan (DACSIP)** This scheme was introduced in the year ended 30 June 2012 and enables the company to grant shares and share options at the market value at the time of grant to executives in a number of associated companies. The main terms of the scheme are the same as for DELTIP.

Savings plans

(a) **UK savings-related share option scheme (SRSOS)** The UK savings-related share option scheme is an HM Revenue & Customs approved scheme available to all UK employees. The scheme provides a long term savings opportunity for employees who can use their savings to pay the exercise price of a share option. Options may normally be exercised after three or five years, according to the length of the option period chosen by the employee, at a price that is not less than 80% of the market value of the shares at grant date.

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

(b) **ROI savings-related share option scheme (ISRSOS)** The ROI savings-related share option scheme operates on a similar basis to the equivalent UK scheme (described above) for employees based in the Republic of Ireland.

(c) **US employee stock purchase plan (USESPP)** This plan provides a long term savings and investment opportunity for US employees who can use their savings to pay the exercise price of a share option. Options may normally be exercised after 12 months at a price equivalent to 85% of the market value of the ADSs at the grant date.

(d) **International sharematch plan (ISMP)** This plan was introduced in September 2010 to replace the International savings-related share option plan (described below). Employees outside the United Kingdom, Ireland and the United States are offered the opportunity to purchase Diageo shares or share units and receive matching shares or share units subject to continued employment. Plan rules permit flexibility for Diageo to set the matching amount annually based on corporate performance and to vary this by country. Target matching for the majority of the countries is buy three shares and receive one free.

(e) **International savings-related share option plan (International)** The group also operated an international savings-related share option plan for employees outside the United Kingdom. The last grant made under this plan was in October 2009. The plan provided a long term savings opportunity for employees who used their savings to pay the exercise price of a share option. Options may be exercised between one and five years after grant. The option exercise price was set at a discount to the market value at grant date, ranging from nil to 20%, in accordance with local conditions and practices.

Executive share award plans

(a) **Performance share plan (PSP 2008)** This plan was introduced in October 2008 and replaced a similar plan. Under the PSP, share awards can take a number of different forms. No payment is made for awards. To date, participants have been granted conditional rights to receive shares. Awards normally vest after a three-year period – the ‘performance cycle’ – subject to achievement of performance tests.

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

For awards up to and including September 2010, the primary performance test is a comparison of Diageo's three year total shareholder return (TSR) – the percentage growth in Diageo's share price (assuming all dividends and capital distributions are reinvested) – with the TSR of a peer group of 16 companies including Diageo. TSR calculations are converted into a common currency (US dollars). The vesting range is 25% if Diageo's TSR produces a median ranking compared with the TSR of the peer group companies, up to 100% if Diageo is ranked first or second in the peer group. The second performance test requires the remuneration committee to consider that there has been an underlying improvement in Diageo's three-year financial performance, typically measured by an improvement in adjusted eps.

For awards made from September 2011, three equally weighted performance tests apply: 1) a comparison of Diageo's three year TSR (as described above) with a peer group of 17 companies including Diageo. TSR calculations are converted into a common currency (US dollars). The vesting range is 25% if Diageo's TSR produces a median ranking compared with the TSR of the peer group companies, up to 100% if Diageo is ranked first, second or third in the peer group; 2) compound annual growth in organic net sales over three years; 3) total organic operating margin improvement over three years. Targets for net sales and operating margin are set annually by the remuneration committee. The vesting range is 25% for achieving minimum performance targets, up to 100% for achieving the maximum target level.

Re-testing of the performance condition is not permitted. Dividends are accrued on awards and are given to participants to the extent that the awards actually vest at the end of the performance cycle. Dividends can be paid in the form of cash or shares.

(b) Discretionary incentive plan 2009 (DIP 2009) This scheme was introduced in October 2009 and replaced a similar plan. Awards over shares or ADSs are granted under the plan, normally in the form of conditional rights to receive shares or ADSs. No payment is made for awards. Awards vest over a three to five year period with performance criteria varying by employee.

In certain markets DELTIP, DACSIP, ISMP and PSP work as cash alternative plans where due to legislation and tax rules it is prohibitive to grant share options or shares settled directly in equity. From the employee's perspective it works in the same way as a normal share option or share except that employees do not have the right to own a share when they exercise their share options or their shares vests.

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

For the three years ended 30 June 2012, the calculation of the fair value of each option and share award used the binomial (share option and savings plans) and Monte Carlo (share award plans) option pricing models and the following weighted average assumptions:

	Executive share option plans	Savings plans	Executive share award plans
2012			
Risk free interest rate	1.3%	0.9%	0.8%
Expected life of the options	60 months	35 months	36 months
Expected volatility	15%	13%	—
Dividend yield	3.3%	3.3%	3.3%
Weighted average exercise price	1257p	987p	—
Weighted average share price	1226p	1319p	1253p
Weighted average fair value of options/awards granted in the year	86p	193p	869p
Number of options/awards granted in the year	5.9 million	1.8 million	4.9 million
Fair value of all options/awards granted in the year	£5 million	£3 million	£43 million
2011			
Risk free interest rate	2.0%	1.1%	1.3%
Expected life of the options	60 months	34 months	36 months
Expected volatility	23%	16%	—
Dividend yield	3.3%	3.3%	3.3%
Weighted average exercise price	1087p	908p	—
Weighted average share price	1098p	1162p	1214p
Weighted average fair value of options/awards granted in the year	171p	247p	652p
Number of options/awards granted in the year	5.3 million	2.0 million	4.3 million
Fair value of all options/awards granted in the year	£9 million	£5 million	£28 million
2010			
Risk free interest rate	2.8%	1.8%	2.2%
Expected life of the options	60 months	36 months	36 months
Expected volatility	18%	17%	—
Dividend yield	3.6%	3.6%	3.6%
Weighted average exercise price	964p	809p	—
Weighted average share price	986p	1030p	985p
Weighted average fair value of options/awards granted in the year	135p	224p	516p
Number of options/awards granted in the year	8.2 million	2.8 million	4.1 million
Fair value of all options/awards granted in the year	£11 million	£6 million	£21 million

The risk free interest rate is based on the UK treasury coupon strips in effect at the time of the grant, for the expected life of the option. The expected life of the options represents the period of time that options granted are expected to be outstanding. The group uses historical data to estimate option exercise and employee termination within the valuation model. Expected volatility is based on implied volatilities from traded options on the group's shares, historical volatility of the group's shares and other factors.

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

Option holdings in the following tables are stated as ordinary share equivalents in pence. Options prices are translated at the following exchange rates: grants at actual exchange rates; exercises and cancellations at average exchange rates; and closing balances at year end exchange rates.

