## **DIAGEO**

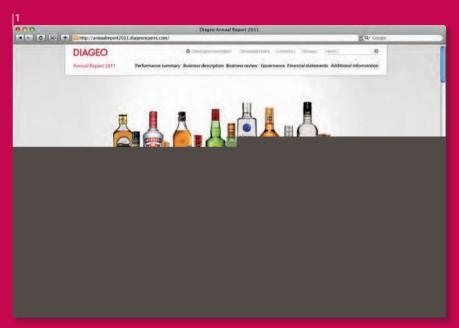
Annual Report 2011

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- 1 Annual Report
- 2 Sustainability & Responsibility Report

This is the Annual Report of Diageo plc for the year ended 30 June 2011 and it is dated 25 August 2011. It includes information that is required by the US Securities and Exchange Commission (SEC) for Diageo's US ling of its Annual Report on Form 20-F. This information may be updated or supplemented at the time of the ling of that document with the SEC or later amended if necessary, although Diageo does not undertake to update any such information. The Annual Report is made available to all shareholders on Diageo's website (www.diageo.com). The content of the company's website and the Sustainability & Responsibility Report should not be considered to form a part of or be incorporated into this document.

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 document.
Diageo's consolidated nancial 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 nancial 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 classications are taken from independent industry sources in the markets in which Diageo operates.

Diageo plc 2011

1

## Diageo

Diageo is the world's leading premium drinks business with an outstanding collection of beverage alcohol brands across spirits, wines and beer categories. These brands include Johnnie Walker, Crown Royal, J&B, Buchanan's, Windsor and Bushmills whiskies, Smirno, Cîroc and Ketel One vodkas, Baileys, Captain Morgan, Jose Cuervo, Tanqueray and Guinness.

Diageo is a global company, with its products sold in more than 180 markets around the world. The management team expects to continue the strategy of investing behind Diageo's global brands, launching innovative new products, and seeking to expand selectively through partnerships or acquisitions that add long term value for shareholders. The company is listed on both the New York Stock Exchange (DEO) and the London Stock Exchange (DGE).

For more information about Diageo, its people and its brands, visit www. diageo.com. For Diageo's global resource that promotes responsible drinking through the sharing of best practice tools, information and initiatives, visit www.DRINKiQ.com.

Diageo's brand positions, global scale and strong routes to market delivered a good performance in the year, and our platform for growth is strong.

#### Essential reads



Performance overview — Page 4



Chief executive's review — Page 10



Brands — Pages 14-17



Regional overview — Page 6



14 strategic brands — Page 12



Governance — Page 80

#### Performance summary

- 2 Introduction
- 4 Performance overview
- 6 Regional overview
- 8 Chairman's statement
- 0 Chief executive's review
- 2 14 strategic brands
- 4 Growing our brands
- 16 Passion for our brands
- 8 Historical information

#### **Business description**

- 23 Strategy
- 24 Premium drinks
- 35 Risk factors
- 39 Cautionary statement concerning forward-looking statements

#### Business review

- 41 Introduction
- 43 Operating results 2011 compared with 2010
- 58 Operating results 2010 compared with 2009
- 72 Trend information
- 72 Liquidity and capital resources
- 75 Capital commitments
- '5 Other contractual obligations
- 76 Post balance sheet events
- 76 O -balance sheet arrangements
- 76 Risk management
- 78 Critical accounting policies
- 79 New accounting standards

#### Governance

- 81 Board of directors and executive committee
- 83 Directors' remuneration report
- 9 Corporate governance report
- 108 Directors' report

#### Financial statements

- 111 Independent auditor's report to the members of Diageo plc
- 112 Consolidated income statement
- 113 Consolidated statement of comprehensive income
- 114 Consolidated balance sheet
- 115 Consolidated statement of changes in equity
- 116 Consolidated statement of cash ows
- 117 Accounting policies of the group
- 121 Notes to the consolidated nancial statements
- 174 Independent auditor's report to the members of Diageo plc
- 175 Company balance sheet
- 176 Accounting policies of the company
- 178 Notes to the company nancial statements
- 181 Principal group companies

#### Additional information for shareholders

- 183 Share capital
- 184 American depositary shares
- 185 Articles of association
- 191 Independent Assurance Report of KPMG Audit Plc to Diageo plc
- IBC Glossary of terms and US equivalents

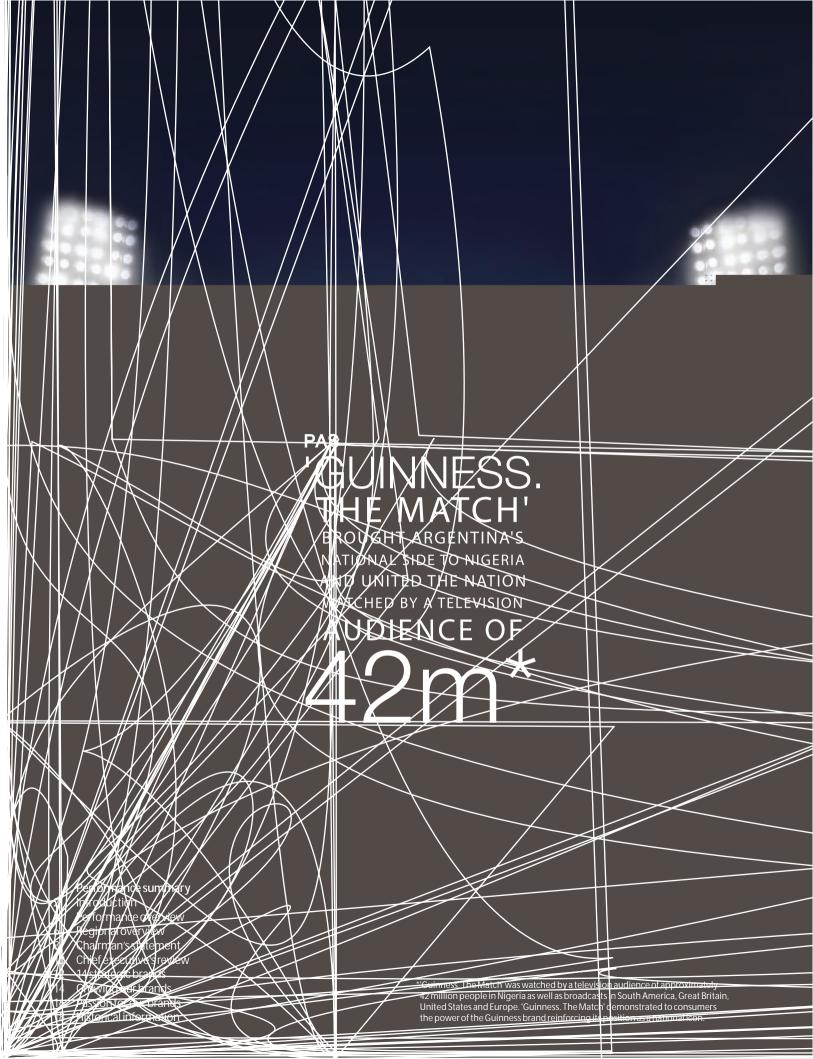
# Diageo Annual Report 2011

## Introduction

2011 was a year of improved performance for Diageo. As we look to capture more growth in the fastest growing markets of the world, the breadth of our brand portfolio, geographic spread and nancial strength is a source of competitive advantage. We are a strong business, getting stronger.







## Performance overview

Diageo's leading brands and superior routes to market delivered volume growth, positive price/mix, continuing gross margin expansion and another year of strong cash ow in 2011.

Net sales breakdown (%)

+19%

Net sales growth in emerging markets between 2009–2011

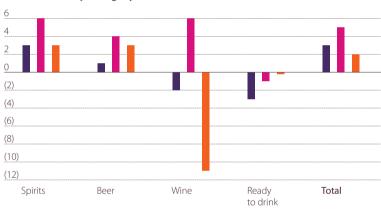
Emerging markets include Africa, Asia excluding Australia, Korea and Japan, Eastern Europe, Turkey, Latin America and the Caribbean, the Middle East, North Africa and Russia.



Emerging marketsDeveloped markets

## 2011 Category performance

#### Performance by category (%)



Organic volume movementOrganic net sales movementReported net sales movement

#### 2011 net sales by category (%)



2-Beer 22%

3 – Vodka 11%

 $4- Ready \,to\,drink\,8\%$ 

 $5-Whiskey\,6\%$ 

6-Rum 6%

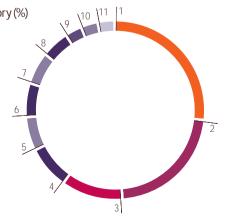
7 - Liqueur 6%

8-Wine 5%

9 – Gin 3%

10 – Tequila 3%

11 - Other 3%



#### Information presented

Unless otherwise stated in this document, commentary refers to organic movements. Share, unless otherwise stated, refers to value share. The market data contained in this document is taken from independent industry sources in the markets in which Diageo operates.

Unless otherwise stated in this document, the % gures presented are re ective of a year-on-year comparison, namely 2010–2011, only.

**Business review** 

## Key gures

40.4p

Full year dividend – 2011

38.1<sub>p</sub>

Full year dividend - 2010



margin\* (%) \*Operating profit before

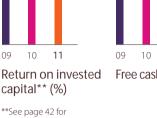
exceptional items expressed as a percentage of net sales.



\*\*See page 42 for calculation of return

on average total

invested capital.



Free cash, ow (£m)

### Our 3 year performance

"Diageo has increased growth year on year in our top and bottom lines, despite continuing weakness in some European markets and the United States. We have seen continuing gross margin expansion, it has been another excellent year in terms of free cash ow, and we have recommende 0 1j5 ()70 (a) 28 (n) 15



3% Reported movement 3% Organic movement



Yoluma (millions of (c) (r) 34 (e) 34 (a) equivalent units) 2%

Reported movement 5% Organic movement



Marketing(e)]TJ ET spend (Em) 8%

Reported movement 8% Organic movement

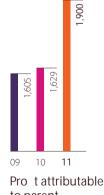


BPPerating 11.1 5759.34 337 pro t before exceptionals (£m)

5% Reported movement 5% Organic movement



1% Reported movement



to parent company's equity shareholders (£m)

17% Reported movement



Baic eanings perhae (pence)

16% Reported movement



final dividend per share (pence)

6%

Additional information

## Diageo Annual Report 201

## Regional overview



#### North America

£3,324m

2011 net sales in the region

Flat Volume 3% Net sales

7% Marketing spend 8% Operating pro t

### Europe

£2,614m

2011 net sales in the region

(2)% /olume

(3)% Net sale

(4)% Marketing spend (7)% Operating pro t

#### North America

1 – During 2011, we began the next phase of Diageo's route to market strategy in the United States. The new agreements will allow for clear leadership through a single management structure, with an increased focus on multicultural, on premise and innovation, areas designated as key priorities for future growth. The new agreements are key milestones toward driving a national sales force approach with our brokers and distributors in North America.

2 – In November, Diageo United States Virgin Islands held the grand opening of its rum distillery in St. Croix. The distillery is part of a 30-year public-private initiative between Diageo and the Government of the USVI that allows Diageo to construct and operate a state of the art, environmentally sound, high-capacity rum distillery in St. Croix that will produce all bulk rum for Captain Morgan products in the United States beginning in 2012.





New agreements for Diageo's route to market strategy in the United States.



Aerial view of the rum distillery in St Croix, USVI.

#### Europe

3 – Winning with our strategic retail customers is a key growth driver in Europe. This year Diageo received supplier of the year awards from ASDA in GB and Tesco in Ireland and Poland. We have also partnered with Metro and Carrefour to not only grow our businesses, but also help their shoppers with information around alcohol and responsibility. In September 2011 we are opening our new collaboration centre which has been built with world leading technology to inspire, partner and grow with our customers.

4 – In August 2011, Diageo completed the acquisition of Mey çki, the leading spirits company in Turkey, for an enterprise value of £1.3 billion. Mey çki is the leading spirits producer and distributor in Turkey – it is the clear market leader in raki and has a leading position in vodka. In addition the company has an extensive nationwide sales and distribution network in Turkey.



Winning with our strategic retail customers is a key growth driver.



Diageo completed the acquisition of Mey çki, the leading spirits producer and distributor in Turkey.

Performance summary

#### International

5 – In October, East African Breweries Limited (EABL) completed the acquisition of 51% of the issued share capital of Serengeti Breweries Limited (SBL) from its existing shareholders for a consideration of £60 million including borrowings acquired of £22 million. SBL is a major brewer and distributor of beverages in Tanzania and produces a portfolio of beer and nonalcoholic products, including its agship Premium Serengeti Lager. SBL forms an integral part of EABL's East African supply footprint providing additional capacity to Kenya and Uganda.

6 – In Latin America and the Caribbean, focus on sales capability growth and reach resulted in 34 category captaincies across the region with key strategic retailers, and over 10,000 Ease of Shop programmes executed at the point of purchase, giving the region a strong platform for both existing brands and its strong innovation pipeline.

### Asia Paci.₄ç

7 – Regulatory approval has been granted for Diageo to own a majority shareholding in the Joint Venture Chinese White Spirits Company (Quanxing). Diageo is now seeking approval from the

### Chairman's statement



"At the end of another year of signicant achievement, the board has a high level of condence in our business and its future prospects."

Diageo is growing stronger

Over the next decade, the companies which prosper will be those which most successfully meet the widely di ering demands of developed and emerging markets and at the same time are able to continue to enjoy the active support of their customers, consumers and suppliers, together with the con dence of their other stakeholders.

Once again, though the 12 months ended 30 June 2011 have posed signicant challenges, Diageo has emerged strongly and is growing stronger. It is now clear that for the foreseeable future the business will have to operate in a global environment with wide variations in economic conditions and considerable volatility. For these reasons it is a major advantage that we operate in over 180 markets, with an outstanding collection of brands, a exible organisation, and very talented people.

As Paul Walsh notes in this report we have taken the decision this year to change the shape of our organisation. We did not do so lightly. However, we recognise that in a world of highly variable economic growth rates there is a vital need for agility and exibility in our capacity to respond to changing conditions. Over the next decade, the companies which prosper will be those which most successfully meet the widely diering demands of developed and emerging markets and at the same time are able to continue to enjoy the active support of their customers, consumers and suppliers, together with the condence of their other stakeholders. We are most determined that Diageo will be such a success story.

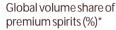
Yet, however varied the conditions in which we trade there can be no compromise on our values and standards of integrity. In the last three years we have devoted much time and energy to ensure that all our employees understand that Diageo must have complete compliance with the high standards of behaviour laid out in our Code of Conduct.

9

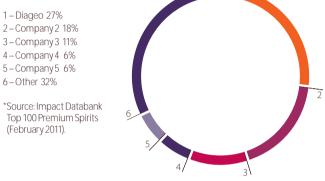


Yearbook 2011

The SAM Sustainability Yearbook measures more than 2,500 of the world's largest companies in terms of their impact on the triple bottom line – economic, social and environmental performance.



- 1 Diageo 27%
- 2 Company 2 18%
- 3 Company 3 11%
- 4-Company 4 6%
- 6-Other 32%



We are also clear that Diageo must play its role in leading our industry in interactions with governments and supra-national bodies, including the World Health Organisation. We know that the beverage alcohol business continues to be under considerable scrutiny from regulators. To have credibility in our discussions with them we must continue to promote responsible drinking and our wider social responsibility agenda with the same vigour that we employ to support our wonderful brands.

At the end of another year of signi cant achievement, the board has a high level of condence in our business and its future prospects. That is why we continue to invest in acquisitions, in our brands, and in our people for the long term. It is why, once again, we are recommending a substantial increase in our dividend. We look forward to the year to come with optimism and with the expectation that it will mark further progress for Diageo.

Dr Franz B Humer, Chairman

## Chief executive's review



"Our outstanding collection of brands has been an asset as ever, but I would single out the performance of scotch whisky as a particular highlight."

A year of improved performance

The strategy we have pursued, and the investment choices we have made, have set our business up to produce attractive and sustainable rates of growth in the medium term. Diageo is a strong business, getting stronger.

Fiscal 2011 was the year when our determination to emerge robustly from the economic downturn was realised.

