

Chairman's statement



Recommended final dividend per share

40.4p ↑5%

2017: 38.5p

Total dividend per share⁽ⁱ⁾

65.3p ↑5%

2017: 62.2p

Total shareholder return (%)

23%

2017: 12%

This year's performance demonstrates the consistent and rigorous execution of our strategy and is testimony to the passion and commitment of all our people around the world. My thanks to everyone at Diageo for another year of progress.

Culture

We are seeing the benefits of the transformation of the company under Ivan's leadership. The entrepreneurial spirit, embodied by many of our brands' founders, is very much alive in today's Diageo. Our culture and values will continue to drive performance and help attract and retain the best talent. There is more work to do, but Diageo is an increasingly agile, efficient, consumer-centric business.

Opportunities for growth

We are a global leader with an enviable portfolio of brands and an extensive geographical footprint. We will seize the opportunities presented by demographic change and rising incomes that allow people to choose premium brands. These are trends that make total beverage alcohol a very attractive sector for growth. Spirits continue to take share from wine, premium beer continues to outperform mainstream beer and people want to drink better, not more.

We expect 730 million new consumers⁽ⁱⁱ⁾ will be able to afford international premium spirits over the next 10 years, driving growth in our business and creating long-term value for all our stakeholders.

The global environment

We find combined economic and political challenges around the world, including questions about international trade and future partnerships between countries. Diageo is experienced in navigating volatility. Our broad portfolio, geographic footprint and leadership position in many markets, together with the flexibility of our operating model, enable us to adapt well to change.

We continue to prepare for all scenarios around the United Kingdom's exit from the European Union in 2019 and are taking Brexit in our stride. We look forward to agreement on a final deal that will provide stability for our workforce and business operations in the United Kingdom and the European Union, as well as clarity on existing and future trade deals between countries. As one of the United Kingdom's most important manufacturing export companies, we are working with the UK government to ensure our priorities are well understood.

“ The entrepreneurial spirit, embodied by many of our brands' founders, is very much alive in today's Diageo. Our culture and values will continue to drive performance and help attract and retain the best talent. There is more work to do, but Diageo is an increasingly agile, efficient, consumer-centric business. ”

Javier Ferrán
Chairman

(i) Includes final recommended dividend of 40.4p.

(ii) Euromonitor 2015 and internal analysis.

Creating value

Looking in more detail at the drivers of performance, we have made further good progress toward our medium term guidance and across the four areas in which we measure our performance: efficient growth, value creation, credibility and trust, and motivated people. Our value creation KPIs, return on average invested capital (ROIC) and total shareholder return (TSR) both increased, to 14.3% and 23%, respectively, this year. Progress has also been made across our efficient growth KPIs.

We continue to target dividend cover (the ratio of basic earnings per share before exceptional items to dividend per share) of between 1.8 and 2.2 times. The recommended final dividend is 40.4 pence per share, an increase of 5%. This brings the recommended full year dividend to 65.3 pence per share and dividend cover to 1.8 times. We continue to expect to maintain dividend increases at a mid-single digit rate until our dividend cover is comfortably back in range.

Subject to shareholder approval, the final dividend will be paid to UK shareholders on 4 October 2018. Payment will be made to US ADR holders on 10 October 2018.

Earlier this year, we completed the purchase of 58.9 million shares, returning £1.5 billion to shareholders. Having delivered another year of strong cash flow generation, the Board has approved an additional share buyback programme of up to £2.0 billion during fiscal 2019.

Our role in society

Making a positive contribution to society is central to our purpose. Social philanthropy played a big part in the lives of the founders of many of our brands and we have a long track record of supporting the communities around us through targeted programmes, as well as creating jobs and increasing prosperity.

We believe that promoting a positive role for alcohol in society and fostering inclusive growth through our value chain are fundamental to achieving our long-term performance goals. Ivan outlines in more detail how we have developed our alcohol in society strategy to deliver more. I am proud of the work Diageo continues to do in helping to reduce alcohol harm and I am pleased to see the wholehearted commitment across the company to stretching targets that will deliver even greater impact.

Our broader sustainability and responsibility framework is embedded in our business strategy and focused on targets for non-financial performance, which are included in this report (see pages 40-55).

Diversity and inclusion

We know that for our business to thrive, we depend on diverse talent and thinking with a range of backgrounds, skills and capabilities. Our employees must reflect our broad consumer base. We believe diversity is one of the key enablers that helps our business to grow and I am particularly proud that Diageo has focused on achieving greater diversity at the most senior levels: women currently make up 50% of our Board.

The Executive Committee is a team of highly successful men and women representing six different nationalities, speaking multiple languages and all having lived and worked in countries across the globe. 40% of the Executive Committee are women.