(a) **Outstanding options** Options over ordinary shares and over ADSs (US schemes only) outstanding at 30 June 2012 are as follows:

	Range of exercise prices pence	Number at 30 June 2012	Weighted average remaining contractual life months	Weighted average exercise price pence
Executive share option plans	600-699	779,087	20	670
	700-799	929,816	22	733
	800-899	1,768,219	45	834
	900-999	6,528,667	71	946
	1000-1099	10,920,816	85	1056
	1100-1199	3,485,563	65	1158
	1200-1299	5,435,533	111	1229
	1300-1399	1,766,508	62	1346
	1500-1599	406,754	116	1520
		<u>32,020,963</u>	78	1065
Savings plans	600-699	218,889	16	690
	700-799	1,143,812	19	755
	800-899	1,401,622	15	840
	900-999	2,383,934	35	951
	1000-1099	624,223	6	1027
	1100-1199	21,739	13	1142
		<u>5,794,219</u>	23	884

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Notes to the consolidated financial statements (continued)

34. Employee share compensation (continued)

(b) **Transactions on schemes** Transactions on the share option and share award plans and the weighted average grant date fair value for options and shares for the three years ended 30 June 2012 were as follows:

	Executive share option plans		Savings plans		Executive share award plans
	Number of options	Weighted average exercise price pence	Number of options	Weighted average exercise price pence	Number of awards
Balance outstanding at 30 June 2009	43,996,921	920	7,600,159	805	7,256,726
Granted	8,241,770	966	2,751,197	794	4,102,143
Exercised/awarded	(9,116,692)	786	(2,108,686)	751	(196,894)
Forfeited/expired	(1,788,598)	943	(1,083,327)	902	(1,925,184)
Balance outstanding at 30 June 2010	41,333,401	1009	7,159,343	817	9,236,791
Granted	5,331,223	1087	2,029,288	940	4,259,304
Exercised/awarded	(5,994,282)	901	(2,033,630)	806	(343,334)
Forfeited/expired	(1,593,508)	965	(558,879)	847	(1,888,630)
Balance outstanding at 30 June 2011	39,076,834	996	6,596,122	865	11,264,131
Granted	5,903,500	1257	1,794,909	987	4,881,856
Exercised/awarded	(9,271,422)	974	(1,992,376)	854	(660,353)
Forfeited/expired	(3,687,949)	1049	(604,436)	910	(3,488,448)
Balance outstanding at 30 June 2012	<u>32,020,963</u>	<u>1065</u>	<u>5,794,219</u>	<u>884</u>	<u>11,997,186</u>
Number of options exercisable at:					
30 June 2012	<u>15,112,388</u>	<u>1025</u>	<u>201,613</u>	<u>933</u>	
30 June 2011	<u>17,194,922</u>	<u>967</u>	<u>136,758</u>	<u>1069</u>	
30 June 2010	<u>16,415,347</u>	<u>687</u>	<u>78,738</u>	<u>916</u>	

(c) **Employee share trusts, potential issues of ordinary shares and voting rights** In order to hedge its obligations under the share option and share award plans, the group either purchases own shares directly and holds them as treasury shares, or it funds trusts to acquire shares in the company. The shares held are accounted for as a deduction in arriving at shareholders' equity. Call options are also used to manage some of the group's obligations. Dividends receivable by the employee share trusts on the shares are waived.

Shares used to satisfy the group's obligations under the employee share plans can be newly issued shares, treasury shares or shares purchased on the open market by the employee share trusts.

Where shares held by employee share trusts have been allocated to employee share plan participants, they may exercise their voting rights. Where shares are held by employee share trusts and have not been allocated to participants, the trustee abstains from voting.

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Notes to the consolidated financial statements (continued)

35. Post balance sheet events

On 9 August 2012, Diageo completed the acquisition of 100% of the equity of Ypióca from Ypióca Agroindustrial Limitada for a cash consideration of BRL 900 million (£284 million). See note 30 for further details.

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Principal group companies

This section on principal group companies forms part of the audited financial statements.

	<u>Country of incorporation</u>	<u>Country of operation</u>	<u>Percentage of equity owned</u>	<u>Business description</u>
Subsidiaries				
Diageo Ireland	Ireland	Worldwide	100%	Production, marketing and distribution of premium drinks
Diageo Great Britain Limited	England	Worldwide	100%	Marketing and distribution of premium drinks
Diageo Scotland Limited	Scotland	Worldwide	100%	Production, marketing and distribution of premium drinks
Diageo Brands BV	Netherlands	Worldwide	100%	Marketing and distribution of premium drinks
Diageo North America, Inc	United States	Worldwide	100%	Production, importing and distribution of premium drinks
Diageo Capital plc(a)	Scotland	United Kingdom	100%	Financing company for the group
Diageo Finance plc(a)	England	United Kingdom	100%	Financing company for the group
Diageo Capital BV	Netherlands	Netherlands	100%	Financing company for the group
Diageo Finance BV	Netherlands	Netherlands	100%	Financing company for the group
Diageo Investment Corporation	United States	United States	100%	Financing company for the US group
Associate				
Moët Hennessy, SNC(b)	France	France	34%	Production and distribution of premium drinks

(a) Directly owned by Diageo plc.

(b) French partnership.

All percentages, unless otherwise stated, are in respect of holdings of ordinary share capital and are equivalent to the percentages of voting rights held by the group.

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Report of independent registered public accounting firm – internal controls

The board of directors and shareholders
Diageo plc:

We have audited Diageo plc's internal control over financial reporting as of 30 June 2012, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Diageo plc's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying management's report on internal control over financial reporting, appearing in the Corporate Governance Report in Diageo plc's Annual Report on Form 20-F. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Diageo plc maintained, in all material respects, effective internal control over financial reporting as of 30 June 2012, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organisations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of Diageo plc and subsidiaries on pages 144 to 240 which comprise the consolidated balance sheets as of 30 June 2012, and 2011, and the related consolidated income statements, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for each of the years in the three-year period ended 30 June 2012, including the disclosures identified as 'part of the audited financial statements' within the 'Critical accounting policies' section on pages 85 to 86, the

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Report of independent registered public accounting firm – internal controls (continued)

‘Share and other interests’ on pages 119 and 120, the ‘Key management personnel related party transactions’ on page 121 and the ‘Principal group companies’ on page 241 and our report dated 22 August 2012 expressed an unqualified opinion on those consolidated financial statements.

KPMG Audit Plc
London, England
22 August 2012

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Unaudited computation of ratio of earnings to fixed charges

	Year ended 30 June				
	2012	2011	2010	2009	2008
	£ million	£ million	£ million	£ million	£ million
Earnings					
Income before taxes on income, non-controlling interests and discontinued operations	3,121	2,360	2,239	1,990	2,078
Less: capitalised interest	(5)	(4)	(5)	(4)	—
Less: Share of associates' income	(213)	(176)	(142)	(164)	(176)
Add: Dividend income receivable from associates	166	138	111	179	143
Add: Fixed charges	710	714	970	869	549
	<u>3,779</u>	<u>3,032</u>	<u>3,173</u>	<u>2,870</u>	<u>2,594</u>
Fixed charges					
Interest payable and other finance charges (note (1))	667	675	935	836	523
Add: Interest capitalised	5	4	5	4	—
Add: One third of rental expense	38	35	30	29	26
	<u>710</u>	<u>714</u>	<u>970</u>	<u>869</u>	<u>549</u>
	<u>ratio</u>	<u>ratio</u>	<u>ratio</u>	<u>ratio</u>	<u>ratio</u>
Ratio	<u>5.3</u>	<u>4.2</u>	<u>3.3</u>	<u>3.3</u>	<u>4.7</u>

Note

(1) Interest payable and other finance charges for the year ended 30 June 2012 includes a £151 million charge (2011 – £107 million charge; 2010 – £275 million charge; 2009 – £164 million charge; 2008 – £75 million charge) in respect of fair value adjustments to the group's derivative instruments. Impact of foreign exchange movements on net borrowings not in a hedge relationship and therefore recognised in the income statement was £nil during the year ended 30 June 2012 (2011 – £nil; 2010 – £nil; 2009 – £11 million charge; 2008 – £6 million charge). In the year ended 30 June 2010 an additional £10 million charge was recognised (2009 – £33 million charge; 2008 – £nil) in respect of exchange rate translation differences on inter-company funding arrangements where hedge accounting was not applicable.