Diageo has increased growth year on year in our top and bottom lines, despite continuing weakness in some European markets and the United States. We have seen continuing gross margin expansion, it has been another excellent year in terms of free cash ow, and we have recommended an increase in the nal dividend of 6%.

Our outstanding collection of brands has been an asset as ever, but I would single out the performance of scotch whisky as a particular highlight. In a category which reached export values of £109 per second to the United Kingdom in 2010 – a renaissance which Diageo led – we are very well placed as the biggest participant in the category, and as owner of the leading brands.

The strategy we have pursued, and the investment choices we have made, have set our business up to produce attractive and sustainable rates of growth in the medium term. Diageo is a strong business, getting stronger.

Today's trading environment for our company is polarised between important, higher margin but lower growth markets – North America and Western Europe – and high growth markets in Eastern Europe, Africa, Latin America, and most of Asia Paci c. Our plan is for those high growth markets – currently around a third of our business – to represent 50% by 2015. This is a realistic goal, and we have continued our progress towards it in the past year.

## 14 strategic brands

Brand performance is now reported using 14 strategic brands. The new classication better rejects the way in which our range is managed.



	Johnnie Walker	Crown Royal	J&B	Buchanan's	Windsor	Bushmills	Smirno
Category	Whisk(e)y	Whisk(e)y	Whisk(e)y	Whisk(e)y	Whisk(e)y	Whisk(e)y	Vodka
gory	No.1 Scotch whisky in the world	No.1 Canadian whisky in the world	No.4 Scotch whisky in the world	Scotch whisky	Scotch whisky	Irish whiskey	No.1 Premium spirit by volume in the world
Keymarkets	Global Travel & Middle East, United States, Brazil, Thailand, Mexico	United States, Canada, Global Travel & Middle East	Spain, France, South Africa, United States, Portugal	Mexico, Venezuela, United States, Caribbean, Global Travel & Middle East	Korea, China	United States, Ireland, Global Travel & Middle East, GB, France	United States, GB, Brazil, Canada, Australia
Volume movement*	11%	1%	(6)%	2%	3%	9%	1%
Organic net sales movement	11%	3%	(8)%	14%	8%	10%	(1)%
Reported net sales movemer	11%	2%	(8)%	(21)%	12%	11%	(1)%

Performance summary

"Our strategy is to respond to changing consumer dynamics particularly those driven by technology and the development of emerging markets. We use a combination of proven growth drivers and pioneering marketing to ensure maximum return for our investment."

Andy Fennell Chief marketing o cer

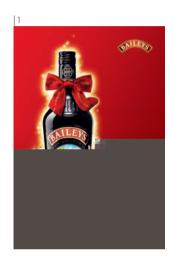


Ketel One vodka	Cîroc	Baileys	Captain Morgan	Jose Cuervo	Tanqueray	Guinness
Vodka	Vodka	Liqueur	Rum	Tequila	Gin	Beer
Super premium vodka	Ultra premium vodka	No.1 Liqueur in the world	No.2 Brand in the rum category in the world	No.1 Tequila in the world	NO.1 Imported gin in the US	No.1 Stout in the world
United States, Canada	United States, Brazil, Global Travel & Middle East	United States, GB, Germany, Global Travel & Middle East, Canada	United States, Canada, GB, South Africa, Germany	United States, Canada, Spain, Australia, Greece	United States, Spain, Canada, Global Travel & Middle East, Greece	Ireland, Nigeria, GB, United States, Cameroon
1%	123%	3%	4%	4%	3%	2%
1%	126%	1%	4%	3%	4%	3%
	122%		4%	1%	3%	2%

## Diageo Annual Report 2011

## Growing our brands

Marketing and innovation is at the heart of Diageo's growth by brand and market. Investing in compelling, targeted campaigns across our marketing mix achieves deep connections – these activities, complemented with a strong and balanced pipeline, allow us to move quickly to target new consumer needs and occasions.



- 1 Baileys growth in Russia and Eastern Europe was the result of a focused celebration campaign around the key periods of Christmas and February to March – including bows on every bottle, gifting and a cope et ime programme. Indoor placement for Baileys in Russia played a big and bold role in this delivery.
- 2 The wine box is established in many countries. We took this one step further and added spirits and mixer to the format. Smirno,

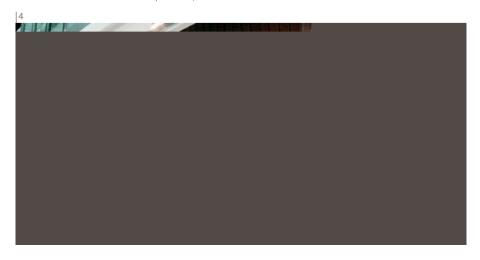


- Signatures delivered share gains in Australia and has created an entirely new category. It has also brought in new consumers to the ready to serve category, particularly attracting women.
- 3 There are over 80 million mobile phone users in Nigeria; this combined with Diageo's strong track record in digital marketing has enabled Guinness Nigeria to launch Guinness VIP. The programme o<sub>e</sub> ers a mobile community access
- to the latest football news, entertainment, trivia, chat forums and instant messaging. Guinness VIP users have grown to 750,000 since launch.
- 4 Global Travel's statement on luxury and retail transformation, Emporium, was opened in Dubai airport. Emporium is just one example of our innovative approach to building categories, transforming airport retail space and forming partnerships to drive growth rates in travel retail.



3

5 – France is the largest Scotch market in the world and one that continues to grow. Our new J&B campaign for the French market plays to the brand's unique, rich history and personality. The So British campaign was supported by vibrant limited edition packs that soon became collector items.









- 6 The Smirno Nightlife
  Exchange Project saw 14 countries
  discover and celebrate the best
  elements of their country's
  nightlife. Nightlife Exchange in
  Brazil was voted the best party of
  the year in Sao Paulo by Veja, the
  local equivalent of Time Out.
- 7 One of the biggest ways to access new occasions is through formats. Simple ideas truly rooted in a deep understanding of what people drink, when and why. Our test in Ghana showed
- something as simple as a 20cl bottle—a ordable, like a round—is a big idea. Following the success in Ghana, we are now rolling out 20cl bottles in Nigeria and Cameroon.
- 8 The Walk with Giants campaign was an unprecedented move for spirits in Africa. The campaign retells Haile Gebrselassie's pioneering story it taps into a speci c insight about the rise of Africa and the hope and dreams of a continent.
- 9 Captain Morgan has become the fastest growing brand amongst the top 100 spirits brands in Mexico through frequent and memorable experiences in bars and discos, irreverent advertising and engaging digital programmes that have created a top 20 facebook community across all brands in all industries in Mexico.
- 10 Wealth creation in emerging markets will continue to outpace the developed world. Diageo is responding with a recent launch of Johnnie Walker XR 21 in China and Taiwan. This innovation was specially created for Asia Paci c to play at the right price point where we are seeing a fast growing demand for super deluxe whisky.





## Diageo Annual Report 2011

## Passion for our brands

Consumers demonstrate passion for our products every day, across the globe. In this multi-speed world individuals want to actively participate with our brands to create their own experiences – through multi-faceted campaigns, we are encouraging loyalty and inspiring brand advocacy.



1 – Vallenato Festival is the most

authentic cultural expression in

Colombia. Old Parr is inherent to

associate the festival directly with

the brand. Taking place in April with up to a million people

participating over four days, it is

a perfect connection moment

approachable and contemporary

to reinforce Old Parr's vibrant,

2 – Arthur's Day is a global

brand attributes.

the event and consumers

- anniversary of the signing of the 9,000 year lease on St. James's Gate in Dublin. It continues to support the philanthropic legacy of Arthur Guinness with the launch of www.quinnessforgood.com.
- 3 Guinness received the US presidential seal of approval when Barack Obama enjoyed a pint of Guinness with the First Lady in the local pub of his ancestral home in Ireland.

  A special delivery of Guinness

was made to the pub in anticipation of the President's visit.



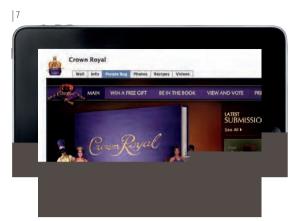
the most successful launch ever at the distillery.

5 – In GB we identied an opportunity to get behind the feel good factor of the Royal Wedding and the additional Bank Holiday with Pimm's. We also introduced a limited edition Union Jack pack and a promotion to win a party pack to celebrate the Royal Wedding.













- 6 Our annual Special Releases of single malt scotch whiskies are eagerly sought-after, exclusive editions from iconic distilleries such as Brora (selling out within days) plus unusual bottlings from working distilleries enchanting connoisseurs and reinforcing our reputation for producing the nest quality whiskies.
- 7 Crown Royal passion was cultivated online and broadcast via Facebook for the rst time through the Purple Bag
- application. This platform allowed Crown enthusiasts to express their dedication for the brand by sharing what they created with the purple velvet bags. Success resulted from allowing consumers numerous ways to participate photograph and story submissions, votes, and sweepstakes entry.
- 8 VIP guests from across the globe descended on Cape Town to Start a Party. J&B will continue to Start a Party in more
- unexpected locations across the world, always reminding guests that great parties start, and nish, responsibly.
- 9 In Thailand we launched Hipkingdom, an online social networking nightlife tool. We worked in collaboration with the most popular local internet portal as their nightlife guide page. Hipkingdom has become known as the nightlife expert for Thailand, with thousands of active participants.

10

10 – In China we partnered with Han Han, the country's most in uential blogger. This ignited a conversation on progress in the rst ever Johnnie Walker blog. More than six million people actively engaged with this campaign, resulting in Johnnie Walker being the most talked about whisky in China.





## Diageo Annuai Report 2011

## 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 2011 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.

		Year ended 30 June					
Income statement data	Notes	2011 £ million	2010 £ million	2009 £ million	2008 £ million	2007 £ million	
Sales		13,232	12,958	12,283	10,643	9,917	
Operating profit	1,2	2,595	2,574	2,418	2,212	2,160	
Profit for the year	•	***************************************			***************************************	***************************************	
Continuing operations	1,2	2,017	1,762	1,704	1,560	1,417	
Discontinued operations	3	_	(19)	2	26	139	
Total pro t for the year	1,2	2,017	1,743	1,706	1,586	1,556	
Per share data		pence	pence	pence	pence	pence	
Dividend per share	4	40.40	38.10	36.10	34.35	32.70	
Earnings per share			***************************************	***************************************		***************************************	
Basic	•	***************************************		***************************************	***************************************	***************************************	
Continuing operations	1	76.2	66.3	64.5	58.0	50.2	
Discontinued operations		_	(0.8)	0.1	1.0	5.2	
Basic earnings per share	1	76.2	65.5	64.6	59.0	55.4	
Diluted							
Continuing operations	1	76.0	66.2	64.3	57.6	49.9	
Discontinued operations		_	(0.8)	0.1	1.0	5.1	
Diluted earnings per share	1	76.0	65.4	64.4	58.6	55.0	
		million	million	million	million	million	
Average shares		2,493	2,486	2,485	2,566	2,688	
					Į.	As at 30 June	
Balance sheet data	Notes	2011 £ million	2010 £ million	2009 £ million	2008 £ million	2007 £ million	
Total assets	1	19,777	19,454	18,018	15,992	13,934	
Net borrowings	5	6,450	6,954	7,419	6,447	4,845	
Equity attributable to the parent company's equity shareholders		5,245	4,007	3,169	3,463	3,947	
Called up share capital	6	797	797	797	816	848	

19

#### Notes to the historical information

#### 1 Accounting policies

The consolidated financial statements for the five years ended 30 June 2011 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 Exceptionalitems

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 for continuing operations is as follows:

		Year ended 30 June				
	2011 £ million	2010 £ million	2009 £ million	2008 £ million	2007 £ million	
Items included in operating pro t						
Restructuring programmes	(111)	(142)	(170)	(78)	_	
Duty settlements	(127)	_	_	_	_	
Brand impairment	(39)	(35)	_	_	_	
SEC settlement	(12)	_	_	_	_	
Disposal of Park Royal property	_	_	_	_	40	
	(289)	(177)	(170)	(78)	40	
Sale of businesses	(14)	(15)	_	9	(1)	
Items included in taxation						
Tax credit on exceptional operating items	51	39	37	8	_	
Tax credit on sale of businesses	3	10	_	_	_	
Settlements agreed with tax authorities	66	_	155	_	_	
	120	49	192	8		
Exceptional items in continuing operations	(183)	(143)	22	(61)	39	
Discontinued operations net of taxation	<del>-</del>	(19)	2	26	139	
Exceptional items	(183)	(162)	24	(35)	178	

#### 3 Discontinued operations

In the year ended 30 June 2010 discontinued operations comprise a charge of £19 million in respect of the discounted value of anticipated future payments to new thalidomide claimants. In the years ended 30 June 2009, 30 June 2008 and 30 June 2007 discontinued operations are in respect of the quick service restaurants business (Burger King, sold 13 December 2002) and 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.

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				
		2011 pence	2010 pence	2009 pence	2008 pence	2007 pence	
Per ordinary share	Interim	15.50	14.60	13.90	13.20	12.55	
	Final	24.90	23.50	22.20	21.15	20.15	
	Total	40.40	38.10	36.10	34.35	32.70	
		¢	•	¢	\$	•	
Per ADS	Interim	1.02	0.90	0.82	1.05	0.99	
	Final	1.60	1.48	1.46	1.46	1.64	
	Total	2.62	2.38	2.28	2.51	2.63	

Note: Subject to shareholders' approval the final dividend for the year ended 30 June 2011 will be paid on 24 October 2011, and payment to US ADR holders will be made on 28 October 2011. In the table above, an exchange rate of £1 = \$1.61 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 24 October 2011.

#### 5 Net borrowings de nition

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 years ended 30 June 2011 and 30 June 2010 the company did not repurchase any ordinary shares for cancellation or to be held as treasury shares (2009 – 38 million ordinary shares, cost of £354 million; 2008 – 97 million ordinary shares, cost of £1,008 million; 2007 – 141 million ordinary shares, cost of £1,405 million).

#### 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 company's financial condition and results of operations, see 'Business review – Risk management'.



- Business description

  23 Strategy

  24 Premium drinks

  35 Risk factors

  39 Cautionary statement concerning forward-looking statements

## **Business description**

Diageo is the world's leading premium drinks business, operating globally across spirits, beer and wine.

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 o ce is located at Lakeside Drive, Park Royal, London NW10 7HQ and its telephone number is +44 (0) 20 8978 6000.

Diageo is a major participant in the global beverage alcohol industry, producing and distributing a leading collection of branded premium spirits, beer and win together world class brands and a management tear seeks to maximise shareholder value over the long to management team expects to continue the strategy investing behind Diageo's strategic brands, launchin innovative new products, and seeking to expand sel either through partnerships or acquisitions that add term value for shareholders.

#### Strategy

Diageo is the leading premium spirits business in the world by volume, by net sales and by operating pro and is one of a small number of premium drinks companies that operate globally across spirits, beer and wine. Diageo creates long term value for shareholders through its outstanding brands, its geographical breadth and the expertise of its people

Diageo manages a broad range of brands acros several categories. It manages eight of the world's to twenty premium spirits brands, including Smirno, t number one brand by volume and Johnnie Walker, t number one brand by value. In beer, Diageo owns th only global stout brand, Guinness, and a range of lag brands sold primarily in Africa. Diageo's wine brands sold predominantly in North America and Great Brita across a full range of price points.

Diageo is a global company with its products sold in more than 180 markets around the world. In the developed markets of North America and Europe, Diageo has built scale and strong routes to market. Diageo is also the number one international spirits company in the emerging markets of Africa, Latin America and Asia. These rapid growth markets now comprise approximately one third of Diageo's net sales, up from 22% in 2005. Through continued organic growth driven by infrastructure investments and targeted acquisitions, these markets are expected to contribute 50% of Diageo's net sales by 2015.

In the majority of markets, Diageo's brands reach customers and consumers through local teams with strong local expertise and networks. In countries where Diageo has not established its own subsidiary, it looks to expand organically through business partners and third party distributors. Diageo is also committed to explore opportunities to expand geographically through acquisitions, within its nancial criteria. The acquisition of companies with strong local routes to market and brands that appeal to the growing number of middle class consumers are particularly appealing. The acquisition of Mey çki in Turkey and the investment in ShuiJingFang in China are two examples of this strategy in action.