I am pleased that we are also receiving recognition for our diversity. In January 2018, Diageo was recognised by the Bloomberg Gender-Equality Index for our performance and disclosure around gender equality and we ranked fifth in the Thomson Reuters Global Diversity and Inclusion Index. In November 2017, Diageo ranked third in the FTSE 100 for 'women on boards and in leadership' in the Hampton-Alexander Review. And Diageo was named joint first in the FTSE 100 'companies with female executive directors', in the Female FTSE Board Report 2017 from Cranfield University School of Management.

Our intent is to have our senior leadership team 35% female by 2020, with an increase to 40% by 2025. This figure currently stands at 34%.

Celebrating our inclusive and diverse culture is core to Diageo's purpose of 'celebrating life, every day, everywhere'. This purpose is inclusive in nature, valuing everybody irrespective of background, religion, sexuality or ethnicity.

Our commitment to fostering greater inclusion and diversity can also be seen through our brands: Smirnoff's 'We're Open' campaign supports LGBT inclusivity. In May, Diageo also pledged support to the United Nation's Global LGBTI Standards of Conduct for Business.

Board changes

In April 2018, we announced the appointment of Susan Kilsby as a Non-Executive Director. Susan's expertise in finance and M&A make her contributions a valuable addition to the Board's deliberations.

In March, we agreed with Ursula Burns that her appointment as Non-Executive Director would be delayed. The delay is a result of her ongoing commitments at VEON Ltd, where she is currently Executive Chairman on an interim basis. We look forward to welcoming Ursula to the Board in due course.

The future

Diageo is a global leader in a highly attractive industry, in which the increasing number of legal purchasing age consumers continue to trade up. It is also a business with a long cycle, as it takes time to build brands sustainably. The consistent execution of strategy has delivered further progress this year and the Board and Executive leadership remain fully committed to building long-term value.



Javier Ferrán
Chairman

Chief Executive's statement



Volume movement	Organic volume movement
↓ 0.7%	↑ 2.5%
2017: ↓ 1.7%	2017: ↑ 1.1%
Net sales movement	Organic net sales movement
↑ 0.9%	↑ 5.0%
2017: ↑ 14.9%	2017: ↑ 4.3%
Operating profit movement	Organic operating profit movement
↑ 3.7%	↑ 7.6%
2017: ↑ 25.3%	2017: ↑ 5.6%

I am pleased to report another year of strong and consistent performance. I am proud of our people's passion and engagement, and want to thank all 30,000 colleagues for their commitment to our purpose and values, and for the spirit with which they are making Diageo a stronger business.

Performance

We have become a more efficient, agile company, through the rigorous execution of our strategy and by capitalising on established trends: consumers in developed markets are moving to better quality, more premium brands; those in emerging markets are also trading up into spirits. Of course, while we are one of the largest distillers in the world, beer is also an important part of our business and accounted for 16% of our net sales. It is the second largest category for Diageo after scotch, and Guinness, our premium beer, is growing strongly.

Organic net sales were up 5%, driven by volume growth and strong price/mix. Growth was broad based across categories and regions, including our three focus areas: scotch, US Spirits and India. Organic operating margin expanded by 78bps. We delivered organic operating profit growth of 7.6% and increased investment behind our brands by 7%.

All our regions delivered growth in net sales, as did all categories, with the exception of vodka. Our global giant brands grew 4%, with Johnnie Walker up 5%, Tanqueray up 15%, Guinness up 5%, Baileys up 6% and Captain Morgan up 2%. Smirnoff organic net sales were down 2%, driven predominantly by US Spirits and Europe, as well as competitive pressure in South Africa. Our local stars were up 6% and reserve was up 14%, with particularly strong performances from Chinese white spirits and Don Julio, up 63% and 39%, respectively.

We have a broad portfolio across geographies and categories, which provides a natural hedge against challenging conditions in some countries, such as Cameroon and Ethiopia, this year. In Ethiopia, currency devaluation, changes in the competitive environment and political unrest created a difficult operating environment.

Earnings per share before exceptionals were up significantly again this year, increasing 9.3%. This was primarily driven by organic operating profit growth.

We delivered another year of strong consistent free cash flow performance, delivering £2.5 billion. I am pleased with our continued focus on driving working capital efficiency and the progress we made on average working capital.

“ Diageo is becoming a great blend of every day efficiency and reinvestment in our brands. Our results reflect the high performance culture we have created in the company, as well as the ongoing rigorous execution of our strategy. We are more consumer focused and our ability to move swiftly on trends and insights means we are better placed to capture opportunities and deliver sustained growth.

”
Ivan Menezes
 Chief Executive

Our focus areas

Scotch net sales grew 2% and US Spirits and India grew 3% and 9%, respectively. In scotch, Johnnie Walker had another strong year with 5% organic net sales growth. However, we know we have more to do on malts and local stars, Buchanan's and Old Parr.