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Additional information for shareholders

Legal proceedings

Information on legal proceedings is set out in note 31 to the consolidated financial statements.

Related party transactions

Transactions with directors are disclosed in the directors' remuneration report (see 'Directors' remuneration report – Additional information') and transactions with other related parties are disclosed in note 32 to the consolidated financial statements.

Share capital

Major shareholders At 24 August 2012, the following substantial interests (3% or more) in the company's ordinary share capital (voting securities) had been notified to the company.

<u>Shareholder</u>	<u>Number of ordinary shares</u>	<u>Percentage of issued ordinary share capital (excluding treasury shares)</u>	<u>Date of notification of interest</u>
BlackRock Investment Management (UK) Limited (indirect holding)	147,296,928	5.89%	3 December 2009
Capital Research and Management Company (indirect holding)	124,653,096	4.99%	28 April 2009
Legal & General Group Plc (direct holding)	99,894,002	3.99%	20 October 2009

The company has not been notified of any other substantial interests in its securities. The company's substantial shareholders do not have different voting rights. Diageo, so far as is known by the company, is not directly or indirectly owned or controlled by another corporation or by any government. Diageo knows of no arrangements, the operation of which may at a subsequent date result in a change of control of the company.

As at the close of business on 24 August 2012, 482,715,607 ordinary shares, including those held through ADSs, were held by approximately 2,551 holders (including ADR holders) with registered addresses in the United States, representing approximately 19.26% of the outstanding ordinary shares (excluding treasury shares). At such date, 120,511,079 ADSs were held by 1,894 registered ADR holders. Since certain of such ordinary shares and ADSs are held by nominees or former GrandMet or Guinness Group ADR holders who have not re-registered their ADSs, the number of holders may not be representative of the number of beneficial owners in the United States or the ordinary shares held by them.

Trading market for shares The Diageo plc ordinary shares are listed on the Exchange and on the Dublin and Paris Stock Exchanges. Diageo ADSs, representing four Diageo ordinary shares each, are listed on the NYSE.

The principal trading market for the ordinary shares is the Exchange. Shares are traded on the Exchange's electronic order book.

Orders placed on the order book are displayed on-screen through a central electronic system and trades are automatically executed, in price and then time priority, when orders match with corresponding buy or sell orders.

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Additional information for shareholders (continued)

Share capital (continued)

Only member firms of the Exchange, or the Exchange itself if requested by the member firm, can enter or delete orders on behalf of clients or on their own account. All orders are anonymous. Although use of the order book is not mandatory, all trades, whether or not executed through the order book and regardless of size, must be published immediately after execution unless they are large trades eligible for deferred publication.

The Markets in Financial Instruments Directive (MiFID) allows for delayed reporting of large trades with a sliding scale requirement based on qualifying minimum thresholds for the amount of consideration to be paid/the proportion of average daily turnover (ADT) of a stock represented by a trade. Provided that a trade/consideration equals or exceeds the qualifying minimum size, it will be eligible for deferred publication ranging from 60 minutes from time of trade to three trading days after time of trade.

Fluctuations in the exchange rate between the pound sterling and the US dollar will affect the US dollar equivalent of the pound sterling price of the ordinary shares on the Exchange and, as a result, will affect the market price of the ADSs on the NYSE. In addition, such fluctuations will affect the US dollar amounts received by holders of ADSs on conversion of cash dividends paid in pounds sterling on the underlying ordinary shares.

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Additional information for shareholders (continued)

Share capital (continued)

The following table shows, for the periods indicated, the reported high and low middle market quotations (which represent an average of bid and asked prices) for the ordinary shares on the Exchange, taken from its Daily Official List, and the highest and lowest sales prices for ADSs as reported on the NYSE composite tape.

	Per ordinary share		Per ADS	
	High pence	Low pence	High \$	Low \$
Year ended 30 June				
2008	1122	911	92.55	72.70
2009	1065	733	76.65	41.14
2010	1160	867	71.99	56.42
2011	1301	1033	85.43	63.08
2012	1642	1112	104.00	72.77
Three months ended				
September 2010	1144	1033	71.55	63.08
December 2010	1215	1092	76.13	69.30
March 2011	1258	1121	80.69	71.77
June 2011	1301	1180	85.43	76.73
September 2011	1308	1112	83.65	72.77
December 2011	1408	1209	87.39	75.16
March 2012	1553	1381	98.09	85.32
June 2012	1642	1478	104.00	93.38
2012 monthly				
January	1427	1381	89.21	85.32
February	1509	1429	95.71	90.55
March	1553	1503	98.09	94.75
April	1589	1504	102.23	95.05
May	1615	1478	104.00	93.42
June	1642	1517	103.03	93.38
July	1732	1649	108.59	102.40
August (to 24 August 2012)	1738	1681	107.98	105.70

At close of business on 24 August 2012, the market prices for ordinary shares and ADSs were 1714 pence and \$107.98 respectively.

American depositary shares

Fees and charges payable by ADR holders

The Bank of New York Mellon serves as the depositary (the 'Depositary') for Diageo's ADS programme. Pursuant to the deposit agreement between Diageo, the Depositary and owners and holders of ADSs (the 'Deposit Agreement'), ADR holders may be required to pay various fees to the Depositary, and the Depositary may refuse to provide any service for which a fee is assessed until the applicable fee has been paid. In particular, the Depositary, under the terms of the Deposit Agreement, shall charge (i) a fee of \$5.00 or less per 100 ADSs (or portion of 100 ADSs) relating to the issuance of ADSs, including issuances resulting from a distribution of ordinary shares, rights or other property or the cancellation of ADSs for the purpose of withdrawal, including if the Deposit Agreement terminates and (ii) in connection with the distribution of other securities to ADR holders, a fee

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Additional information for shareholders (continued)

American depositary shares (continued)

equivalent to the fee that would be payable, if securities distributed by Diageo had been ordinary shares and such ordinary shares had been deposited for issuance of ADSs.

In addition, ADR holders may be required under the Deposit Agreement to pay the Depositary (i) any tax, duty, governmental charge or fee or stock transfer or registration fee arising in connection with the foregoing transactions or otherwise, (ii) any expense resulting from the conversion of a foreign currency into US dollars and (iii) the expense of certain communications made, at the request of the ADR holder, by cable, telex or facsimile. The Depositary may (i) withhold dividends or other distributions or sell any or all of the shares underlying the ADSs in order to satisfy any tax or governmental charge and (ii) deduct from any cash distribution any tax payable thereon or the cost of any currency conversion.