Diageo combines the bene ts of global scale with local insights into consumer trends and behaviours to deliver world class marketing

campaigns. For example, the Keep Walking campaign on Johnnie Walker has been running globally for over 10 years, based on the universal appeal of personal progress. The marketing campaign is true to this insight although the local creative executions look dierent around the world. Likewise, consumer insights inform Diageo's innovation launches and pipeline. The premiumisation of scotch to appeal to consumers of luxury brands and the development of ready to serve cocktails as at-home consumption increases have been particularly successful.

> Diageo is also focused on driving category growth with its customers through shopper insights. The sales ambition t the point of purchase. The 'Diageo Way of Selling' me equips four thousand salesmen with best practice processes. It builds capabilities in sales execution, r service and the e cient use of trade investment iageo becomes an indispensable business partner stomers.

Diageo is committed to building a sustainable iness across its value chain through its 'Sustainability Responsibility' strategy. The way in which Diageo omotes a positive role for alcohol in society; respects e natural resources, communities and people it relies ; and champions a culture of good governance and hics are all important drivers of growth. The company which its brands are marketed and the positive role industry e orts to promote responsible drinking d works with other stakeholders to combat

Diageo recognises that it operates in a world where any of the natural resources that the business relies on, ch as fossil fuels and water, are limited. In 2007 Diageo t highly challenging environmental targets covering ater e ciency, the reduction of carbon dioxide, olluting power of water and waste-to-land II, and in 09 Diageo expanded these to include the stainability of its packaging. Measuring and managing environmental impact is not only important for the net, it is essential for the nancial sustainability of

Diageo is also proud of the positive impact it has on the communities in which it operates. For example, from its start in 2007, the 'Water of Life' programme has brought clean and safe drinking water to millions of people in Africa. In Latin America, the Learning for Life programme provides vocational training and has directly transformed the lives of tens of thousands of young adults. Diageo also

recognises that the way in which it conducts its business, treats its people and works with local stakeholders can have an impact on community development.

Diageo believes that industry leading performance will be delivered through great leadership. The Diageo Leadership Performance Programme builds leadership capabilities and creates the conditions for all employees to grow and perform at their best.

#### Market participation

Johnnie Walker is the

spirit by value (Impact

growth in 2011.

world's leading premium

Databank, March 2011) and

was the biggest contributor to Diageo's total net sales

> Since 2005 up to the year ended 30 June 2011 Diageo managed its business through four regions: North America, Europe, International, and Asia Paci c. The North American region, comprising the United States and Canada, accounts for the largest proportion

d its employees are proud of the responsible manner at moderate consumption of its brands plays in the es of many people. Diageo seeks to be at the forefront

ageo's supply chain and its business.

of Diageo's net sales and operating pro t. Europe is comprised of Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe. The International region is made up of three business units: Latin America and the Caribbean (including Mexico), Africa and Global Travel and Middle East (GTME), The Asia Paci cregion comprises South Korea, Japan, the People's Republic of China, India and other Asian markets, Australia and New Zealand. In the past nancial year roughly two-thirds of net sales were derived from developed markets (mainly North America and Western Europe) and one-third from emerging markets (mainly Latin America and the Caribbean, Africa and Asia Paci c). In 2005 approximately four-fths of net sales arose in developed markets and one-fth in emerging markets.

During the year ended 30 June 2011 the group reviewed its operating model across its businesses and commenced a restructuring programme that is expected to be fully implemented by 30 June 2013. The main objective of the programme is to improve the e ectiveness and productivity of the group's operations and to deploy resources closer to the market and in those geographical regions where the potential for growth is greatest. This review will result in changes to the group's regional structure and the way it organises its central functions. The principal countries impacted are the United Kingdom, Ireland and the United States.

On 25 May 2011 Diageo announced that th International region from 1 July 2011 will have two autonomous regions: Diageo Latin America and Diageo Africa. The Global Travel business will be divided and each speci c duty free operation will be allocated to the market of the geographic region where it is located. The Middle East business will become part of Asia Paci c.

#### Producto ering

Diageo classi es 14 brands as global strategic brands: Johnnie Walker, Smirno, Baileys, Crown Royal, Captain Morgan, Jose Cuervo, J&B, Buchanan's, Windsor, Ketel One vodka, Cîroc, Tangueray, Bushmills and Guinness. These brand are the main focus for the business and 78% of the group's marketing spend supports these brands. In aggregate, for the year ended 30 June 2011, they comprised 66% of Diageo's net sales.

Brand performance for the year ended premium bourbon consumers. 30 June 2011 is now reported for the 14 strategic brands above which replaces the brand performance reporting of eight global priority brands disclosed in prior years and re ects the way the brands are managed.

#### Businesse ectiveness

Over the long term, Diageo's strategy continues to focus on driving growth and increasing shareholder value.

#### Premium drinks

Diageo is engaged in a broad range of activities within the beverage alcohol industry, with products sold in approximately 180 markets around the world. Its operations include producing, distilling, brewing, bottling, packaging, distributing, developing and marketing a range of brands. Diageo markets a wide range of recognised beverage alcohol brands including a number of the world's leading spirits and beer brands. In calendar year 2010, the Diageo brand range included 17 of the top 100 premium distilled spirits brands worldwide.

References to ready to drink products in this report include progressive adult beverages in the United States and certain markets supplied by the United States.

In the year ended 30 June 2011, Diageo sold 118.6 million equivalent units of spirits (including ready to drink), 25.8 million equivalent units of beer and 3.1 million equivalent units of wine. In the year ended 30 June 2011, ready to drink products contributed 5.7 million equivalent units of total volume, of which Smirno ready to drink variants accounted for 3.8 million equivalent units. Volume 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 ve, ready to drink in nine-litre cases divide by 10 and certain pre-mixed products that are classie ed as ready to drink in nine-litre

cases divide by ve.

Diageo's portfolio of premium drinks comprises brands owned by the company as a principal and brands held by the company under agency or distribution agreements. Diageo's

nts vary depending on the particular brand, e for a xed number of years. Diageo's bal agency brand is Jose Cuervo in North erica and many other markets (with istribution rights extending to 1 July 2013). 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 iageo will be able to prevent termination of stribution, manufacturing or licence reements or to renegotiate distribution, nufacturing or licence agreements on ourable terms when they expire. Diageo classi es its brands as strategic nds and other brands.

The strategic brands

nnie Walker scotch whiskies

- Smirno vodka and Smirno ready to drink products
- Baileys Original Irish Cream liqueur
- Crown Royal Canadian whisky
- Captain Morgan rum and rum based products
- Jose Cuervo tequila (agency brand in North America and many other markets)
- J&B scotch whisky
- Buchanan's scotch whisky
- Windsor Premier scotch whisky
- Ketel One vodka (exclusive worldwide distribution rights)
- Cîroc vodka

Crown Royal in 2011, with the

successful launch of Crown Royal

Black, a variant which attracts super

- Tanqueray gin
- Bushmills Irish whiskey
- Guinness stout

Diageo has 14 strategic brands that it markets worldwide. Diageo considers these brands to have the greatest current and future earnings potential. Figures for strategic brands include related ready to drink products, unless otherwise indicated.

In the year ended 30 June 2011, strategic brands accounted for 65% of total volume (95.8 million equivalent units) and contributed net sales of £6,576 million.

Production

#### Other beer brands include:

- Malta Guinness non-alcoholic malt
- Harp lager
- Tusker lager
- Smithwick's ale
- Senator lager
- Red Stripe lager

In the year ended 30 June 2011, Diageo sold 14.8 million equivalent units of beers other than Guinness, achieving net sales of £1,029 million. Other beer volume was mainly attributable to owned brands with a minority being attributable to beers brewed and/or sold under licence, such as Budweiser lager and Carlsberg lager in Ireland, Tiger beer in Malaysia and Heineken lager in Jamaica.

#### Wine brands include:

- Blossom Hill
- Sterling Vineyards
- Beaulieu Vineyard
- Navarro Correas
- Acacia Vineyard
- Rosenblum Cellars
- Piat d'Or
- Chalone Vineyard
- Santa Rita

For the year ended 30 June 2011, wine volume was 3.1 million equivalent units, contributing net sales of £488 million.

#### Production

Diageo owns 106 production facilities including maltings, distilleries, breweries, packaging plants, maturation warehouses, cooperages, vineyards, wineries and distribution warehouses. Production also occurs at plants owned and operated by third parties and joint ventures

at a number of locations internationally.

Approximately 85% of total production is undertaken

by Global Supply organised into four production centres, (e) oon centres, (e) oon centres,

Production codes	L. and L.	District
Production centre	Location	Principal products
Europe Supply	United Kingdom	Scotch whisky, gir
	Ireland (Baileys)	Irish cream liqueu
	Italy (Santa Vittoria)	Vodka, wine, rum
America Supply	United States	Vodka, gin, tequil progressive adult
	Canada	Vodka, gin, rum, C
Global Beer Supply	Ireland (Guinness)	Beer
	Jamaica	Beer
Asia Supply	Australia	Rum, vodka, read
	Philippines	Whisky ain vodk

Principal products	Production capacity in millions of equivalents units*	volume in 2011 in millions of equivalent units
Scotch whisky, gin, vodka, rum, ready to drink	81	51
rish cream liqueur, vodka	13	8
odka, wine, rum, ready to drink	10	6
/odka, gin, tequila, rum, wine, American whiskey, progressive adult beverages, ready to drink	37	30
/odka, gin, rum, Canadian whisky	9	9
Beer	9	8
Beer Seer	1	1
Rum, vodka, ready to drink	4	3
Vhisky, gin, vodka	2	1

<sup>\*</sup>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 2011 adjusted for the elimination of unplanned losses and ine ciencies, 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, a whisky distillery in the United States and vodka/gin distilleries in the United Kingdom and the United States. Diageo produces Smirno vodka internationally, Popov vodka and Gordon's vodka in the United States, and Baileys 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 Australia and Venezuela. All of Diageo's maturing scotch whisky is located in warehouses in Scotland (primarily at Blackgrange), its maturing Canadian whisky in La Salle and Gimli in Canada and all its maturing American whiskey in Kentucky and Tennessee in the United States.

In July 2009, the group announced a restructuring of its operations in Scotland. The plans included the consolidation of distilling, packaging and warehousing activities and involved the closure of a packaging plant, a distillery and a cooperage over a three-year period. Investment is concentrated in the production sites at Leven in Fife where a new packaging facility has become operational in the summer of 2011, at Shieldhall near Glasgow and at a new state of the art cooperage at Cambus near Alloa. The Kilmarnock packaging facility will close in the spring of 2012.

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 will be made in the North American spirits supply chain over the next 18 months principally in the packaging plants at Plain eld in Illinois and Relay in Maryland.

In the year ended 30 June 2010 Diageo also announced the closure of the Dorval bottling plant in Quebec Canada with the production moved to Delta Beverages in Woodbridge, Ontario. In addition, a restructuring of the Daventry distribution centre in the United Kingdom was announced in 2010.

In June 2008, Diageo and the government of the US Virgin Islands announced a public/private initiative for the construction and operation of a high capacity distillery in St Croix. This new facility became operationa in November 2010 and 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 and in Kilkenny,
Waterford and Dundalk in the Republic of Ireland, and in Nigeria, Kenya,
Ghana, Cameroon, Tanzania, Malaysia and Jamaica. Ireland is the main exporter of the Guinness brand. In other countries, Guinness is brewed by third parties under licence arrangements. In addition, Diageo owns a 25% equity interest in Sedibeng brewery in South Africa.

'Baileys. Let's do this again'.

Burnier ber from supplies to the main from supplies to the principal brewery in South Africa.

All Guinness Draught production is at the St James's Gate brewery in Dublin in the Republic of Ireland. 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.

Diageo announced the restructuring of its brewing operations in Ireland in 2008 with the intention of consolidating operations to a new green eld brewery in the Dublin area and decommissioning the existing brewing infrastructure. The project was reviewed in 2009 due to the changing economic conditions both globally and locally in Ireland. A review of options continued in 2011 to examine the desirability of network consolidation. The project remains under

review and a business case for investment behind consolidation is being developed for approval.

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 or leases land and buildings throughout the world. The principal production facilities are described above. As at 30 June 2011, Diageo's land and buildings are included in the group's consolidated balance sheet at a net book value of £734 million. Diageo's two largest individual facilities, in terms of book value, are Leven bottling and blending facility in Scotland and St James's Gate brewery in Dublin. Diageo's properties are primarily a variety of manufacturing, distilling, brewing, bottling and administration facilities spread across the group's worldwide operations, as well as vineyards and wineries in the

United States. Approximately 40%, 20% and 19% of the book value of Diageo's land and buildings comprise properties located in Great Britain, Ireland and the United States, respectively. Approximately 90% by value of the group's properties are owned and approximately 3% are held under leases running for 50 years or longer.

ring the years ended 30 June 2011 and 30 June 2010 er of vineyards and facilities located in Napa Valley, ia were purchased and leased back to Diageo under ear lease, with Diageo holding options to extend lease at fair value for up to 80 years in total. Diageo emains 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 signicant 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 elects of short term price uctuations.

Cream is the principal raw material used in the production of Irish cream liqueur and is sourced from reland. Grapes are used in the production of wine and are sourced from suppliers in the United States and Argentina. Other raw materials purchased in signicant quantities for the production of spirits and beer are tequila, bulk whisky, neutral spirits, molasses, rum, cereals, sugar and a number of avours (such as

juniper berries, agave, 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 has a supply agreement with Destilería Serrallés Inc, a Puerto Rican corporation, under which Diageo purchases all bulk rum for use in Captain Morgan products sold in the United States. Diageo and Destilería Serrallés Inc have agreed that this supply agreement will terminate with e ect from the end of December 2011, from which time Diageo intends to source rum for its Captain Morgan products from the Diageo distillery that has recently been constructed in the US Virgin Islands.



launch of the new campaign

Diageo has an exclusive and perpetual supply agreement with the Nolet Group, a Dutch company, for the supply of Ketel One vodka.

#### Marketing and distribution

Diageo is committed to investing in its brands. In the year ended 30 June 2011, £1,538 million was spent worldwide on marketing brands with a focus on the fourteen strategic brands that accounted for 78% of total marketing spend.

Diageo makes extensive use of magazine, newspaper, point of sale and poster and billboard advertising, and uses radio, cinema, television and internet 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 o trades with shopper/consumer promotions. Sponsorship is utilised in brand marketing with Diageo currently active in the sponsorship of the Vodafone McLaren Mercedes Formula One Team, a NASCAR racing team and the Johnnie Walker golf championships.

#### Business analysis

In the year ended 30 June 2011, North America, Europe, International and Asia Paci c contributed 41%, 26%, 26% and 7%, respectively, of the group's operating pro t before exceptional items and corporate costs.

An analysis of net sales and operating pro t by operating segment for the year ended 30 June 2011 is set out in the table below.

#### North America

North America is the largest market for Diageo in terms of operating prot, and the largest market for premium drinks in the world. In the year ended 30 June 2011 Diageo marketed its products through four units: US Spirits, Diageo Chateau & Estate Wines, Diageo-Guinness USA and Diageo Canada. For the year ending 30 June 2012 North America will include the North American operations of Global Travel.

The US Spirits business, while managed as a single business unit, executes sales and marketing activities through 14 teams or clusters. National brand strategy and strategic accounts marketing are managed at the corporate North America level. The spirits clusters market the majority of Diageo's collection of spirits brands (including Smirno vodka, Baileys Original Irish Cream liqueur, Jose Cuervo tequila, Johnnie Walker scotch whisky, Captain Morgan, Tanqueray gin, J&B scotch whisky, Crown Royal Canadian whisky, Seagram's 7 Crown American whiskey, Seagram's VO Canadian whisky, Buchanan's scotch whisky, Ketel One vodka and Cîroc vodka) across the United States.

Diageo Chateau & Estate Wines (DC&E) owns, leases and operates wineries in California (including Beaulieu Vineyard, Sterling Vineyards, Chalone Vineyard, Acacia, Rosenblum and Provenance Vineyards) and markets these and other wines across the United States. Over the last 12 months, DC&E completed its rationalisation strategy and disposed of its vineyards and facilities at Canoe Ridge, Echelon, Edna Valley, Sagelands and Moon Mountain and disposed of other brands and assets.