In US Spirits, share gains were made across all key brands, except vodka. Net sales were down 3% in vodka and although there were early signs of improvement in Ketel One vodka and Ciroc vodka, we know we have more to do. A stronger performance in India reflected a more stable operating environment in the second half, following a year of challenges brought about by regulatory headwinds.

Creating value

We have developed a better understanding of how our consumers celebrate life with our brands. Alongside improved performance, we are creating long-term value by building brands that consumers love. It requires insight, time and investment. The consistency in our execution is supported by a blend of creativity, data and analytics.

Our insights have led to the development of some exciting innovations. In US Spirits, we launched Ketel One Botanicals, in response to increasing interest in natural ingredients. Distilled with real botanicals and infused with natural fruit and botanical essences, Ketel One Botanicals has no artificial flavours and sweeteners and no added sugars. It is made with 100% non-GMO grain and is 30% ABV. In Great Britain, Gordon's Premium Pink Distilled Gin has become the number one new product launch in spirits and the most successful new spirits launch of the last decade.⁽ⁱ⁾ Overall, our brands continue to receive many accolades: at the San Francisco

World Spirits Competition, we were awarded 72 medals, including three Best in Class and 12 Double Gold.

Increasingly, we find consumers want a greater and more personal connection to the brands they admire. In response to this, we recently announced plans for a state-of-the-art Johnnie Walker immersive visitor experience in Edinburgh and a new Bulleit Bourbon Visitor Centre in Kentucky.

Diageo in society

A company that wishes to be truly sustainable must strive to have the most positive impact it can on society. For Diageo, this means developing the most talented and engaged employees; investing and innovating to ensure we are environmentally sustainable; creating a positive role for alcohol around the world; and investing in the community with programmes that support job creation, access to clean water and women's empowerment.

We know the misuse of alcohol can harm individuals and communities and we are committed to promoting moderation. This year, we set out a new strategy to drive further progress globally through hard-hitting campaigns to reduce excessive consumption, drink driving and underage drinking. We advocate to establish laws and industry standards, such as minimum legal purchase age or drink driving enforcement, where these are not already in place. We also continue to lead the fight against consumption of illicit and dangerous alcohol in emerging markets.

I am honoured to represent Diageo as Chairman of the CEO Group at the International Alliance for Responsible Drinking (IARD), which brings together the 11 largest alcohol producers to encourage moderation and tackle harm. This year, IARD members have committed to address the use of technology and data in digital marketing, to ensure we are targeting adult consumers in a responsible way.

Our community investment and programmes promote skills and employability, empower women and increase access to clean water. Our Learning for Life programme has reached more than 130,000 people since 2008, with training that opens up permanent and high quality job opportunities in the hospitality sector. Through our leadership of Movement to Work in the United Kingdom, our ambition is to remove barriers to

employment with quality work placement opportunities for young people not in education or training.

Our Water of Life programme has reached over 10 million people in 21 countries since 2006, making a real impact on vulnerable communities. And the impact of our gender equality and empowerment programmes for women and girls is amplified across many markets through our global partnership with CARE International.

We have set ourselves stretching environmental targets, supported by capital investment. Over the last decade, we have reduced carbon emissions from our direct operations by 41% and from our entire supply chain by 23%, against our 2007 baseline. We cannot be complacent, however, as we do face challenges and it has taken longer than expected to implement certain environmental projects. We are now focused on investments in renewable energy and water efficiency, as well as our new ambition on plastics.

Outlook

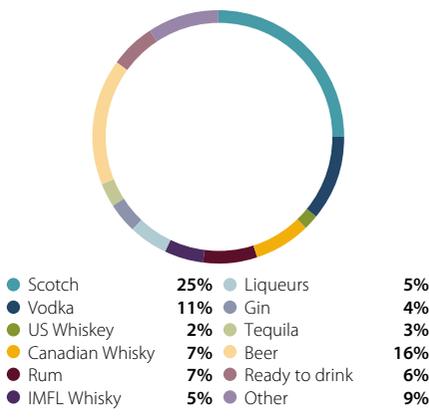
Diageo is becoming a great blend of every day efficiency and reinvestment in our brands. Our results reflect the high performance culture we have created in the company, as well as the ongoing rigorous execution of our strategy. We are more consumer focused and our ability to move swiftly on trends and insights means we are better placed to capture opportunities and deliver sustained growth.

We are on track to deliver our medium term guidance of 175bps of organic operating margin expansion for the three years ending 30 June 2019 and our expectation of mid-single digit net sales growth over this period is unchanged. Diageo is a stronger company and I am confident that we continue to make progress toward our ambition to be one of the best performing, most trusted and respected consumer products companies in the world.



Ivan Menezes
Chief Executive

2018 net sales by category (%)



(i) Based on £RSV in the first 14 weeks since launch in the off-trade only. Data provided from Nielsen Scantrack and dated back to 1 June 2007.