Direct and indirect payments by the Depositary

The Depositary reimburses Diageo for certain expenses it incurs in connection with the ADR programme, subject to a ceiling set out in the agreement pursuant to which the Depositary provides services to Diageo. The Depositary has also agreed to waive certain standard fees associated with the administration of the programme.

During the financial year ended 30 June 2012, the company received from the Depositary \$1,200,000 for continuing annual stock exchange listing fees, routine reporting and programme maintenance, standard out-of-pocket maintenance costs for the ADSs (consisting of the expenses of postage and envelopes for mailing annual financial reports, printing and distributing dividend checks, electronic filing of US Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls), legal fees and certain investor relationship programmes and investor relations promotional activities.

Articles of association

Diageo is incorporated under the name Diageo plc, and is registered in England and Wales under registered number 23307.

The following description summarises certain provisions of Diageo's articles of association (as adopted by special resolution at the Annual General Meeting on 14 October 2009) and applicable English law concerning companies (the Companies Acts), in each case as at 24 August 2012. This summary is qualified in its entirety by reference to the Companies Acts and Diageo's articles of association.

Information on where investors can obtain copies of Diageo's articles of association is provided under 'Additional information for shareholders – Documents on display' below.

All of Diageo's ordinary shares are fully paid. Accordingly, no further contribution of capital may be required by Diageo from the holders of such shares.

Any amendment to the articles of association of the company may be made in accordance with the provisions of the Companies Act by way of special resolution.

Directors Diageo's articles of association provide for a board of directors, consisting (unless otherwise determined by an ordinary resolution of shareholders) of not fewer than three directors and not more than 25 directors, in which all powers to manage the business and affairs of Diageo are vested.

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Additional information for shareholders (continued)

Articles of association (continued)

Directors may be elected by the members in a general meeting or appointed by the board of directors. At each annual general meeting, the following are required to retire and are then reconsidered for re-election, assuming they wish to stand for re-election: any director who has been appointed by the board of directors since the last annual general meeting; any director who has been in office during the two previous general meetings and did not retire at either of them; and any director who has been in office, other than in an executive position, for a continuous period of nine years or more at the date of the meeting. There is no age limit requirement in respect of directors. Directors may also be removed before the expiration of their term of office in accordance with the provisions of the Companies Acts.

Under Diageo's articles of association, a director cannot vote in respect of any proposal in which the director has an interest.

However, this restriction on voting does not apply where the interest cannot reasonably be regarded as giving rise to a conflict of interest, nor to resolutions (a) giving the director any guarantee, security or indemnity in respect of obligations or liabilities incurred for the benefit of Diageo, (b) giving any guarantee, security or indemnity to a third party in respect of obligations of Diageo for which the director has assumed responsibility under an indemnity or guarantee or by the giving of security, (c) relating to an offer of securities of Diageo in which the director participates or may participate as a holder of shares or other securities or in the underwriting, (d) relating to any contract in which the director is interested by virtue of the director's interest in securities of Diageo or by reason of any other interest in or through Diageo, (e) concerning any other company in which the director is directly or indirectly interested, provided that the director does not have a relevant interest in that company, (f) relating to the arrangement of any employee benefit (including any retirement benefit plan) in which the director will share equally with other employees, (g) relating to any insurance that Diageo purchases or maintains for its directors or any group of people, including directors, (h) giving the director an indemnity where all the other directors are being offered indemnities on substantially the same terms, and (i) for the funding by Diageo of the director's expenditure on defending proceedings or the doing by Diageo of anything to enable the director to avoid incurring such expenditure where all the other directors are being offered substantially the same arrangements. A director cannot vote in relation to any resolution of the board concerning his own appointment, or the settlement or variation of the terms or the termination of his own appointment, as the holder of any office or place of profit with Diageo or any company in which Diageo is interested.

Under Diageo's articles of association, compensation awarded to directors may be decided by the board or any authorised committee of the board. The remuneration committee is responsible for making recommendations to the board concerning matters relating to remuneration policy. It is comprised of all the non-executive directors except for the chairman.

The directors are empowered to exercise all the powers of Diageo to borrow money, subject to the limitation that the aggregate amount of all net external borrowings of the group outstanding at any time shall not exceed an amount equal to twice the aggregate of the group's adjusted capital and reserves calculated in the manner prescribed in Diageo's articles of association, unless sanctioned by an ordinary resolution of Diageo's shareholders.

Directors are not required to hold any shares of Diageo as a qualification to act as a director.

Dividend rights Holders of Diageo's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the directors. The directors may also pay interim dividends or fixed rate dividends. No dividend may be paid other than out of

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Additional information for shareholders (continued)

Articles of association (continued)

profits available for distribution. All of Diageo's ordinary shares rank equally for dividends, but the board may withhold payment of all or any part of any dividends or other monies payable in respect of Diageo's shares from a person with a 0.25% interest (as defined in Diageo's articles of association) if such a person has been served with a restriction notice (as defined in Diageo's articles of association) after failure to provide Diageo with information concerning interests in those shares required to be provided under the Companies Acts. Dividends may be paid in currencies other than pounds sterling and such dividends will be calculated using an appropriate market exchange rate as determined by the directors in accordance with Diageo's articles of association.

If a dividend has not been claimed, the directors may invest the dividend or use it in some other way for the benefit of Diageo until the dividend is claimed. If the dividend remains unclaimed for 12 years after the date such dividend was declared or became due for payment, it will be forfeited and will revert to Diageo (unless the directors decide otherwise). Diageo may stop sending cheques, warrants or similar financial instruments in payment of dividends by post in respect of any shares or may cease to employ any other means for payment of dividends if either (a) at least two consecutive payments have remained uncashed or are returned undelivered or that means of payment has failed, or (b) one payment remains uncashed or is returned undelivered or that means of payment has failed and reasonable enquiries have failed to establish any new postal address or account of the holder. Diageo must resume sending dividend cheques, warrants or similar financial instruments or employing that means of payment if the holder requests such resumption in writing.

Diageo's articles of association permit payment or satisfaction of a dividend wholly or partly by distribution of specific assets, including fully paid shares or debentures of any other company. Such action must be directed by the general meeting which declared the dividend and upon the recommendation of the directors.

Voting rights Voting on any resolution at any general meeting of shareholders is by a show of hands unless a poll is duly demanded. On a show of hands, (a) every shareholder who is present in person at a general meeting, and every proxy appointed by any one shareholder and present at a general meeting, has/have one vote regardless of the number of shares held by the shareholder (or, subject to (b), represented by the proxy), and (b) every proxy present at a general meeting who has been appointed by more than one shareholder has one vote regardless of the number of shareholders who have appointed him or the number of shares held by those shareholders, unless he has been instructed to vote for a resolution by one or more shareholders and to vote against the resolution by one or more shareholders, in which case he has one vote for and one vote against the resolution. On a poll, every shareholder who is present in person or by proxy has one vote for every share held by that shareholder, but a shareholder or proxy entitled to more than one vote need not cast all his votes or cast them all in the same way (the deadline for exercising voting rights by proxy is set out in the form of proxy).