Diageo-Guinness USA markets Diageo's US beer brands (including Guinness stout, Harp lager, Red Stripe lager and Smithwick's ale) as well as the group's progressive adult beverages (including Smirno lce, Smirno premium mixed drinks, Captain Morgan Parrot Bay Tropical Malt Beverage and Jeremiah Weed ready to drink).

The Canada business unit distributes the group's collection of spirits, wine and beer brands across all Canadian territories. Within the United States, there are generally two types of regulatory environments: open states and control states. In open states, spirits companies are allowed to sell spirits, wine and beer 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 o trade retailers. In most control states, Diageo markets 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 control states for spirits are open states for wines. Beer distribution generally follows open states regulation across the United States. 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 2,800 dedicated sales people focused on selling its spirits and wine brands. Diageo has pursued a distribution strategy centred around 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 Diageo's and distributors' 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 is now focused on building the capabilities and selling tools of the distributors' dedicated sales forces and creating a more excient and executive value chain.

#### Europe

In the year ended 30 June 2011 Diageo Europe comprised six units: Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe. For the year ending 30 June 2012 Europe will comprise four units: Western Europe, Russia and Eastern Europe, Turkey and the European operations of Global Travel.

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

North America	
Europe	
International	
Asia Paci c	
Global Supply	
Corporate	
Total	

		2011			2010
Net sales £ million	Operating pro t/(loss) before exceptional items £ million	Operating pro t/ (loss) £ million	Net sales £ million	Operating pro t/(loss) before exceptional items £ million	Operating pro t/(loss) £ million
3,324	1,255	1,232	3,306	1,170	1,132
2,614	778	621	2,759	859	806
2,747	804	791	2,627	771	766
1,181	208	158	1,018	176	146
_	_	(35)		_	(39)
70	(161)	(172)	70	(225)	(237)
9,936	2,884	2,595	9,780	2,751	2,574

(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. In particular, Great Britain's top four national multiple grocers together make up over 60% of home consumption total spirits volume.

Ireland comprises the Republic of Ireland and Northern Ireland. In both territories, Diageo sells and distributes directly to both the on trade and the o trade (for example, retail shops and wholesalers) through a telesales operation, extensive sales calls to outlets and third party logistics providers. The Guinness, Smirno and Baileys brands are market leaders in their respective categories of long alcoholic

interest in a venture with Heineken which owns a brewery in Gauteng, South Africa. Diageo has a wholly owned brewery in Cameroon and also has majority owned breweries in Nigeria, Kenya, Tanzania, Ghana, Uganda and the Sevchelles.

Global Travel and Middle Fast encompasses a sales and marketing organisation which targets the international consumer in duty free and travel retail outlets such as airport shops, airlines and ferries around the world, and distribution of Diageo brands in the Middle East and North Africa. The global nature of the travel channel and its organisation structure allows a specialist Diageo management team to apply a co-ordinated approach to brand building initiatives and to build on consumer insights in this trade channel, where consumer behaviour tends to be di erent from domestic markets. In the Middle East and North Africa, distribution is achieved through third party distributors. Lebanon is an exception, where a Diageo subsidiary distributes the majority of the Diageo brands sold there.

#### Asia Pacj c

In the year ended 30 June 2011, Diageo Asia Paci c comprised India, the People's Republic of China, South Korea, Japan, Thailand, Vietnam, Singapore, Malaysia and other Asian markets, Australia and New Zealand. For the year ending 30 June 2012, Asia Paci c will also comprise the Middle East business and Global Travel operations that are located in that region.

> In China, Hong Kong and Macau Diageo distributes the majority of its spirit brands through a joint venture arrangement with Moët Hennessy. Diageo has a wholly owned subsidiary in China for brands not included in the joint venture such as Smirno , Windsor and Baileys. On 14 July 2011, Diageo acquired an additional 4% equity stake in Sichuan Chengdu Quanxing Company Ltd. (Quanxing) from Chengdu Yingsheng Investment Holding Co., Ltd. bringing the equity stake owned by Diageo 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. Diageo is the sole distributor of ShuiJingFang's Chinese white spirits outside of China.

Diageo works with a number of joint venture partners in Asia Paci c. In Thailand, Malaysia and Singapore, Diageo distributes the majority of its spirits brands through joint venture arrangements with Moët Hennessy.

In South Korea, India, Vietnam and Taiwan, Diageo's own distribution companies distribute the

majority of Diageo's brands. In Vietnam, Diageo entered into a strategic partnership agreement with Hanoi Liquor Joint Stock Company (Halico) in January 2011. In addition, Diageo acquired a 24.9% equity stake in Halico from VinaCapital Vietnam Opportunity Fund Limited, for £34 million.

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 Smirno, as well as Guinness and Smirno Ice. Other spirit brands, which are not distributed by either Moët Hennessy or the Kirin joint venture, are distributed by third parties.

In Indonesia, Guinness is brewed by PT Multi Bintang Indonesia (MBI), and is distributed through a distribution agreement with PT Dima Indonesia while spirit brands are distributed by government licensed distributors. In the Philippines, Diageo Philippines Inc, a 51% Diageo owned joint venture, distributes the brands. In Malaysia, Diageo's own



Marketing spend on Windsor 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.

of competitive advantage. It continues to be Diageo's goal to release the potential of all of its people.

Diageo aims to be amongst the most admired companies in all key geographies. Consistent with this, Diageo participated in independent surveys during the year and is currently rated in the top 10 employers in eight of its key markets. Further to this aim, Diageo endeayours to create a workplace that is both welcoming and challenging for all employees. 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 exible 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 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 bene ts, 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.

Inspirational leadership to deliver great results is critical to the success of the business. The Diageo Leadership Performance Programme, which was launched in 2007, remains a key programme for the organisation. The focus in the year ending 30 June 2011 was on continuing to apply and embed the learnings across the entire leadership community. The aim is for Diageo to be recognised for the outstanding quality of its business leaders and their ability to deliver great performance for the group.

Employee engagement is a key element of Diageo's people strategy. Diageo's values are embedded in the business and guide how all employees operate and behave. A values survey, which includes a measure of employee engagement, is conducted with employees every year. Now in its ninth year, this survey provides an annual insight into what employees are thinking and feeling about the business. The values survey allows Diageo, at group, function and team levels, to assess how the business is tracking against the long term goals of engaging employees and consistently bringing Diageo's values to life. 89% of Diageo's employees participated in the 2011 values survey and the overall engagement score was 85%. The highest level of engagement as measured by the survey is termed 'super engaged'.

Diageo's aspiration is that 50% or more of its employees are superengaged 2 1(2 p26816 (2gBT 9 0 0 20 ) -2 (I (h313 ((t)4 (e) 19 () 75 (a) 22 (-) ) (19 (12 125 (c) 1 Diageo strives to keep its employees well informed on and engaged with the company's strategy and business goals as a high priority, focusing on dialogue and consultation (both formal and informal) on changes that a ect its employees.

#### Average number of employees

	2011	2010	2009
North America	1,690	1,615	2,258
Europe	2,912	3,007	3,253
International	5,867	5,097	4,952
Asia Paci c	2,705	2,636	2,668
Global Supply	7,802	8,171	8,116
Corporate and other	2,810	2,761	2,792
	23,786	23,287	24,039

Supply operations of the US wines business were transferred from North America to Global Supply in the year ended 30 June 2010.

#### Sustainability & responsibility

Diageo realises that it is increasingly important for investors to understand not only its nancial performance, but also the manner in which it manages its social and environmental impacts. This is integral to the company's business strategy and supports the purpose: 'celebrating life every day, everywhere'.

Diageo's 'Sustainability & Responsibility' strategy aims to address the company's key impacts at every stage of the value chain. This is driven by the needs and concerns of Diageo's business partners and other stakeholders, including employees, regulators, customers, non-protorganisations (NGOs), as well as the investment community.

The particular impacts Diageo focuses on are alcohol in society, water, environmental sustainability, community, people and governance and ethics. In the year ended 30 June 2011 Diageo prioritised water within its environmental and community programmes and now reports on an integrated sustainability approach. Diageo focuses on these six impacts with suppliers as well as with customers and consumers, the parts of the value chain outside of Diageo's direct operations.

Below is a summary of each impact area, with the exception of people, which is reported on above under 'employees', and governance and ethics, which is primarily reported in the 'executive direction and control', 'internal control and risk management' and 'compliance and ethics programme' sections of the Corporate Governance Report.

A separate Sustainability & Responsibility Report with full details of each impact area is available on the Diageo website.

#### Alcohol in society

Drinking alcohol has been part of the social and cultural life of communities throughout the world for centuries. It can play a positive role in social occasions and celebrations for those who choose to drink, however, Diageo recognises that the misuse of alcohol can cause serious problems for individuals, communities and society. As such Diageo works to market its brands responsibly to adults, and support programmes and policies that create a more positive role for alcohol in society. As the world's leading premium drinks business, Diageo wants to play an active part in tackling alcohol misuse and focuses on areas where resources and expertise can be used most e ectively, Diageo works with the beverage alcohol industry, governments and other groups to establish high company and industry standards on responsible marketing and selling; providing information to help consumers make informed and responsible choices about when, whether and how they drink; investing in programmes that aim to minimise alcohol misuse; and promoting e ective government alcohol policies and debate about the role of alcohol in society.

Diageo runs more than 200 programmes throughout the world to address alcohol misuse with a focus on drink driving, underage drinking and overconsumption. In the year ended 30 June 2011, Diageo

increasingly focused on digital marketing, using social networking to encourage responsible attitudes to drinking. In addition, Diageo updated its Digital Code of Practice.

To engage the industry around actions supporting the World Health Organisation (WHO) Global Strategy to Reduce the Harmful Use of Alcohol, Diageo worked with the International Center for Alcohol Policies and its members who held consultations with relevant alcohol beverage companies and trade associations in four dierent regions during the year ended 30 June 2011. Diageo continues to play its part in helping WHO member states in their implementation of the Global Alcohol Strategy. In the year ended 30 June 2011, Diageo also signed the UK Responsibility Deal in which the industry committed to specical cactions to address alcohol misuse.

#### Water

A reliable supply of good quality water is essential to Diageo's business because water is the main ingredient in almost all of Diageo's products and is also used for cleaning and cooling at production sites. Water resources are under pressure from development in many parts of the world and from climate changes that may restrict availability in the future. Using United Nations (UN) and World Business Council for Sustainable Development data, Diageo has designated 9 of its 106 production sites as being located in areas which are 'water stressed', identifying them as higher risk in terms of having a sustainable water supply in the coming years. In Africa, where the United Nations (UN) predicts that nearly 50% of the population will face water scarcity by 2025, approximately half of Diageo's production sites are located in water stressed areas. As such, water challenges in these areas in particular will a ect not only Diageo's business but also its business partners and the local communities who rely on water for their livelihoods.

In May 2010 Diageo launched a new water framework: the Diageo Blueprint Water Framework. This guides Diageo's approach to managing water and protecting water sources in the regions where Diageo operates. The framework aims to improve water use e ciency and reduce the wastewater impacts of Diageo's direct operations; reduce water scarcity problems that a ect local populations; and contribute to the water and sanitation Millennium Development Goals by working with other organisations in accordance with the UN Global Compact CEO Water Mandate.

In its operations, Diageo works to improve its understanding of its water footprint, the impact of its water usage, and how a further reduction in its use of water resources may be achieved. Diageo collects and reviews water consumption data from across the markets where it operates and the production sites and o ces over which it has operational control using internally developed guidelines. The guidelines de ne water usage based on the total amount of water abstracted from source (such as groundwater, surface water or mains) less any clean water provided back to local communities directly from a site and water returned for agricultural irrigation. Cooling water abstracted and returned to the same source is excluded from the total water used. In addition to reviewing total water usage, Diageo strives to improve its e ciency, by monitoring the amount of water used to produce one litre of product packaged and re ning an operations process to minimise water usage wherever possible. Particular attention is being devoted to the nine production sites designated as being located in water stressed areas where Diageo has made additional investment in water treatment and water recovery systems.

Diageo has set targets aspiring to reduce the amount of water used against a baseline set in the year ended 30 June 2007 and a target year of 2015. In the year ended 30 June 2011, Diageo achieved a decrease of 520,000m³ of total water used compared to the year ended 30 June 2010. This improvement was achieved despite increased production and was driven by investments in water recovery in packaging operations and maltings, optimisation programmes such as Clean-in-Place systems, and water e ciencies at Diageo's Cameronbridge distillery in Scotland. Ongoing projects are expected

The release of greenhouse gases – notably carbon dioxide generated by burning fossil fuels – has an impact on climate change (in terms of global temperatures, weather patterns and weather severity) which, either directly or indirectly, presents considerable risks both to the business and the planet. These risks include impacts on agriculture on which the company depends for raw materials; disruption to the company's operations or those of commercial partners; and changes to the nature or distribution of consumer demand. Diageo assumes that the risks from climate change could be mitigated if the releases of greenhouse gases were su-ciently diminished and, as such, has worked for many years to reduce direct emissions (from fuels) and indirect emissions (from electricity). Accordingly, the group has set targets aspiring to reduce greenhouse gas emissions against a baseline

Complementing the company's focus on its own waste is its focus on designing packaging that consumers can recycle easily. Diageo de nes sustainable packaging as that which has the lowest possible environmental footprint while still full lling the functional requirements to protect, deliver and present its products and brands. In the year ended 30 June 2011, Diageo further embedded its 'Sustainable Packaging Guidelines' throughout its markets and focused on Diageo's highest volume brands to maximise the impact of any packaging changes. Among the initiatives is 'light weighting', or reducing the weight of packaging; removing materials that cannot be or are di cult to recycle, including PVC, foil, mixed plastics, ceramics and some laminates; and, where viable alternatives exist, removing materials from the packaging, such as inks and heavy metals that may pose a risk to the environment.

#### Community

stakeholders.

Diageo recognises that its success in the future will depend in part on the prosperity of the communities in which it operates and the strength of its relationships with those communities. Diageo is committed to contributing to those communities by fostering inclusive business by encouraging local hiring and sourcing of raw materials, engaging local stakeholders, and contributing through community investment and payment of local taxes. Diageo believes that supporting long term sustainable initiatives in the communities where Diageo does business advances the developirae(h126f (h)o\$e250(ro)m(ur) ilhides, retotropeis, 1ets e2900 r65 19 Tni employees, builds Diageo's reputation and enhances its relationships with governments and other

Community investment, which in the year ended 30 June 2011 amounted to 1.1% of Diageo's operating pro t before exceptional items, is focused on providing safe water access to local communities, supporting skills training to help disadvantaged people and employment, and contributing to organisations that drive local economic development. Diageo's investment comes from its businesses around the world in the form of cash, in-kind donations and volunteer time, together with grants from the Diageonesnces the

Responsible sourcing is critical to maintaining Diageo's positive reputation and meeting customers' and consumers' demands. To this end, Diageo manages social and ethical risk, ranging from labour and human rights to commercial integrity, through a four-stage screening and auditing process. Diageo's expectations of business ethics and sustainability are made clear to suppliers. Minimum compliance and ethics standards as well as aspirational goals are set out in Diageo's Partnering with Suppliers Standards. Additionally, Diageo plays a leading role in AIM-PROGRESS, the collaborative consumer goods sector forum working to improve processes and standards in a more e ective way through member organisations' supply chains.

In the year ended 30 June 2011, Diageo launched its Sustainable Agriculture Sourcing Guidelines and subsequently worked to

> determine how the guidelines could help support broader sustainable development, focusing rst on cream. As a part of this initiative, Diageo helped its main cream supplier in Ireland create their sustainability programme, including an advisory committee, on which Diageo sits along with members of the private, independent and public sectors, to help drive sustainability performance in the Irish dairy farming industry.

#### **Customers and consumers**

Sustainability performance is becoming increasingly important in the consumer product marketplace. Diageo

sees this directly in its relationships with many of its customers, who are looking for suppliers who meet their sustainability criteria and can contribute to reducing the environmental impact of their supply chains, and in its relationships with its consumers, who are increasingly interested in the company's sustainability practices.

Driven in part by consumer demand, as well as regulatory and commercial trends, customers are increasingly interested in working with Diageo on its sustainability programmes. As a result, Diageo is further integrating sustainability objectives into its commercial strategies, such as developing sustainable packaging solutions that help to reduce our customers' environmental footprint. Diageo also actively works with its customers in consumer facing campaigns.