A poll may be demanded by any of the following:

- the chairman of the meeting;
- at least three shareholders entitled to vote on the relevant resolution and present in person or by proxy at the meeting;
- any shareholder or shareholders present in person or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote on the relevant resolution; or

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Additional information for shareholders (continued)

Articles of association (continued)

- any shareholder or shareholders present in person or by proxy and holding shares conferring a right to vote on the relevant resolution on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

Diageo's articles of association and the Companies Acts provide for matters to be transacted at general meetings of Diageo by the proposing and passing of two kinds of resolutions:

- ordinary resolutions, which include resolutions for the election, re-election and removal of directors, the declaration of final dividends, the appointment and re-appointment of the external auditor, the increase of authorised share capital and the grant of authority to allot shares; and
- special resolutions, which include resolutions for the amendment of Diageo's articles of association, resolutions relating to the disapplication of pre-emption rights, and resolutions modifying the rights of any class of Diageo's shares at a meeting of the holders of such class.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast by those entitled to vote at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast by those entitled to vote at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of Diageo is a minimum of two shareholders present in person or by proxy and entitled to vote.

A shareholder is not entitled to vote at any general meeting or class meeting in respect of any share held by him if he has been served with a restriction notice (as defined in Diageo's articles of association) after failure to provide Diageo with information concerning interests in those shares required to be provided under the Companies Acts.

Liquidation rights In the event of the liquidation of Diageo, after payment of all liabilities and deductions taking priority in accordance with English law, the balance of assets available for distribution will be distributed among the holders of ordinary shares according to the amounts paid up on the shares held by them.

Pre-emptive rights and new issues of shares: While holders of ordinary shares have no pre-emptive rights under Diageo's articles of association, the ability of the directors to cause Diageo to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Acts, the directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's articles of association or given by its shareholders in general meeting, but which in either event cannot last for more than five years. Under the Companies Acts, Diageo may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Disclosure of interests in Diageo's shares: There are no provisions in Diageo's articles of association whereby persons acquiring, holding or disposing of a certain percentage of Diageo's shares are required to make disclosure of their ownership percentage, although there are such requirements under the Companies Acts. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure and Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify Diageo and the Financial Services

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Additional information for shareholders (continued)

Articles of association (continued)

Authority of the percentage of the voting rights in Diageo he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

- reaches, exceeds or falls below 3% and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
- reaches, exceeds or falls below any such threshold as a result of any change in the breakdown or number of voting rights attached to shares in Diageo.

The Disclosure and Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons.

Under section 793 of the Companies Act 2006, Diageo may, by notice in writing, require a person that Diageo knows or has reasonable cause to believe is or was during the three years preceding the date of notice interested in Diageo's shares to indicate whether or not that is the case and, if that person does or did hold an interest in Diageo's shares, to provide certain information as set out in that Act.

Rule 3 of the Disclosure and Transparency Rules further requires persons discharging managerial responsibilities within Diageo (and their connected persons) to notify Diageo of transactions conducted on their own account in Diageo shares or derivatives or certain financial instruments relating to Diageo shares.

The City Code on Takeovers and Mergers also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

General meetings and notices At least 21 clear days' written notice of an annual general meeting is required. Any general meeting which is not an annual general meeting is called a 'general meeting'. Since the coming into force of the Companies (Shareholders' Rights) Regulations 2009, the minimum notice period for general meetings has increased from 14 to 21 clear days. This can, however, be reduced to 14 clear days, subject to shareholder approval, and offering shareholders the facility to vote electronically. Diageo already offers shareholders the facility to vote by electronic means (via its online proxy service), and intends to put the necessary resolution to the forthcoming Annual General Meeting, as it did in 2011, to approve the holding of subsequent general meetings on not less than 14 clear days' notice. This approval will expire at the next Annual General Meeting.

An annual general meeting of shareholders must be held within six months of Diageo's accounting reference date and at a time and place determined by the directors.

The chairman of any general meeting is entitled to refuse admission to (or eject from) that general meeting any person who fails to comply with any security arrangements or restrictions that the board may impose.

Variation of rights If, at any time, Diageo's share capital is divided into different classes of shares, the rights attached to any class of shares may be varied, subject to the provisions of the Companies Acts, either with the consent in writing of the holders of not less than three-quarters in nominal value of the issued shares of that class or upon the adoption of a special resolution passed at a separate meeting of the holders of the shares of that class.

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Additional information for shareholders (continued)

Articles of association (continued)

At every such separate meeting, all of the provisions of Diageo's articles of association relating to proceedings at a general meeting apply, except that (a) the quorum is to be the number of persons (which must be at least two) who hold or represent by proxy not less than one-third in nominal value of the issued shares of the class or, if such quorum is not present on an adjourned meeting, one person who holds shares of the class regardless of the number of shares he holds, (b) any holder of shares of the class who is present in person or by proxy may demand a poll, and (c) each shareholder present in person or by proxy and entitled to vote will have one vote per share held in that particular class in the event a poll is taken.

Class rights are deemed not to have been varied by the creation or issue of new shares ranking equally with or subsequent to that class of shares in all respects or by the reduction of the capital paid up on such shares or by the purchase or redemption by Diageo of its own shares, in each case in accordance with the Companies Acts and Diageo's articles of association.

Repurchase of shares Subject to authorisation by shareholder resolution, Diageo may purchase its own shares in accordance with the Companies Acts. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of Diageo's issued share capital. Diageo currently has shareholder authority to buy back up to 250 million ordinary shares during the period up to the next Annual General Meeting. The minimum price which must be paid for such shares is 28¹⁰¹/₁₀₈ pence and the maximum price is the higher of (a) an amount equal to 105% of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List 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.

Restrictions on transfers of shares The board may decline to register a transfer of a certificated Diageo share unless the instrument of transfer (a) is duly stamped or certified or otherwise shown to the satisfaction of the board to be exempt from stamp duty and is accompanied by the relevant share certificate and such other evidence of the right to transfer as the board may reasonably require, (b) is in respect of only one class of share and (c) if to joint transferees, is in favour of not more than four such transferees.

Registration of a transfer of an uncertificated share may be refused in the circumstances set out in the uncertificated securities rules (as defined in the articles of association) and where, in the case of a transfer to joint holders, the number of joint holders to whom the uncertificated share is to be transferred exceeds four.

The board may decline to register a transfer of any of Diageo's certificated shares by a person with a 0.25% interest (as defined in Diageo's articles of association) if such a person has been served with a restriction notice (as defined in Diageo's articles of association) after failure to provide Diageo with information concerning interests in those shares required to be provided under the Companies Acts, unless the transfer is shown to the board to be pursuant to an arm's-length sale (as defined in the articles of association).

Exchange controls

There are currently no UK foreign exchange control restrictions on the payment of dividends to US persons on Diageo's ordinary shares or on the conduct of Diageo's operations.

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Additional information for shareholders (continued)

Exchange controls (continued)

There are no restrictions under the company's articles of association or under English law that limit the right of non-resident or foreign owners to hold or vote the company's ordinary shares.

Please refer to the 'Taxation' section below for details relating to the taxation of dividend payments.

Documents on display

The Form 20-F and any other documents filed by the company with the US Securities Exchange Commission may be inspected at the Securities and Exchange Commission's public reference room located at 100 F Street, NE, Washington, DC 20549. Information on the operation of the public reference room can be obtained by calling the Securities and Exchange Commission at 1 800 SEC 0330.

Taxation

This section provides a descriptive summary of certain US federal income tax and UK tax consequences that are likely to be material to the holders of the ordinary shares or ADSs, but only those who hold their ordinary shares or ADSs as capital assets for tax purposes.

It does not purport to be a complete technical analysis or a listing of all potential tax effects relevant to the ownership of the ordinary shares and ADSs. This section does not apply to any holder who is subject to special rules, including:

- a dealer in securities or foreign currency;
- a trader in securities that elects to use a mark-to-market method of accounting for securities holdings;
- a tax-exempt organisation;
- a life insurance company;
- a person liable for alternative minimum tax;
- a person that actually or constructively owns 10% or more of the voting stock of Diageo;
- a person that holds ordinary shares or ADSs as part of a straddle or a hedging or conversion transaction;
- a person that holds ordinary shares or ADSs as part of a wash sale for tax purposes;
- a US holder (as defined below) whose functional currency is not the US dollar; or
- a partnership or a partner in a partnership that holds ordinary shares or ADSs.

For UK tax purposes, this section applies only to persons who are the absolute beneficial owners of their shares or ADSs and who hold their shares or ADSs as investments. It assumes that holders of ADSs will be treated as holders of the underlying ordinary shares. In addition to those persons mentioned above, this section does not apply to holders that are banks, regulated investment companies, other financial institutions or to persons who have or are deemed to have acquired their ordinary shares or ADSs in the course of an employment or trade. This summary does not apply to persons who are treated as non-domiciled and resident or ordinarily resident in the United Kingdom for the purposes of UK tax law. This section is based on the Internal Revenue Code of 1986, as

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Additional information for shareholders (continued)

Taxation (continued)

amended, its legislative history, existing and proposed regulations, published rulings and court decisions, the laws of the United Kingdom and the practice of Her Majesty's Revenue and Customs, all as currently in effect, as well as on the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Tax on Income and Capital Gains (the Treaty). These laws are subject to change, possibly on a retroactive basis.

In addition, this section is based in part upon the representations of the Depositary and the assumption that each obligation in the Deposit Agreement and any related agreement will be performed in accordance with its terms. In general, and taking into account this assumption, for US federal income tax purposes and for the purposes of the Treaty, holders of ADRs evidencing ADSs will be treated as the owner of the shares represented by those ADSs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to US federal income tax or to UK tax on profits or gains.

A US holder is a beneficial owner of ordinary shares or ADSs that is for US federal income tax purposes:

- a citizen or resident for tax purposes of the United States and who is not and has at no point been resident or ordinarily resident in the United Kingdom;
- a US domestic corporation;
- an estate whose income is subject to US federal income tax regardless of its source; or
- a trust if a US court can exercise primary supervision over the trust's administration and one or more US persons are authorised to control all substantial decisions of the trust.

This section is not intended to provide specific advice and no action should be taken or omitted in reliance upon it. This section addresses only certain aspects of US federal income tax and UK income tax, corporation tax, capital gains tax, inheritance tax and stamp taxes. Holders of the ordinary shares or ADSs are urged to consult their own tax adviser regarding the US federal, state and local, and UK and other tax consequences of owning and disposing of the shares or ADSs in their respective circumstances. In particular, holders are encouraged to confirm with their adviser whether they are a US holder eligible for the benefits of the Treaty.

Dividends UK taxation There is no UK withholding tax on dividends. A shareholder who is an individual resident for UK tax purposes in the United Kingdom that receives a dividend from the company will generally be entitled to a tax credit equal to one-ninth of the dividend. The individual will be taxable on the total of the dividend and the related credit, known as the gross dividend, which will be regarded as the top slice of the individual's income. In the case of a shareholder who is liable to income tax at the basic rate, the tax credit will be treated as discharging the individual's liability to income tax in respect of the gross dividend. In the case of a shareholder who is liable to income tax at the higher rate, the individual will be subject to tax on the gross dividend at the rate of 32.5%, to the extent that the gross dividend falls above the threshold for the higher rate of income tax when it is treated (as mentioned above) as the top slice of the individual's income. This means that the tax credit will satisfy only part of the individual's liability to income tax on the gross dividend, so that the individual will have to account for income tax equal to 22.5% of the gross dividend. In the case of a shareholder who is liable to income tax at the additional rate, the individual will be subject to tax on the gross dividend at the rate of 42.5%, to the extent that the gross dividend falls above the threshold

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Additional information for shareholders (continued)

Taxation (continued)

for the additional rate of income tax when it is treated (as mentioned above) as the top slice of the individual's income. This means that the tax credit will satisfy only part of the individual's liability to income tax on the gross dividend, so that the individual will have to account for income tax equal to 32.5% of the gross dividend. Shareholders within the charge to UK corporation tax which are small companies (for the purposes of the UK taxation of dividends) will not generally be subject to tax on dividends from Diageo. Other shareholders within the charge to UK corporation tax will not be subject to tax on dividends from Diageo so long as the dividends fall within an exempt class and certain conditions are met. In general, dividends paid on shares that are ordinary share capital for UK tax purposes and are not redeemable and dividends paid to a person holding less than 10% of the issued share capital of the payer (or any class of that share capital) are examples of dividends that fall within an exempt class. A shareholder who is not liable for tax on dividends received on the shares will not be entitled to claim payment of the tax credit in respect of those dividends.

Eligible US holders will not normally be entitled to a tax credit under the Treaty, nor will they be subject to a withholding tax by the United Kingdom.

US taxation Under the US federal income tax laws, and subject to the passive foreign investment company, or PFIC, rules discussed below, the gross amount of any dividend paid to a US holder by Diageo in respect of its ordinary shares or ADSs out of its current or accumulated earnings and profits (as determined for US federal income tax purposes) is subject to US federal income taxation.

Dividends paid to a non-corporate US holder in taxable years beginning before 1 January 2013 that constitute qualified dividend income will be taxable to the holder at a maximum tax rate of 15%, provided that the ordinary shares or ADSs are held for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and the holder meets other holding period requirements. Dividends paid by Diageo with respect to its ordinary shares or ADSs generally will be qualified dividend income to US holders that meet the holding period requirement. Under UK law, dividends are not subject to UK withholding tax. Therefore, the US holder will include in income for US federal income tax purposes the amount of the dividend received, and the receipt of a dividend will not entitle the US holder to a foreign tax credit.

The dividend must be included in income when the US holder, in the case of shares, or the Depositary, in the case of ADSs, receives the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to US corporations in respect of dividends received from other US corporations. Dividends will be income from sources outside the United States, and, depending on the US holder's circumstances, will generally either be 'passive' or 'general' income for purposes of computing the foreign tax credit, if allowable, to a US holder. The amount of the dividend distribution that must be included in income of a US holder will be the US dollar value of the pence payments made, determined at the spot pounds sterling/US dollar foreign exchange rate on the date the dividend distribution is included in income, regardless of whether the payment is in fact converted into US dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date the dividend payment is included in income to the date the payment is converted into US dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for US federal income tax purposes, will be treated as a non-taxable return of capital to the extent of the holder's basis in the ordinary shares or ADSs and thereafter as capital gain.