Additionally, Diageo's brands reach consumers through responsible drinking campaigns as well as cause-related sustainability campaigns. In the year ended 30 June 2011, Johnnie Walker continued its fourth year 'Join the Pact' campaign along with the Vodafone McLaren Mercedes Formula One Team. The Arthur Guinness Fund signed a three-year agreement with Ashoka, an association of social entrepreneurs, to help deliver a €3 million project to identify, fund and support innovative social entrepreneurship around the world. Buchanan's

continued its 'Buchanan Forever' campaign initiated in 2007 by creating a documentary Im with the objective of raising funds to support, train and educate the Pasacaballos community in Colombia. Diageo believes that, when these sustainability activities are done well, they engage consumers to become partners, and thus build its brands and contribute to business performance.

#### 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.



**Captain** 

Morgan

Captain Morgan, Diageo's largest rum brand, delivered a good performance in 2011, with particularly strong growth in Canada, Great Britain and Germany.

In beer, the Guinness brand competes globally as well as on a regional and local basis (with the pro le 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.

#### 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. 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 2011, the group's research and development expenditure amounted to £17 million (2010 – £13 million; 2009 – £17 million). Research and development expenditure is generally written o 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 signicant trademarks are registered and/or otherise 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 a reasonable steps to protect these rights.

#### Regulations and taxes

Diageo's worldwide operations are subject to extensive regulatory requirements regarding production, product liability, distribution, importatio 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 subjet o 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 signicantly 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 taris. Within the European Union, such products are subject to diener trates 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 signicant impact on the nal 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 o trade, varying from government or state operated monopoly outlets (for example, Canada, Norway and certain US states) to the

common system of licensed on trade outlets (for example, licensed bars and restaurants) which prevails in much of the western world (for example, most US states and the European Union). In about one-third of the states in the United States, price changes must be led or published 30 days to three months, depending on the state, before they become e ective.

Labelling of beverage alcohol products is also regulated in many markets, varying from health warning labels to importer identication, alcohol strength and other consumer information. As well as producer, importer or

bottler identi cation, speci cwarning 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 nancial 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 nance activities, using captive and outsourced

centres. A captive business service centre in Budapest, Hungary, performs various process tasks for markets and operational entities. Diageo uses third party service centres in Manila, Shanghai and Bucharest to perform these tasks for basic processes. Certain central nance activities, including elements of group nancial 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 2011, the share of pro ts of associates after tax was £176 million (2010 - £142 million; 2009 - £164 million), of which Moët Hennessy accounted for £179 million (2010 s£13 million; 2009 £151 million).



the acquisition of a 50% equity controlling stake in Zacapa from Industrias Licoreras de Guatemala (ILG).

Diageo Annual Report 2011

consideration of VND 798 billion (£24 million). The purchase of a further 6.26% equity stake in Halico was completed on 26 May 2011 for a consideration of VND 268 billion (£8 million). Additional costs of £2 million in respect of the acquisition have been incurred in the year ended 30 June 2011 (2010 – £1 million).

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 consideration of \$225 million (£140 million) (including \$35 million of deferred compensation). ILG has a put option to sell the remaining

35

#### 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, nancial condition and results of operations could su er 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 in ation were to become prevalent in the economic environment, or upon an increase in the costs of raw materials. These factors may also lead to intensied competition for market share, with consequential potential adverse e ects on volumes and prices. The nancial and economic situation may have a negative impact on third parties with whom Diageo does, or may do, business. Any of these factors may a ect the group's results of operations, nancial condition and liquidity. Diageo has taken and may take steps to manage its business through this challenging economic environment and position its business to bene t 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 ows 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 e ect on the group's growth rate. Such developments may adversely a ect shareholder returns or share price. Additionally, continued volatility in exchange rates used to translate foreign currencies into pounds sterling may have a signi

such business combination, acquisition, disposal, joint venture or partnership would deliver the bene ts, 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 e ciencies and deliver cost-savings will deliver the expected bene ts.

## 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 a ect 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 e ect 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 a ect 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 excise, import duty or other duties could have a signicant adverse election Diageo's sales revenue or margin, both through reducing overall consumption and by encouraging consumers to switch to lower-taxed categories of beverage alcohol.

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

### Diageo is subject to 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 nes as well as reputational damage to Diageo or its brands, and as a result, Diageo's business could be materially adversely a ected. For additional information with respect to legal proceedings, see 'Additional information for shareholders – Legal proceedings' and note 31 to the consolidated nancial statements.

## Contamination, counterfeiting or other events could harm the integrity of customer support for Diageo's brands and adversely a ect 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 a ect 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 signi cant product liability judgement or a widespread product recall may negatively impact on sales and protability of the a ected 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 a ect 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 and adversely a ect Diageo's business.

## Demand for Diageo's products may be adversely a ected 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 o er 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 e ects and a downturn in economic conditions, which may reduce consumers' willingness to purchase premium branded products. In addition, concerns about health e ects due to negative publicity regarding alcohol consumption, negative dietary e ects, regulatory action or any litigation or customer complaints against companies in the industry may have an adverse e ect on Diageo's protability.

The competitive position of Diageo's brands could also be a ected adversely by any failure to achieve consistent, reliable quality in the product or service levels to customers.

In addition, both 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-o s and other costs and can a ect consumer perception of an existing brand. Growth in Diageo's business has been based on both the launch of new products and the growth of existing products. Product innovation remains a signi cant 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 pro table lifespan of newly or recently developed products. Any signi cant 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 nancial 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 e ect on Diageo's protability.

## If the social acceptability of Diageo's products declines, Diageo's sales volume could decrease and the business could be materially adversely a ected

In recent years, there has been increased social and political attention directed to the beverage alcohol industry. Diageo believes that this attention is the result of public concern over problems related to alcohol abuse, including drink driving, underage drinking and health

consequences from the misuse of alcohol. If, as a result, the general social acceptability of beverage alcohol were to decline signicantly, sales of Diageo's products could materially decrease.

## 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 a ected 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. A signi cant deterioration in these conditions, including a reduction in consumer spending levels, customer destocking, the failure of customer, supplier or nancial counterparties or a reduction in the availability of, or an increase in the cost of nancing to, Diageo, could have a material adverse e ect on Diageo's business and results of operations. Moreover, a substantial portion of Diageo's operations, representing approximately one third of Diageo's net sales for the year ended 30 June 2011, are carried out in emerging markets, including Brazil, Venezuela, Mexico, Russia and emerging markets in Africa and Asia.

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 tari s 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 a ect Diageo's ability to import or export products and to repatriate funds, as well as a ecting the levels of consumer demand (for example, in duty free outlets at airports or in on trade premises in a ected regions) and therefore Diageo's levels of sales or pro tability. Emerging markets are also generally exposed to relatively higher risk of liquidity, in ation, devaluation, price volatility, currency convertibility and country default. Due to Diageo's specie c exposures, any or all of the foregoing factors may a ect Diageo disproportionately or in a dierent 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.

#### Diageo's operating results may be adversely a ected by increased costs or shortages of labour

Diageo's operating results could be adversely a ected by labour or skill shortages or increased labour costs due to increased competition for employees, higher employee turnover or increased employee bene t 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 quali ed personnel in the future could make it dicult to manage the business and could adversely a ect operations and nancial results.

and nancial systems as further changes to such processes are e ected. They could also lead to adverse customer or consumer reaction.

## Climate change, or legal, regulatory or market measures to address climate change, may negatively a ect 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 e ect 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 a ected by increasing production costs or capacity constraints, which could adversely a ect Diageo's results of operations and protability.

#### Diageo's operations and nancial results may be adversely a ected by movements in the value of its pension funds, uctuations in exchange rates and uctuations in interest rates

Diageo has signi cant pension funds. These funds may be a ected by, among other things, the performance of assets owned by these plans, the underlying actuarial assumptions used to calculate the surplus or de cit in the plans, in particular the discount rate and long term in ation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. If there are signi cant declines in nancial markets and/or a deterioration in the value of fund assets or changes in discount rates or in ation rates, Diageo may need to make signi cant 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 a ect Diageo's nancial position. There is no assurance that interest rates or in ation rates will remain constant or that pensiterest rates or in

these agreements on favourable terms could have an adverse impact on Diageo's sales and operating pro t. In addition, Diageo's sales and operating pro t may be adversely a ected 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 e ort 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 con dential information and trade secrets. However, Diageo cannot be certain that the steps it has taken will be su cient 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 o er 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 e ective in preventing material loss of prots 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 nancial results and ability to develop its business.

#### It may be discult to esect 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 ocers, 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 ect 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 identied 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 interest or exchange rates, the availability or cost of nancing to Diageo, anticipated cost savings or synergies, the completion of Diageo's strategic transactions and restructuring programmes,

- 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 nancial 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 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 bene ts 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 uctuations and changes in the cost of capital, which may reduce or eliminate Diageo's access to or increase the cost of nancing or which may a ect Diageo's nancial 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 qualied in their entirety by the above factors and those described 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 rect 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 les 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 oer 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.

# TO EX - OI Business review 43 Operating results 201 Operating results 2017 compared with 2010 Operating results 2010 compared with 2009 Trend information Liquidity and capital resources Capital commitments Other contractual obligations Post balance sheet events Spalance sheet arrap waccounting s

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, gross margin, marketing spend and operating profit 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 on 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 and operating profit, 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

Return on average total invested capital is a non-GAAP measure that is used by management to assess the return obtained from the group's asset base and is calculated to aid comparison of the performance of the business.

The profit used in assessing the return on total invested capital reflects the operating performance of the business after applying the tax rate for the year stated before exceptional items and interest. Average total invested capital is calculated using the average derived from the consolidated balance sheets at the beginning, middle and end of the year. Average capital employed comprises average net assets for the year, excluding post employment benefit net liabilities (net of deferred tax) and average net borrowings. This average capital employed is then aggregated with the average restructuring and integration costs net of tax, and goodwill written off to reserves at 1 July 2004, the date of transition to IFRS, to obtain the average total invested capital.

**Economic pro** t is a non-GAAP measure that is used by management to assess the group's return from its asset base compared to a standard cost of capital charge and is calculated to aid comparison of the performance of the business.

The profit used in assessing the return from the group's asset base and the asset base itself are the same as those used in the calculation for the return on average total invested capital (see above). The standard capital charge applied to the average total invested capital is currently 8%, being management's assessment of a constant minimum level of return that the group expects to generate from its asset base. Economic profit is calculated as the difference between the standard capital charge on the average invested assets and the actual return achieved by the group on those assets.

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

## Operating results 2011 compared with 2010

#### Summary consolidated income statement

	Year ended 30 June 2011	30 June 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 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 comprise £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). An exceptional charge of approximately £120 million is expected to be incurred in the year ending 30 June 2012 primarily in respect of the operating model review, while cash expenditure is expected to be approximately £200 million.

Return on average total invested capital

Calculations for the return on average total invested capital for the years ended 30 June 2011 and 30 June 2010 were as follows:

	2011 £ million	2010 £ million
Operating profit	2,595	2,574
Exceptional items	289	177
Associates' profits after interest and tax	176	142
Tax at the tax rate before exceptional items of 17.4% (2010 – 21.6%) <sup>(1)</sup>	(532)	(625)
	2,528	2,268
Average net assets (excluding net post employment liabilities)	6,221	5,329
Average net borrowings	6,805	7,226
Average integration and restructuring costs (net of tax)	1,274	1,195
Goodwill at 1 July 2004	1,562	1,562
Average total invested capital	15,862	15,312
Return on average total invested capital	15.9%	14.8%
Economic profit		
Calculations for economic profit for the years ended 30 June 2011 and 30 June 2010 were as follows:	2011 _£ million	2010 £ million
Average total invested capital (see above)	==::	
	£ million	£ million
Average total invested capital (see above)	£ million 15,862	£ million 15,312
Average total invested capital (see above)  Operating profit	£ million 15,862 2,595	£ million 15,312 2,574
Average total invested capital (see above)  Operating profit Exceptional items	£ million 15,862 2,595 289	£ million 15,312 2,574 177
Average total invested capital (see above)  Operating profit  Exceptional items  Associates' profit after interest and tax	£ million 15,862 2,595 289 176	£ million 15,312 2,574 177 142
Average total invested capital (see above)  Operating profit  Exceptional items  Associates' profit after interest and tax	£ million 15,862 2,595 289 176 (532)	£ million 15,312 2,574 177 142 (625)

<sup>(1)</sup> 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.

<sup>(2)</sup> Economic profit increased by £369 million from £890 million in the year ended 30 June 2010 to £1,259 million in the year ended 30 June 2011. As a result of the change in long term interest rates the weighted average cost of capital rate has been established at 8% from 9%, which increased economic profit by £153 million. This change also reflects the increased return over the risk free rate that investors require as a result of increased volatility of returns.

#### Analysis by business area and brand

In order to assist the reader of the financial statements, the following comparison of 2011 with 2010 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 above expressed as a percentage of the aggregate of the amount in the column headed 2010 Reported, the amount in the column headed Exchange and the amount, if any, in respect of acquisitions and disposals that have benefited the prior year included in the column headed Acquisitions and disposals. The inclusion of the column headed Exchange in the organic movement calculation reflects the adjustment to recalculate the prior year results as if they had been generated at the current year's exchange rates.

(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 directly attributable to acquisitions that have been publicly announced and charged to operating profit in the current or prior year.

The organic movement calculations for volume, sales, net sales, marketing spend and operating profit for the year ended 30 June 2011 were as follows:

		2010 Reported units million	Acquisitions and disposals <sup>(2)</sup> units million	Organic movement units million	2011 Reported units million	Organic movement <u>%</u>
Volume						***************************************
North America		51.8	(0.2)		51.6	
Europe		39.2	(0.1)	(0.6)	38.5	(2)
International		40.3	0.6	3.4	44.3	9
Asia Pacific		12.1	_	1.0	13.1	9
		143.4	0.3	3.8	147.5	3
Total volume		110.1				***************************************
	2010 Reported £ million	Exchange <sup>(1)</sup>	Acquisitions and disposals <sup>(2)</sup> £ million	Organic movement £ million	2011 Reported £ million	Organic movement %
Sales	Reported £ million	Exchange <sup>(1)</sup> <u>f</u> million	Acquisitions and disposals <sup>(2)</sup> £ million	Organic movement	2011 Reported	movement
	Reported	Exchange <sup>(1)</sup>	Acquisitions and disposals <sup>(2)</sup>	Organic movement	2011 Reported	movement
Sales	Reported £ million	Exchange <sup>(1)</sup> <u>f</u> million	Acquisitions and disposals <sup>(2)</sup> £ million	Organic movement <u>£</u> million	2011 Reported £ million	movement %
Sales North America	Reported £ million  3,853	Exchange <sup>(1)</sup> £ million (33)	Acquisitions and disposals <sup>(2)</sup> £ million	Organic movement £ million	2011 Reported £ million	movement % 2
Sales North America Europe	Reported £ million  3,853 4,371	Exchange <sup>(1)</sup> £ million  (33)  (39)	Acquisitions and disposals <sup>(2)</sup> £ million (58)	Organic movement £ million  91 (109)	2011 Reported £ million 3,853 4,190	movement
Sales North America Europe International	Reported £ million  3,853 4,371 3,222	Exchange <sup>(1)</sup> £ million  (33) (39) (281) 101	Acquisitions and disposals <sup>(2)</sup> £ million (58) (33) 36	Organic movement £ million  91 (109) 407	2011 Reported £ million 3,853 4,190 3,384	2 (3) 14

## Diageo Annual Report 2011

#### Category review

Category performance	Volume* movement %	Organic net sales movement %	Reported net sales movement %
Spirits	3	6	3
Beer	. 1	4	3
Wine	(2)	6	(11)
Ready to drink	(3)	(1)	
Total	3	5	2
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	9	10	11
Vodka:	2	7	7
Smirnoff		(1)	(1)
Ketel One vodka		1	_
Cîroc	123	126	122
Liqueurs:	3	1	7
Baileys	3	1	
Rum:	2	2	(3)
Captain Morgan	4	4	4
Tequila:	5	5	3
Jose Cuervo	4	3	1
Gin:		2	1
Tanqueray	3	4	3
Beer:	1	4	3
Guinness	2	3	2

 $<sup>^{\</sup>star}$  Organic equals reported movement except for beer which was 3% and wine which was (11)% due to acquisitions and disposals.  $^{\star\star}$  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 19% supported by incremental marketing investment behind proven global 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

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 declines 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.

**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 launch of the new Hazelnut flavour. Performance improved in North America and in emerging markets net sales grew 21%.

**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 and Middle East. 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.

## | 2011 | North America

"While overall consumer confidence remains subdued we have seen some recovery and, importantly for our business, this recovery has been stronger in the premium, and especially the super premium, segments. Against this background we have focused on value creation. We have reduced the level of promotional activity, invested behind our premium brands and driven strong growth through innovation. The result has been that volume has been maintained while net sales grew 3%. Focus on supply efficiencies and better top line mix led to gross margin improvement. Overheads were reduced as marketing was increased and operating profit grew 8%. We have put in place improvements to our sales structure and distribution footprint that will drive further efficiencies and even better alignment with our wholesalers, all of which will enhance our strong platform."

#### Ivan Menezes

President, Diageo 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 7% 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 Smithwicks. 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

Key financials	2010 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2011 Reported £ million	Reported movement %
Net sales	3,306	(25)	(58)	101	3,324	1
Marketing spend	472	(3)	(1)	34	502	6
Operating profit before exceptional items	1,170	(12)	(1)	98	1,255	7
Exceptional items	(38)				(23)	
Operating profit	1,132	***************************************	***************************************	***************************************	1,232	9

	Volume*	Organic net sales	Reported net sales
Brand performance	movement %	movement %	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	(2)	1	
Smirnoff	_	(1)	(2)
Baileys	1	_	(1)
Captain Morgan	(2)	(2)	(2)
Jose Cuervo	4	3	2
Tanqueray	_	1	_
Crown Royal	1	3	2
Ketel One vodka	(1)	_	(1)
Buchanan's	37	41	39
Cîroc	124	128	126
Guinness	3	4	3

 $<sup>^*</sup> Organic equals reported movement for volume, except for wine where reported movement was (19)\% due to disposals in the year. \\ ** Spirits brands excluding ready to drink.$ 

## Diageo Annual Report 201

#### 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 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

#### Performance

Key financials	2010 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2011 Reported £ million	Reported movement %
Net sales	2,759	(32)	(25)	(88)	2,614	(5)
Marketing spend	412	(5)	(1)	(16)	390	(5)
Operating profit before exceptional items	859	(12)	(7)	(62)	778	(9)
Exceptional items	(53)				(157)	
Operating profit	806				621	(23)

	Volume*	Organic net sales	Reported net sales
Brand performance	movement %	movement %	movement %
Key countries and categories:			
Europe	(2)	(3)	(5)
Great Britain	<del>-</del>	2	2
Ireland	(1)	(5)	(11)
Iberia	(18)	(18)	(21)
Greece	(33)	(38)	(39)
Russia	9	21	23
Spirits	(1)	(4)	(5)
Beer	(5)	(4)	(7)
Wine	(1)	11	2
Ready to drink	(4)	(8)	(9)
The strategic brands:**			
Johnnie Walker	(3)	(5)	(6)
Smirnoff	(4)	(11)	(12)
Baileys	_	(2)	(3)
J&B	(5)	(8)	(9)
Captain Morgan	40	38	39
Guinness	(5)	(4)	(5)

<sup>\*</sup> 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

"During the year we reinforced our focus on generating growth in International through brand and portfolio development, innovation and customer partnering. In Latin America scotch continued to grow driven by strong marketing, increased sales focus and improved customer relationships. The vodka, rum and liqueur categories also thrived, as we widened our consumer offerings across new price points. Diageo's spirits business drove a third of the growth in net sales in Africa, as distributor relationships were improved and the introduction of 20cl bottles increased accessibility. Guinness returned to growth in Nigeria and the strong growth of local beers continued, fuelling an 11% increase in net sales for beer in Africa. The role of the Global Travel and Middle East business as the shop window for Diageo's premium brands was reinforced with an increase in marketing spend, significantly ahead of net sales, focusing on scotch and the luxury retail experience. Overall therefore, International delivered net sales growth of 13% and organic operating profit growth of 19%, while continuing to invest in infrastructure, sales execution, innovation and acquisitions, including Serengeti Breweries, creating an enhanced platform for future growth."

#### Stuart Fletcher

President, Diageo International

#### Key highlights

- In Latin America, 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 17.7%.
- 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 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.

- 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 1%. Net sales growth of scotch more than offset the decline in ready to drink and total net sales increased 2%. 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.
- The Global Travel and Middle East business delivered double digit net sales growth driven by scotch and innovation particularly Johnnie Walker Double Black. Marketing spend increased significantly ahead of net sales as passenger numbers increased, focused on the Johnnie Walker 'Step Inside the Circuit' and 'Walk with Giants' campaigns and on luxury sampling and brand experiences in major airports across the globe.

#### Performance

Key financials Net sales	2010 Reported £ million 2,627	Exchange <u>£ million</u> (229)	Acquisitions and disposals £ million	Organic movement £ million 321	2011 Reported £ million 2,747	Reported movement %
Marketing spend	302	(6)	4	68	368	22
Operating profit before exceptional items	771	(90)	(5)	128	804	4
Exceptional items	(5)				(13)	
Operating profit	766				791	3
Brand performance				Volume* movement 	Organic net sales	
Brand performance				movement		
Brand performance				movement		
Brand performance				movement		
Brand performance				movement		
Brand performance				movement		

### 2011 Asia Pacific

"Our Asia Pacific business built momentum this year, particularly in fast growing emerging markets and in the high value super deluxe segment. The region was focused on accelerating net sales growth, enhancing our position as the number one international spirits company in the region and delivering double digit operating profit growth. With net sales up 9%, share gains in scotch across the region and 13% growth in operating profit, each of these goals was achieved. We also made significant progress on two important transactions this year, ShuiJingFang in China and Halico in Vietnam. Both of these will expand our footprint in key emerging markets and high growth categories, and will help drive future growth across our brand portfolio."

#### Gilbert Ghostine

President, Diageo 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.
- Marketing spend increased 13% 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 12% 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 VAT 69 and innovation in Smirnoff with the introduction of Smirnoff Lime drove this growth.
- The strong performance of the Southeast 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

Key financials	2010 Reported £ million	Exchange £ million	Acquisitions and disposals £ million	Organic movement £ million	2011 Reported £ million	Reported movement %
Net sales	1,018	65		98	1,181	16
Marketing spend	233	12	1	32	278	19
Operating profit before exceptional items	176	8	(1)	25	208	18
Exceptional items	(30)				(50)	
Operating profit	146				158	8

	Volume*	Organic net sales	Reported net sales
Brand performance	movement %	movement %	movement %
Key countries and categories:			
Asia Pacific	9	9	16
Australia	4	4	15
Korea	1	8	12
China	1	(4)	(1)
India	42	79	34
Southeast Asia	12	14	25
Spirits	10	11	17
Beer	_	7	14
Wine	2	10	(8)
Ready to drink	7	7	19
The strategic brands:**			
Johnnie Walker	16	12	19
Smirnoff	8	5	12
Windsor	3	8	12
Guinness	(1)	6	12

<sup>\*</sup> Organic equals reported movement for volume, except for wine where the reported movement is (25)% due to the disposal of Barton & Guestier. \*\* Spirits brands excluding ready to drink.

## Diageo Annual Report 201

## Operating results 2010 compared with 2009

#### Summary consolidated income statement

	Year end	led 30 June
	2010 £ million	2009 £ million
Sales	12,958	12,283
Excise duties	(3,178)	(2,972)
Net sales	9,780	9,311
Operating costs before exceptional items	(7,029)	(6,723)
Operating profit before exceptional items	2,751	2,588
Exceptional operating items	(177)	(170)
Operating profit	2,574	2,418
Sale of businesses	(15)	_
Net finance charges	(462)	(592)
Share of associates' profits after tax	142	164
Profit before taxation	2,239	1,990
Taxation	(477)	(286)
Profit from continuing operations	1,762	1,704
Discontinued operations	(19)	2
Profit for the year	1,743	1,706
Attributable to:		
Equity shareholders	1,629	1,605
Non controlling interests	114	101
	1,743	1,706

#### Sales and net sales

On a reported basis, sales increased by £675 million from £12,283 million in the year ended 30 June 2009 to £12,958 million in the year ended 30 June 2010. On a reported basis net sales increased by £469 million from £9,311 million in the year ended 30 June 2009 to £9,780 million in the year ended 30 June 2010. Exchange rate movements increased reported sales by £346 million and reported net sales by £267 million.

#### Operating costs before exceptional items

On a reported basis, operating costs before exceptional items increased by £306 million in the year ended 30 June 2010 due to an increase in cost of sales of £175 million, from £3,878 million to £4,053 million, an increase in marketing spend of £92 million from £1,327 million to £1,419 million, and an increase in other operating expenses before exceptional costs of £39 million, from £1,518 million to £1,557 million. The impact of exchange rate movements increased total operating costs before exceptional items by £141 million.

#### Exceptional operating items

Exceptional items are those that, 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.

Exceptional operating costs of £177 million for the year ended 30 June 2010 (2009 – £170 million) comprised a net charge of £142 million (2009 – £170 million) in respect of restructuring programmes and an impairment charge of £35 million (2009 – £nil) in respect of the Ursus brand reflecting the impact of the significant downturn in the economy in one of its principal market, Greece. Restructuring programmes comprise £85 million (2009 – £166 million) for the global restructuring programme announced in February 2009 primarily in respect of employee and contract termination charges,

£93 million (2009 – £nil) for the restructuring of Global Supply operations announced in July 2009 principally in Scotland, £12 million (2009 – £4 million) for the restructuring of brewing operations in Ireland announced in 2008 in respect of accelerated depreciation, and a £48 million net credit (2009 – £nil) for the restructuring of the wines business in the United States comprising an £89 million gain on the sale and leaseback of land, a £17 million charge for the write down of inventories and other charges of £24 million.

The total restructuring cash expenditure in the year ended 30 June 2010 is £145 million (2009 – £53 million) of which £122 million relates to the global restructuring programme.

#### Post employment plans

Post employment net costs for the year ended 30 June 2010 were a charge of £133 million (2009 – £63 million) comprising £92 million (2009 – £98 million) included in operating costs before exceptional items, pension curtailment gains of £6 million (2009 – £33 million) in exceptional operating items and a charge of £47 million (2009 – gain of £2 million) in net finance charges.

The deficit before taxation in respect of post employment plans decreased by £178 million from £1,383 million at 30 June 2009 to £1,205 million at 30 June 2010. The reduction in the deficit included £147 million transferred into the UK Diageo Pension Scheme (the UK Scheme) from escrow under the deficit funding arrangements paid by the company in prior years. Deficit funding contributions to the group's UK and Irish pension schemes in the year ended 30 June 2010, other than the transfer to the UK Scheme of amounts paid into escrow in prior years, were £55 million.

#### Return on average total invested capital

Calculations for the return on average total invested capital for the years ended 30 June 2010 and 30 June 2009 were as follows:

	2010 £ million	2009 £ million
Operating profit	2,574	2,418
Exceptional items	177	170
Associates' profits after interest and tax	142	164
Tax at the tax rate before exceptional items of 21.6% (2009 – 22.1%)*	(625)	(608)
	2,268	2,144
Average net assets (excluding net post employment liabilities)	5,329	4,758
Average net borrowings	7,226	7,427
Average integration and restructuring costs (net of tax)	1,195	1,049
Goodwill at 1 July 2004	1,562	1,562
Average total invested capital	15,312	14,796
Return on average total invested capital	14.8%	14.5%
Economic profit Calculations for economic profit for the years ended 30 June 2010 and 30 June 2009 were as follows:	2010 £ million	2009 £ million
Average total invested capital (see above)	15,312	14,796
Operating profit	2,574	2,418
Exceptional items	177	170
Associates' profits after interest and tax	142	164
Tax at the tax rate before exceptional items of 21.6% (2009 – 22.1%)*	(625)	(608)
	2,268	2,144
Capital charge at 9% of average total invested capital	(1,378)	(1,332)
Economic profit	890	812

<sup>\*</sup> The reported tax rate for the year ended 30 June 2010 was 21.3% compared with 14.4% for the year ended 30 June 2009. Factors that reduced the reported tax rate in the prior year included settlements agreed with tax authorities that gave rise to changes in the value of deferred tax assets and tax provisions. The tax rate before exceptional items for the year ended 30 June 2010 was 21.6% and for the year ended 30 June 2009 was 22.1%.

#### Analysis by business area and brand

In order to assist the reader of the financial statements, the following comparison of 2010 with 2009 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.

The organic movement calculations for volume, sales, net sales, marketing spend and operating profit before exceptional items for the year ended 30 June 2010 were as follows:

	Acquisitions			
2009 Reported units million	and disposals units million	Organic movements units million	2010 Reported units million	Organic movement %
53.0	0.1	(1.3)	51.8	(2)
39.0	(0.1)	0.3	39.2	1
37.0*	0.3	3.0	40.3	8
11.8	_	0.3	12.1	2
140.8*	0.3	2.3	143.4	2
	Reported units	Reported units units million	Reported units million	Reported units million         disposals units million         movements units million         Reported units million           53.0         0.1         (1.3)         51.8           39.0         (0.1)         0.3         39.2           37.0*         0.3         3.0         40.3

<sup>\*</sup> Decreased by 0.5 million equivalent units from the figures reported for the year ended 30 June 2009.

Sales	2009 Reported £ million	Exchange <sup>(1)</sup> £ million	Acquisitions and disposals <sup>(2)</sup> £ million	Organic movement <u>£</u> million	2010 Reported £ million	Organic movement %
North America	3,858	103	15	(123)	3,853	(3)
Europe	4,279	78	13	1	4,371	(5)
International	2,803	18	10	391	3,222	14
Asia Paci c	1,268	146	-	28	1,442	2
Corporate	75	1		(6)	70	
Total sales	12,283	346	38	291	12,958	2
Net sales						
North America	3,290	91	15	(90)	3,306	(3)
Europe	2,750	53	10	(54)	2,759	(2)
International	2,286	21	9	311	2,627	13
Asia Paci c	910	101	_	7	1,018	1
Corporate	75	1	_	(6)	70	
Total net sales	9,311	267	34	168	9,780	2
Excise duties	2,972				3,178	***************************************
Total sales	12,283				12,958	
Marketing spend				<u></u>		
North America	431	12	1	28	472	6
Europe	429	9		(26)	412	(6)
International	259	7	1	35	302	13
Asia Paci c	208	18		7	233	3
Total marketing spend						***************************************
		<del></del>			<u></u>	<u></u>

\* Volume movement is both reported and organic.

\*\*\* Spirits brands excluding ready to drink.

Johnnie Walker: Strong second half growth led by emerging markets was the key driver of the full year performance of the Johnnie Walker brand. Johnnie Walker Black Label was the fastest growing variant with double-digit net sales growth driven by GTME, Latin America and South East Asia.

Marketing spend increased globally behind the 'Walk with Giants' campaign and visibility of the brand was increased in GTME. Four percentage points of negative price/mix resulted from the slower volume growth of super deluxe variants and an increase in price promotional activity.

Smirno: In developed markets, which account for over 80% of Smirnoff's net sales, the vodka category was intensely competitive. In North America, Smirnoff net sales declined 7% mainly due to lapping the increase in stock levels of the prior year. Effective marketing campaigns continued to build the brand's equity and strong consumer offers during key selling periods led to volume share gains in the United States. There was a similar trend in promotional activity in Great Britain where volume grew ahead of net sales. In the brand's largest emerging markets of Brazil and South Africa, net sales grew solidly reflecting Diageo's confidence in the future growth of the vodka category in these key markets. Globally, marketing spend was increased, accelerating in the second half behind flavour launches and activation of the global marketing programme 'Be There'.

**Baileys:** After a difficult first half, the brand grew volume and net sales in the second half as markets increased visibility on shelf through the 'Baileys Bows' activation and flavours were launched into new markets. An increase in promotional activity, particularly in Europe over the Christmas period, led to 3 percentage points of negative price/mix.