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Additional information for shareholders (continued)

Taxation (continued)

Taxation of capital gains UK taxation A citizen or resident (for tax purposes) of the United States who has at no time been either resident or ordinarily resident in the United Kingdom will not be liable for UK tax on capital gains realised or accrued on the sale or other disposal of ordinary shares or ADSs, unless the ordinary shares or ADSs are held in connection with a trade or business carried on by the holder in the United Kingdom through a UK branch, agency or a permanent establishment. A disposal (or deemed disposal) of shares or ADSs by a holder who is resident or (in the case of an individual) resident or ordinarily resident in the UK may, depending on the holder's particular circumstances, and subject to any available exemption or relief, give rise to a chargeable gain or an allowable loss for the purposes of UK taxation of chargeable gains.

US taxation Subject to the PFIC rules discussed below, a US holder who sells or otherwise disposes of ordinary shares or ADSs will recognise capital gain or loss for US federal income tax purposes equal to the difference between the US dollar value of the amount that is realised and the tax basis, determined in US dollars, in the ordinary shares or ADSs. Capital gain of a non-corporate US holder is generally taxed at preferential rates where the property is held for more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

A US holder who is liable for both UK and US tax on a gain on the disposal of ordinary shares or ADSs will generally be entitled, subject to certain limitations, to a credit against the holder's US federal income tax liability for the amount of any UK tax paid in respect of such gain.

PFIC rules Diageo believes that ordinary shares and ADSs should not be treated as stock of a PFIC for US federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change. If treated as a PFIC, unless a US holder elects to be taxed annually on a mark-to-market basis with respect to the ordinary shares or ADSs, gain realised on the sale or other disposition of ordinary shares or ADSs would in general not be treated as capital gain. Instead, US holders would be treated as if the holder had realised such gain and certain 'excess distributions' pro-rated over the holder's holding period for the ordinary shares or ADSs and would be taxed at the highest tax rate in effect for each such year to which the gain or distribution was allocated, together with an interest charge in respect of the tax attributable to each such year. With certain exceptions, a holder's ordinary shares or ADSs will be treated as stock in a PFIC if Diageo were a PFIC at any time during the holding period in a holder's ordinary shares or ADSs. In addition, dividends received from Diageo will not be eligible for the special tax rates applicable to qualified dividend income if Diageo is a PFIC either in the taxable year of the distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

UK inheritance tax Subject to certain provisions relating to trusts or settlements, an ordinary share or ADS held by an individual shareholder who is domiciled in the United States for the purposes of the Convention between the United States and the United Kingdom relating to estate and gift taxes (the Convention) and is not a UK national as defined in the Convention will not be subject to UK inheritance tax on the individual's death (whether held on the date of death or gifted during the individual's lifetime) except where the ordinary share or ADS is part of the business property of a UK permanent establishment of the individual or pertains to a UK fixed base of an individual who performs independent personal services. In a case where an ordinary share or ADS is subject both to UK inheritance tax and to US federal gift or estate tax, the Convention generally provides for inheritance tax paid in the United Kingdom to be credited against federal gift or estate tax payable in

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Additional information for shareholders (continued)

Taxation (continued)

the United States, or for federal gift or estate tax paid in the United States to be credited against any inheritance tax payable in the United Kingdom, based on priority rules set forth in the Convention.

UK stamp duty and stamp duty reserve tax Stamp duty reserve tax (SDRT) arises upon the deposit of an underlying ordinary share with the Depositary, generally at the higher rate of 1.5% of its issue price or, as the case may be, of the consideration for transfer. The Depositary will pay the SDRT but will recover an amount in respect of such tax from the initial holders of ADSs. No UK stamp duty will be payable on the acquisition or transfer of ADSs in practice, provided that the instrument of transfer is not executed in the United Kingdom and remains at all times outside the United Kingdom. Furthermore, an agreement to transfer ADSs in the form of ADRs will not give rise to a liability to SDRT.

Purchases of ordinary shares will be subject to UK stamp duty, or SDRT as the case may be, at the rate of 0.5% of the price payable for the ordinary shares at the time of the transfer. However, where ordinary shares being acquired are transferred direct to the Depositary's nominee, the only charge will generally be the higher SDRT charge of 1.5% of the price payable for the ordinary shares so acquired.

Warning to shareholders – share fraud

Please beware share fraud of “boiler room” scams, where shareholders are called ‘out of the blue’ by fraudsters (sometimes claiming to represent Diageo) attempting to obtain money or property dishonestly. Further information is available in the investor section of the company's website (www.diageo.com) but in short, if in doubt, take proper professional advice before making any investment decision.

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Signature

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the Registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorised.

DIAGEO plc
(REGISTRANT)

/s/ DA MAHLAN

Name: DA Mahlan
Title: *Chief financial officer*

5 September 2012

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Exhibits

- 1.1 Articles of Association of Diageo plc (incorporated by reference to Exhibit 99.1 to the Report on Form 6-K (File No. 001-10691) filed with the Securities and Exchange Commission on 15 October 2009).
- 2.1 Indenture, dated as of 3 August 1998, among Diageo Capital plc, Diageo plc and The Bank of New York Mellon (incorporated by reference to Exhibit 4.1 to the Registration Statement on Form F-1 (File No. 333-8874) filed with the Securities and Exchange Commission on 24 July 1998 (pages 365 to 504 of paper filing)).*
- 2.2 Indenture, dated as of 1 June 1999, among Diageo Investment Corporation, Diageo plc and The Bank of New York Mellon (incorporated by reference to Exhibit 2.2 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 November 2001 (pages 241 to 317 of paper filing)).*
- 2.3 Indenture, dated as of 8 December 2003, among Diageo Finance B.V., Diageo plc and The Bank of New York Mellon (incorporated by reference to Exhibit 1 to the Report on Form 6-K (File No. 001-10691) filed with the Securities and Exchange Commission on 9 December 2003).*
- 4.1 Service Agreement, dated 1 November 2005, between Diageo plc and Paul S. Walsh (incorporated by reference to Exhibit 4.6 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 25 September 2006).
- 4.2 Service Agreement, dated 1 July 2010, between Diageo plc and Deirdre A. Mahlan (incorporated by reference to Exhibit 4.4 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 14 September 2010).
- 4.3 Service Agreement, dated 1 March 2012, between Diageo plc, Diageo North America, Inc and Ivan Menezes.
- 4.4 Letter of Agreement, dated 19 July 2007, between Diageo plc and Dr Franz B. Humer (incorporated by reference to Exhibit 4.4 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.5 Form of Service Agreement for Diageo plc's executives in the United Kingdom, dated as of 1 July 2006 (incorporated by reference to Exhibit 4.7 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 17 September 2007).
- 4.6 Form of Service Agreement for Diageo plc's executives in the United States, dated as of 1 July 2006 (incorporated by reference to Exhibit 4.8 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 17 September 2007).
- 4.7 Diageo 2010 Sharesave Plan, dated 14 October 2010 (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 (File No. 333-169934) filed with the Securities and Exchange Commission on 14 October 2010).
- 4.8 Diageo 2001 Share Incentive Plan, dated 14 October 2010 (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-8 (File No. 333-169934) filed with the Securities and Exchange Commission on 14 October 2010).
- 4.9 Rules of the Diageo plc 2009 International Share Match Plan, dated 14 October 2010 (incorporated by reference to Exhibit 4.4 to the Registration Statement on Form S-8 (File No. 333-169934) filed with the Securities and Exchange Commission on 14 October 2010).