Captain Morgan: Very strong growth of Captain Morgan in Europe and International offset 3% net sales decline in North America. In the United States, growth of the rum category slowed during the year but Captain Morgan benefited from a range of successful innovations and grew volume and value share. The brand grew strongly in Canada with net sales up 7%. Marketing spend increased 25% in North America and 36% globally. This spend was weighted to the second half and drove net sales up 7% in that period.

Jose Cuervo: The ongoing weakness of the North American on trade and aggressive pricing from competitors led to a sharp decline in Jose Cuervo. The new variant, Especial Silver continued to perform well and is now the fastest growing silver tequila in the US off trade. However, Jose Cuervo's super and ultra premium variants, Tradicional and Platino, were significantly impacted as consumers traded down to less expensive 100% agave tequilas.

<sup>\*\*</sup> Other brands consist of local priority brands and category brands. Movements in organic volume, reported volume, organic net sales and reported net sales for local priority brands are 2%, 2%, 1% and 4%, respectively, and for category brands 5%, 6%, 8% and 12%, respectively. The classification of brands as local priority brands and category brands has been discontinued for reporting purposes.

J&B: The majority of the brand's net sales decline stemmed from Iberia as the spirits market in that region continued to decline, particularly in the on trade. J&B grew share in the on trade in Spain but lost share in the off trade as consumers traded down to less expensive brands in that channel. There was improvement in the second half led by growth in emerging markets and a reduction in the rate of decline in Spain.

*Tanqueray:* Double-digit net sales growth in Spain and Great Britain only partially off

#### 2010

## North America

#### Key highlights

- Diageo's key spirits brands gained share, outperforming most major competitors
- Shipments and depletions were in line and therefore comparison against fiscal 2009, when shipments exceeded depletions, contributed to the volume decline against the prior year
- Strong performance by reserve brands improved mix in the second half as the super premium segment returned to growth
- Diageo's brands continued to sell at a price premium
- Diageo's beer brands outperformed other imported beers and gained share
- Innovation in the year added significantly to net sales as Diageo addressed changing consumer trends
- Ready to drink declined overall but innovation in the year improved the performance of Smirnoff ready to drink in the United States
- Marketing spend increased by 20% in the second half with investment behind innovation launches and key brands
- Margins benefited from production and overhead cost savings and lower raw material costs

#### Performance

#### Reported performance

Net sales increased by £16 million in the year ended 30 June 2010 to £3,306 million, from £3,290 million in the prior year. Reported operating profit before exceptional items increased by £32 million in the year ended 30 June 2010 to £1,170 million, from £1,138 million in the prior year. Operating profit increased by £17 million in the year ended 30 June 2010 to £1,132 million, from £1,115 million in the prior year.

#### Organic performance

The weighted average exchange rate used to translate US dollar sales and profit moved from £1 = \$1.60 in the year ended 30 June 2009 to £1 = \$1.57 in the year ended 30 June 2010. Exchange rate impacts increased net sales by £91 million, acquisitions increased net sales by £15 million and there was an organic decrease in net sales of £90 million. Exchange rate impacts increased operating profit before exceptional items by £26 million, acquisitions and disposals increased operating profit before exceptional items by £3 million and there was an organic increase in operating profit of £3 million.

#### United States

Johnnie Walker continued to outperform a difficult scotch category. Net sales grew 5% and share grew 1.1 percentage points led by Johnnie Walker Red, Black and Gold Labels. Discounting in the first half and slower net sales growth of some of the higher priced variants led to negative price/mix. Marketing spend increased 23% in the second half focused on the House of Walker mentoring programme, multicultural programmes and Father's Day media.

The premium vodka segment in the United States continued to be highly competitive. Comparison against the prior fiscal year when stock levels rose, led to volume decline of Smirnoff. Smirnoff maintained its position as the leading vodka gaining 0.4 percentage points of volume share while value share declined 0.1 percentage points as a result of consumer promotions. Marketing spend behind the brand increased 24% behind the 'Be There' campaign and launch of the new 'I Choose' platform using television, digital, social networking and experiential programming.

Despite continued consumer sentiment that liqueurs are luxury products, Baileys' performance markedly improved in the second half, driven by a reduction in the price gap against its leading competitor and targeted promotions. Baileys gained 0.4 percentage points of volume

Key measures Volume	2010 £ million	2009 £ million	Organic movement % (2)	Reported movement
Net sales	3,306	3,290	(3)	_
Marketing spend	472	431	6	10
Operating profit before exceptional items	1,170	1,138		3
Operating profit	1,132	1,115		2

share and maintained its value share. Marketing spend reduced as focus was limited to the holiday season and a reduction in non-working dollars, which increased efficiency of the total marketing spend.

Captain Morgan volume declined as stock levels were maintained against an increase in fiscal 2009 and a slowdown of growth in the rum category. Captain Morgan Original Spiced Rum posted strong share gains of 0.6 percentage points despite decline in net sales and volume. This was partially offset by the introduction of Captain Morgan Lime Bite. Increased discounting to meet consumer demand for lower priced alternatives contributed to the decline in net sales. Marketing spend increased dramatically behind the 'Calling All Captains' campaign, 'Captain and Cola' programming and the launch of Captain Morgan Lime Bite.

Jose Cuervo continued to be impacted as the competitive tequila category and heavy discounting from the leading competitor drove the reduction in volume and net sales. This was partially offset by the strong performance of Especial Silver, which has become the fastest growing silver tequila in the US off trade. Although Jose Cuervo lost share overall in the United States, down 1.7 percentage points, Especial, its leading variant, extended its position and gained 0.8 percentage points of share.

Tanqueray net sales declined 3% as the gin category continued to decline with domestic brands taking share from imports. There was some negative mix caused by the weak performance of Tanqueray 10. Marketing spend increased and brand image improved.

Crown Royal net sales were flat for the full year, but the brand grew strongly in the second half driven by innovation and growth of some of the higher priced variants. Crown Royal Black quickly became the number 1 new product in IRI's new product tracker. Price/mix was flat as price reductions on Crown Royal Extra Rare and Crown Royal Cask 16

Brand performance	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	(4)	(5)	(4)	(2)
Other brands	(1)	_	_	4
Total	(2)	(3)	(2)	
Key spirits brands:*				
Johnnie Walker	5	4	5	6
Smirnoff	(3)	(7)	(3)	(4)
Baileys	(7)	(7)	(7)	(4)
Captain Morgan	(2)	(3)	(2)	_
Jose Cuervo	(15)	(16)	(15)	(14)
Tanqueray	(2)	(4)	(2)	(1)
Crown Royal	_	(1)	_	2
Guinness	5	4	5	8
Ready to drink	(5)	(7)	(5)	(2)

<sup>\*</sup> Spirits brands excluding ready to drink.

performance with the introduction of pomegranate and mango flavoured margaritas but the segment remains highly competitive.

Diageo launched over 30 innovations during the year spanning spirits, beer, wine and ready to drink and through the fiscal year averaged five of the top 10 new items in IRI. Innovation included extensions, which enhanced core brands such as Captain Morgan Lime Bite, Smirnoff Dark Roasted Espresso, Cîroc Coconut and Ketel One Oranje, as well as new brands such as Wily Jack wine and Moon Mountain vodka. Performance of innovation was led by Crown Royal Black, Cîroc Red Berry and Smirnoff mixed drinks.

Marketing spend increased by 7%. In the second half spend was up 23%, focused behind innovation and up-weighted investment on key spirits brands, such as Captain Morgan, Johnnie Walker, Smirnoff, Crown Royal and Cîroc.

Diageo has worked with key accounts at national, regional and local levels to bring shopper and category insights to optimise sales of beverage alcohol in their stores. In addition, Diageo has developed and rolled out shopper-insight driven programmes behind Diageo's brands. These programmes capture the shoppers' attention in off trade stores

## 2010

## Europe

#### Key highlights

- Volume increase was led by the strong performance in Great Britain, up 9%, where successful customer focus increased visibility of Diageo's brands in the off trade during key selling periods
- Continued consumer weakness in Spain and Ireland led to a decline in net sales in those markets
- Russia delivered a very strong performance with significant share gains and double-digit growth following the launch of new brands to capture opportunities in the scotch category as consumers traded down
- Marketing spend reduced in line with consumer trends in difficult markets and was focused behind key brands, Smirnoff and Captain Morgan, and innovation
- Guinness grew share in Great Britain and Ireland but volume was down in a tough beer market

#### Performance

#### Reported performance

Net sales increased by £9 million in the year ended 30 June 2010 to £2,759 million, from £2,750 million in the prior year. Reported operating profit before exceptional items increased by £6 million in the year ended 30 June 2010 to £859 million, from £853 million in the prior year. Operating profit increased by £5 million in the year ended 30 June 2010 to £806 million, from £801 million in the prior year.

#### Organic performance

The weighted average exchange rate used to translate euro sales and profit moved from £1 = €1.17 in the year ended 30 June 2009 to £1 = €1.13 in the year ended 30 June 2010. Exchange rate impacts increased net sales by £53 million, acquisitions and disposals increased net sales by £10 million and there was an organic decrease in net sales of £54 million. Exchange rate impacts increased operating profit before exceptional items by £11 million, acquisitions and disposals increased operating profit before exceptional items by £1 million and there was an organic decrease in operating profit before exceptional items of £6 million.

#### **Great Britain**

A strong performance was delivered in Great Britain with volume up 9% and net sales up 5%, driven by double-digit volume growth from spirits and wine. Solid share gains were achieved in spirits in the key off trade channel through a continued promotional strategy although key Diageo brands continued to sell at a price premium relative to their category. The on trade, in contrast, continued to decline in the low single digits although the rate of pub closures slowed. In this context, Guinness outperformed the beer category with broadly flat net sales through the success of the 'Bring It to Life' and '250th Celebration' campaigns. Baileys and Pimm's both performed well with good volume, net sales and share growth driven by the continued strength of Baileys Flavours and distribution gains of Pimm's supported by a national television campaign. Smirnoff Flavours continued to grow strongly and have been particularly successful in the off trade, where it is now the best selling flavoured vodka range. The negative price/mix of 4 percentage points in Great Britain was driven by the faster growth of the grocery channel with its competitive promotional environment.

#### Ireland

Diageo's volume and net sales declined 6% and 8% respectively in Ireland, primarily driven by the weakness of the key on trade channel, but with share gains in beer and spirits. Guinness net sales decreased 5% but grew

Key measures Volume	2010 £ million	2009 £ million	Organic movement ————————————————————————————————————	Reported movement
Net sales	2,759	2,750	(2)	-
Marketing spend	412	429	(6)	(4)
Operating profit before exceptional items	859	853	(1)	1
Operating profit	806	801		1

share, especially in the key Republic of Ireland on trade channel, where it has shown over 30 months of consecutive share growth, driven partly by the success of the '250th Celebration' campaign. Harp and Smithwick's also grew share following the successful launch of Harp Ice Cold and the repositioning of Smithwick's brand. Carlsberg performed broadly in line with the market while Budweiser lost share.

#### Iberia

Difficult economic conditions continued to impact Iberia, with consumer driven sectors still experiencing weakness. The rate of decline of spirits slowed but the category remained adversely affected by consumers trading down to less expensive brands and categories and the shift towards at home consumption. The off trade continued to grow and is now approaching 40% of the total market, although the majority of this growth is being driven by own label brands at lower price points. Diageo's volume and net sales were down 5% and 7% respectively. Aggressive pricing and on trade decline led to negative price/mix. J&B was impacted by the fall in scotch consumption in the on trade channel in Spain and volume decreased 12%. In contrast, Johnnie Walker continued to capitalise on its great brand momentum and increased volume, net sales and share. Similarly, cocktail innovation including Cacique Mojito performed well in the off trade.

#### Eastern Europe

Double-digit volume and net sales growth were delivered in Russia, reflecting the successful introduction of lower priced scotch brands into the market to appeal to value conscious consumers and maintain category participation. White Horse and Bell's captured this momentum, delivering strong volume and net sales growth. Captain Morgan also achieved good growth following the introduction of smaller sized bottles. In Eastern Europe, net sales declined as distributors

Brand performance	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	(1)	(3)	(1)	(2)
Other brands	5	_	5	3
Total	1	(2)	1	
Key brands:*				
Johnnie Walker	(6)	(4)	(6)	(2)
Smirnoff	_	(6)	_	(5)
Baileys	3	(3)	3	(1)
balloys				
J&B	(8)	(10)	(8)	(6)

<sup>\*</sup> Spirits brands excluding ready to drink.

through the success of the 'Bring it to Life' and '250th Celebration' campaigns. Share gains were also achieved in Ireland, led by the performance in the key Republic of Ireland on trade channel. Price/mix was positive mainly because of a price increase on Guinness Draught in Great Britain.

The ready to drink segment remained weak with volume and net sales down 6% and 2% respectively, reflecting the continued decline of the segment across the region and more particularly in the on trade. Smirnoff Ice remained in decline in larger markets, where investment in the brand was focused on improving visibility in the off trade.

Premix cans delivered strong growth in Great Britain with volume and net sales up 23% and 28% respectively, making spirits more accessible to the at home consumer. The successful launch of Smirnoff & Cola in February 2010, supported by television and in-store activity, expanded the range of premix variants to eight. Cacique Mojito in Spain had a strong start and the introduction of Smirnoff Cocktails in Great Britain strengthened Diageo's offering in the growing ready to serve segment.

As consumer behaviours evolved in Europe, innovation remained a crucial performance driver with particular success in Great Britain, Spain and Russia. In Great Britain performance was driven by a full rollout on Baileys with a hint of Coffee, premix cans and Smirnoff flavoured vodka. The launch of Cacique Mojito ready to serve cocktails in Spain addressed the at home consumption trend. In Russia the launch of \$\delta 5 (0)25 (f) o

## Diageo Annual Report 201

## 2010 International

#### Key highlights

- Latin America and the Caribbean delivered 15% net sales growth, driven by scotch brands Johnnie Walker, Buchanan's and Old Parr
- Growth of lager brands led to 10% net sales growth in Africa
- Global Travel and Middle East returned to growth, led by the strong growth of premium and super premium brands
- Marketing spend increased ahead of net sales behind the key categories of scotch, beer and vodka

#### Performance

#### Reported performance

Net sales increased by £341 million in the year ended 30 June 2010 to £2,627 million, from £2,286 million in the prior year. Reported operating profit before exceptional items increased by £122 million in the year ended 30 June 2010 to £771 million, from £649 million in the prior year. Operating profit increased by £139 million in the year ended 30 June 2010 to £766 million, from £627 million in the prior year.

#### Organic performance

Exchange rate impacts increased net sales by £21 million, acquisitions and disposals increased net sales by £9 million and there was an organic increase in net sales of £311 million. Exchange rate impacts decreased operating profit before exceptional items by £27 million, acquisitions and disposals decreased operating profit before exceptional items by £6 million and there was an organic increase in operating profit before exceptional items of £155 million.

#### Latin America and the Caribbean

Net sales grew 17% in Venezuela driven by price increases taken to reflect inflation and the weaker Bolivar/US dollar exchange rate. However, volume decreased 4% as the slowdown of the economy resulted in category declines within international spirits. This was especially true of the higher priced scotch segments where many consumers either switched into lower priced categories such as rum or locally produced vodka, or traded down within the category to standard variants. Within this environment, Diageo maintained its clear leadership position of both the scotch and rum categories.

Volume grew 22% and net sales 15% in the Brazil hub, led by Johnnie Walker and Smirnoff which both grew share and extended their category leadership positions. Negative price/mix was a result of price reductions made in the second half of fiscal 2009. Marketing spend increased behind global brand campaigns such as Johnnie Walker 'Walk with Giants', category marketing programmes such as the Whisky Festival and activation behind Smirnoff, Cîroc and Ketel One vodka during the 2010 football World Cup.

In Mexico, the strong performance of Johnnie Walker Red Label and Buchanan's Deluxe extended Diageo's position as the clear leader in scotch and led to volume growth of 25% and net sales growth of 31%. Price increases across the scotch range and the faster growth of deluxe variants resulted in 6 percentage points of positive price/mix. Marketing spend was significantly increased behind Johnnie Walker 'Keep Walking' and the 'Buchanan's Forever' platform.