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- 4.10 Diageo plc 2009 Executive Long Term Incentive Plan, dated 14 October 2009 (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 (File No. 333-162490) filed with the Securities and Exchange Commission on 15 September 2009).
- 4.11 Diageo plc 2009 Discretionary Incentive Plan, dated 14 October 2009 (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-8 (File No. 333-162490) filed with the Securities and Exchange Commission on 15 September 2009).
- 4.12 Diageo plc 2008 Performance Share Plan, dated as of 15 October 2008 (incorporated by reference to Exhibit 4.2 to the Registration Statement on Form S-8 (File No. 333-154338) filed with the Securities and Exchange Commission on 16 October 2008).
- 4.13 Diageo plc 2008 Senior Executive Share Option Plan, dated as of 15 October 2008 (incorporated by reference to Exhibit 4.3 to the Registration Statement on Form S-8 (File No. 333-154338) filed with the Securities and Exchange Commission on 16 October 2008).
- 4.14 Diageo plc Senior Executive Share Option Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.7 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.15 Diageo plc Executive Share Option Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.8 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.16 Diageo plc Associated Companies Share Option Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.9 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.17 Diageo plc Long Term Incentive Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.10 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.18 Diageo plc 1998 United States Employee Stock Purchase Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.12 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.19 Diageo plc 2007 United States Employee Stock Purchase Plan, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.13 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.20 Diageo plc UK Sharesave Scheme 2000, dated as of 26 August 2008 (incorporated by reference to Exhibit 4.14 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.21 Addendum to Form of Service Agreement for Diageo plc's executives in the United States (incorporated by reference to Exhibit 4.16 to the Annual Report on Form 20-F (File No. 001-10691) filed with the Securities and Exchange Commission on 15 September 2008).
- 4.22 Diageo plc Associated Companies Share Incentive Plan, dated as of 23 August 2011.
- 6.1 Description of earnings per share (included in note 10 to the consolidated financial statements on page 189 of this Annual Report on Form 20-F).
- 7.1 Description of unaudited computation of ratio of earnings to fixed charges (included on page 244 of this Annual Report on Form 20-F).
- 8.1 Principal group companies (included on page 241 of this Annual Report on Form 20-F).
- 12.1 Certification of Paul S. Walsh filed pursuant to 17 CFR 240.13a-14(a).

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- 12.2 Certification of Deirdre A. Mahlan filed pursuant to 17 CFR 240.13a-14(a).
- 13.1 Certification of Paul S. Walsh furnished pursuant to 17 CFR 240.13a-14(b) and 18 U.S.C. 1350(a) and (b).
- 13.2 Certification of Deirdre A. Mahlan furnished pursuant to 17 CFR 240.13a-14(b) and 18 U.S.C. 1350(a) and (b).
- 15.1 Consent of independent registered public accounting firm.

* Pursuant to an Agreement of Resignation, Appointment and Acceptance dated 16 October 2007 by and among Diageo plc, Diageo Capital plc, Diageo Finance BV, Diageo Investment Corporation, The Bank of New York and Citibank NA, The Bank of New York Mellon has become the successor trustee to Citibank NA under Diageo's indentures dated 3 August 1998, 8 December 2003 and 1 June 1999.

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Cross reference to Form 20-F

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It is possible to read and copy documents that have been filed by Diageo plc with the U.S. Securities and Exchange Commission (SEC) at the SEC's public reference room, located at 450 5th Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room and their copy charges. Filings with the SEC are also available to the public from commercial document retrieval services and on the web site maintained by the SEC at www.sec.gov.

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Glossary of terms and US equivalents

In this document the following words and expressions shall, unless the context otherwise requires, have the following meanings:

Term used in UK annual report	US equivalent or definition
Acquisition accounting	Purchase accounting
Associates	Entities accounted for under the equity method
American Depositary Receipt (ADR)	Receipt evidencing ownership of an ADS
American Depositary Share (ADS)	Registered negotiable security, listed on the New York Stock Exchange, representing four Diageo plc ordinary shares of 28 ^{10/108} pence each
Called up share capital	Common stock
Capital allowances	Tax depreciation
Capital redemption reserve	Other additional capital
Company	Diageo plc
CPI	Consumer price index
Creditors	Accounts payable and accrued liabilities
Debtors	Accounts receivable
Employee share schemes	Employee stock benefit plans
Employment or staff costs	Payroll costs
Equivalent units	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. To convert volume of products other than spirits to equivalent units: 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 classified as ready to drink in nine-litre cases divide by five.
Euro, €, €	Euro currency
Exceptional items	Items that, in management's judgement, need to be disclosed separately by virtue of their size or incidence
Excise duty	Tax charged by a sovereign territory on the production, manufacture, sale or distribution of selected goods (including imported goods) within that territory. It is generally based on the quantity or alcohol content of goods, rather than their value, and is typically applied to alcohol products and fuels.
Finance lease	Capital lease
Financial year	Fiscal year
Free cash flow	Net cash flow from operating activities, net purchase and disposal of property, plant and equipment and movements in loans and other investments
Freehold	Ownership with absolute rights in perpetuity
GAAP	Generally accepted accounting principles
Group and Diageo	Diageo plc and its consolidated subsidiaries
IFRS	International Financial Reporting Standards as endorsed and adopted for use in the European Union and International Financial Reporting Standards as issued by the International Accounting Standards Board
Impact Databank	An international data resource for the beverage alcohol industry that is independent from industry participants
LIBOR	London Interbank Offered Rate
Merger accounting	Pooling of interests
Net sales	Sales after deducting excise duties
Noon buying rate	Buying rate at noon in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York
Operating profit	Net operating income
Organic movement	At level foreign exchange rates and after adjusting for exceptional items, acquisitions and disposals for continuing operations
Own shares	Treasury stock
Pound sterling, sterling, £, pence, p	UK currency
Price/mix	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
Profit	Earnings
Profit for the year	Net income
Provisions	Accruals for losses/contingencies
Reserves	Accumulated earnings, other comprehensive income and additional paid in capital
RPI	Retail price index
RTD	Ready to drink products. Ready to drink 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.
SEC	US Securities and Exchange Commission
Share premium	Additional paid in capital or paid in surplus
Shareholders' funds	Shareholders' equity
Shares	Common stock
Shares and ordinary shares	Diageo plc's ordinary shares
Shares in issue	Shares issued and outstanding
Trade and other payables	Accounts payable and accrued liabilities
Trade and other receivables	Accounts receivable
US dollar, US\$, \$, €	US currency

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