Key measures Volume	2010 £ million	2009 £ million	Organic movement ————————————————————————————————————	Reported movement    9
Net sales	2,627	2,286	13	15
Marketing spend	302	259	13	17
Operating profit before exceptional items	771	649	25	19
Operating profit	766	627		22

#### Africa

Despite a challenging economic environment in South Africa, volume and net sales grew 1%. The scotch category was most affected by the reduction in consumer confidence, however Bell's remained the best selling scotch in the market and Diageo's scotch brands grew share. Smirnoff delivered a strong performance, with net sales up 8%. Trading has generally improved in the second half, with signs of trading up starting to appear, particularly in scotch. Sales of beer through the brandhouse joint venture performed very well and grew share. The strong performance in Nigeria continued with net sales up 23% and Diageo gained share of the beer category. Harp, in particular, performed strongly as distribution gains and increased media activity led to excellent net sales growth for the brand. Guinness net sales declined 1% as a weaker economy led many consumers to trade down to lower priced beers. Marketing activity on Guinness was stepped up significantly, primarily behind television advertising of 'The Scout' and activation around the sponsorship of the Nigerian football team, the 'Super Eagles', during the 2010 football World Cup.

In the East Africa hub, comprising Kenya, Uganda and Tanzania, trading conditions significantly improved in the second half as the domestic economies showed signs of recovery. Diageo's performance steadily improved and the hub delivered flat volume and net sales growth of 10% for the full year. The positive price/mix was due to price increases coupled with the faster growth of the higher margin Guinness brand, which grew net sales 21%. Tusker in Kenya was another highlight, growing net sales 26%.

Elsewhere in Africa, net sales grew 1% in both Cameroon and Ghana. In Cameroon, growth of Malta Guinness and the introduction of Pilsner lager in November 2009 drove performance. Ghana faced a difficult year as water shortages and power outages reduced production volume while a significant increase in excise duties in

Brand performance	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	7	9	7	11
Other brands	9	19	10	19
Total	8	13	9	15
Key brands:*				
Johnnie Walker	22	17	22	26
Smirnoff	7	7	7	18
0.1				
Baileys	1	2	1	8
	1	15	1 11	13
Baileys	1			8

<sup>\*</sup> Spirits brands excluding ready to drink.

markets of Nigeria, Cameroon and Ghana, the brand commands a price premium of upwards of 75% compared to mainstream lager brands. To support brand equity and this strong pricing position, marketing spend was significantly increased behind the '250th Celebration' in the first half and in strengthening the brand's association with football in the second half.

Ready to drink net sales grew 7% led by the strong performance of Smirnoff ready to drink in Nigeria and Brazil. In South Africa, Smirnoff Ice volume declined as consumers traded into less expensive mainstream beer but the launch of premix versions of Captain Morgan and J&B helped grow ready to drink net sales 8% in that market.

Marketing spend increased in line with net sales at 13% and was focused behind the largest categories and proven campaigns. By category, the majority of the additional spend was behind scotch as the 'Walk with Giants' marketing programme on Johnnie Walker was activated at scale in both Latin America and GTME. Guinness also received significantly more support in fiscal 2010. Marketing spend increased between 30% and 70% in the largest markets of Nigeria, Cameroon and East Africa.

International was the largest contributor to Diageo's innovation net sales growth mainly due to new beer formats in Nigeria and Kenya and the introduction of super deluxe variants of scotch brands in the

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## 2010

### Asia Pacific

#### Key highlights

- Double-digit growth in South East Asia was driven by strong growth in Johnnie Walker and Guinness
- Australia volume and net sales declined slightly driven by weakness of Bundaberg ready to drink in an increasingly competitive segment
- Good depletions of Johnnie Walker and Windsor drove share growth in China as the scotch category returned to growth, although overall performance was held back by destock of Dimple
- The scotch category was weak in Korea, however share gains extended Diageo's leadership position
- A strong performance from The Singleton led to 10% net sales growth in Taiwan
- India was impacted by a destock in the first half but the business performed more strongly in the second half
- Marketing spend increased 3% with focused investment on Windsor, Guinness, Johnnie Walker and Smirnoff

#### Performance

#### Reported performance

Net sales increased by £108 million in the year ended 30 June 2010 to £1,018 million, from £910 million in the prior year. Reported operating profit before exceptional items increased by £17 million in the year ended 30 June 2010 to £176 million, from £159 million in the prior year. Operating profit increased by £22 million in the year ended 30 June 2010 to £146 million, from £124 million in the prior year.

#### Organic performance

Exchange rate impacts increased net sales by £101 million and there was an organic increase in net sales of £7 million. Exchange rate impacts increased operating profit before exceptional items by £14 million and there was an organic increase in operating profit before exceptional items of £10 million.

#### Australia

In Australia net sales declined 1% as a result of a 5% decline in ready to drink net sales. In spirits the performance was stronger. The 'Strides' marketing campaign drove share gains and the strong performance of Johnnie Walker Red Label, with net sales growth of 19%, offset weakness in Baileys which was impacted by imports of the brand from outside Australia. Smirnoff volume was down 4%, however moderate price increases delivered flat net sales in a category that has seen increased competition from own label. Bundaberg volume declined 8% as growth slowed in dark spirits and a price increase held net sales flat. Marketing spend increased 2% and investment focused on the Smirnoffrange.

#### Korea

The contraction of scotch in Korea during the global economic downturn combined with consumers trading down, led to a decline in volume and net sales of 8% and 3% respectively. A double-digit increase in marketing spend was focused on Windsor and Johnnie Walker Black Label and delivered 4 percentage points of volume share gain in the scotch category. Price increases on both Windsor 12 year old and Windsor 17 year old delivered price/mix improvement.

#### South East Asia

South East Asia, which includes Vietnam, Malaysia and Indonesia, performed well, delivering double-digit volume and net sales growth. Negative price/mix was driven by the increase in the level of business done through third party distributors, which led to a reduction in net

Key measures Volume	2010 £ million	2009 £ million	Organic movement ————————————————————————————————————	Reported movement %
Net sales	1,018	910	1	12
Marketing spend	233	208	3	12
Operating profit before exceptional items	176	159	6	11
Operating profit	146	124		18

sales per case and some destocking of super deluxe brands. Johnnie Walker performed well, as a result of a 15% increase in marketing spend which focused on the 'Keep Walking' campaign and Grand Prix sponsorship, and drove both share gains and increased brand equity. Guinness posted strong performance and the brand's price premium drove strong price/mix backed by a significant increase in marketing spend behind the '250th Celebration' and sponsorship of World Series Pool in Indonesia.

#### Thailand

In Thailand volume grew 9% as Johnnie Walker Black Label and Smirnoff both delivered good growth. However, the key growth driver in the market was Benmore, which delivered double-digit volume and net sales growth, and as a result of improved brand health grew share in a declining category as the uncertain political and economic environment led to trading down. The strong growth of Benmore at a lower price point to Johnnie Walker drove negative price/mix and net sales grew 4% in Thailand.

#### China

The second half performance in China was very strong although the destocking of Dimple in the first half of the year impacted overall performance, with volume down 1% and net sales down 2% for the full year. Global priority brands grew in China and the strong performance of Johnnie Walker Black Label, delivered over 2 percentage points of share in a scotch category which had returned to growth. Smirnoff and Baileys also performed well, albeit from a smaller base, as brand equity improved. Both brands increased share in their respective categories and trade investment efficiencies delivered positive price/mix. Increased focus behind Windsor delivered strong growth in volume and net sales. A double-digit increase in marketing spend focused on

Brand performance	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands		3	5	14
Other brands	(2)	(2)	(2)	10
Total	2	1	2	12
Key brands:*				
Johnnie Walker	14	2	14	10
Smirnoff	(5)	(1)	(5)	11
Bundaberg rum	(8)	_	(8)	22
		***************************************	***************************************	0
Windsor	_	_	_	9
Guinness		13	2	27

<sup>\*</sup> Spirits brands excluding ready to drink.

Guinness performed well and volume increased 2%. Price/mix improvement was driven by its premium price positioning in South East Asia and net sales grew 13%. Marketing spend increased by over a third to support the brand's '250th Celebration' activity, the new 'Rise Together' campaign and sponsorship of World Series Pool in South East Asia.

Ready to drink volume was broadly flat as the performance of Smirnoff Cocktails and Johnnie Walker ready to drink offset a 3% decline in Bundaberg ready to drink in Australia. Price competition intensified between beer and ready to drink in Australia and net sales declined 4% in the region.

Marketing spend grew 3%, primarily driven by increases in Korea, South East Asia and China. Investment increased behind the Johnnie

### **Business review**

### Trend information

The following comments were made by Paul Walsh, chief executive of Diageo, in Diageo's preliminary announcement on 25 August 2011:

"Diageo is a strong business as these results show. Our leading brands and superior routes to market have delivered volume growth, positive price/mix, gross margin expansion and strong cash flow. We have strengthened the business, investing more behind our brands and in our routes to market and we have deepened our leading brand and market positions in the fastest growing markets of the world. In addition we have implemented changes to drive further operational efficiencies.

This is a strong platform. It is the basis of our medium term outlook for average top line growth of 6%, operating margin improvement, with the first 200 basis points achieved in the next three years, and double digit eps growth. Diageo is not immune from a fragile global economy, however achievement of these aims would underpin even stronger dividend growth."

### 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 2011 is as follows:

	Year ended 30		
	2011 £ million	2010 £ million	2009 £ million
Operating profit after exceptional items	2,595	2,574	2,418
Depreciation and amortisation	352	372	300
Movements in working capital	(112)	334	(253)
Dividend income from associates	138	111	179
Other items	(94)	(207)	10
Cash generated from operations	2,879	3,184	2,654
Net interest paid	(311)	(305)	(415)
Dividends paid to equity non controlling interests	(112)	(107)	(98)
Taxation paid	(365)	(474)	(522)
Net cash from operating activities	2,091	2,298	1,619
Net investment in property, plant and equipment and computer software	(372)	(231)	(341)
Net disposal/(purchase)of other investments	1	(43)	(24)
Payment into escrow in respect of the Diageo UK Pension Scheme	_	_	(50)
Free cash flow	1,720	2,024	1,204
Net acquisition of businesses	(83)	(205)	(101)
Proceeds from issue of share capital	1	_	_
Net (purchase)/sale of own shares for share schemes	(9)	85	(38)
Own shares repurchased	_	_	(354)
Net (decrease)/increase in loans	(414)	(422)	256
Equity dividends paid	(973)	(914)	(870)
Net increase in net cash and cash equivalents	242	568	97
Net decrease/(increase) in loans	414	422	(256)
Exchange differences	(17)	(429)	(784)
Borrowings acquired through purchase of businesses	(22)	_	_
Other non-cash items	(113)	(96)	(29)
Decrease/(increase) in net borrowings	504	465	(972)
Net borrowings at the beginning of the year	(6,954)	(7,419)	(6,447)
Net borrowings at the end of the year	(6,450)	(6,954)	(7,419)

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 decreased from £3,184 million in the year ended 30 June 2010 to £2,879 million in the year ended 30 June 2011. This decrease of £305 million is primarily due to a lower increase in payables in the year compared with the prior year. Cash generated from operations is after exceptional restructuring costs of £118 million. Other items include £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 includes cash receipts of £71 million following the renegotiation of the terms of certain interest rate swaps. Tax payments in the year ended 30 June 2010 were lower than in the year ended 30 June 2010 primarily as a result of beneficial timing of settlement payments agreed with tax authorities.

Cash generated from operations increased from £2,654 million in the year ended 30 June 2009 to £3,184 million in the year ended 30 June 2010. This increase of £530 million primarily arose from an increase of £156 million in operating profit, an increase of £587 million in cash flows from net movements in working capital, partly offset by a reduction of £63 million in the dividend received from Moët Hennessy. Cash generated from operations was after exceptional restructuring costs of £145 million (2009 – £53 million). The reduction in working capital of £334 million (2009 – increase of £253 million) was mainly achieved through initiatives to improve the collection of receivables and by agreeing new payment terms with certain suppliers. In the year ended 30 June 2010 inventories increased by £104 million (2009 – £236 million) principally in respect of maturing inventories to satisfy forecast demand. Other items included £114 million of cash contributions to post employment schemes in excess of the income statement charge (2009 – £68 million higher contributions) and gains on sale of property, included in operating profit, of £89 million (2009 – £6 million) partly offset by the fair value charge in respect of share-based incentive plans of £31 million (2009 – £31 million). Net interest payable in the year ended 30 June 2010 was £110 million lower than the year ended 30 June 2009 primarily due to lower interest rates on floating rate debt and the receipt of £113 million following the renegotiation of the terms of certain interest rate swaps. Tax payments in the years ended 30 June 2010 and 2009 included settlements agreed with tax authorities and paid over two years.

### Net cash from investing activities

The purchase of tangible fixed assets and computer software increased from £374 million in the year ended 30 June 2010 to £419 million in the year ended 30 June 2011. The expenditure was incurred on a number of projects throughout the world with the largest projects in Global Supply in Scotland and North America. Additional expenditure was invested in returnable bottles in Nigeria and casks in Scotland. Property disposals decreased from £143 million in the year ended 30 June 2010 to £47 million in the year ended 30 June 2011. Property disposals in the year ended 30 June 2011 included the receipt of £22 million (2010 – £134 million) on the sale and leaseback of land and buildings located in Napa Valley, California and £15 million on sale of certain non-strategic wine businesses.

In the year ended 30 June 2011 expenditure of £117 million arose in respect of business acquisitions. This included £34 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, an additional equity investment of £18 million in DHN Drinks, an associate company in South Africa and transaction costs on a number of acquisitions including Quanxing (£11 million) and Mey İçki (£7 million).

In the year ended 30 June 2010 the group spent £206 million on acquisitions of which £123 million was deposited with China's securities depositary and clearing agency, Shanghai branch in connection with a possible tender offer to the shareholders of Sichuan ShuiJingFang Co., Ltd., £25 million in respect of the purchase 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.

In the year ended 30 June 2009 the group spent £102 million on acquisitions of which £35 million was in respect of the remaining 25% equity stake in the company that owns the Smirnov brand in Russia, £18 million in respect of additional equity stake in Sichuan Chengdu Quanxing Group Company Ltd. in China and £19 million on Sedibeng Brewery, an associate company in South Africa.

### Free cash ow

Free cash flow decreased by £304 million to £1,720 million in the year ended 30 June 2011.

Cash ows from nancing activities
Cash flows from financin byws from

### 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 14 October 2010 to purchase a maximum of 250,554,000 shares at a minimum price of 28<sup>101</sup>/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 19 October 2011.

### Borrowings

The group's net borrowings and gross borrowings in the tables below 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. Net borrowings, reported on this basis, comprise the following:

	2011 £ million	2010 £ million	2009 £ million
Overdrafts	(12)	(55)	(68)
Other borrowings due within one year	(1,435)	(532)	(822)
Borrowings due within one year	(1,447)	(587)	(890)
Borrowings due between one and three years	(2,441)	(2,189)	(1,537)
Borrowings due between three and five years	(1,741)	(2,732)	(2,747)
Borrowings due after five years	(2,566)	(3,256)	(3,401)
Fair value of foreign currency forwards and swaps	182	227	170
Fair value of interest rate hedging instruments	58	191	93
Finance lease liabilities	(79)	(61)	(21)
Gross borrowings	(8,034)	(8,407)	(8,333)
Offset by: Cash and cash equivalents	1,584	1,453	914
Net borrowings	(6,450)	(6,954)	(7,419)

Based on average monthly net borrowings and interest charge, the effective interest rate for the year ended 30 June 2011 was 4.9% (2010 – 4.8%; 2009 – 6.2%). For this calculation, net borrowings exclude interest rate related fair value adjustments and the interest charge excludes finance charges unrelated to net borrowings, the forward element on derivative financial instruments and fair value adjustments to interest rate swaps and borrowings.

Net borrowings designated in net investment hedge relationships amounted to £5,409 million as at 30 June 2011 (2010 – £5,451 million; 2009 – £5,266 million).

The group's gross borrowings – including the impact of foreign currency forwards and swaps – are denominated in the following currencies:

	Total £ million	US dollar %	Sterling %	Euro %	Other %
Gross borrowings					
2011	(8,034)	46	22	25	7
2010	(8,407)	46	20	22	12
2009	(8,333)	39	25	25	11
	Total <u>£ million</u>	US dollar	Sterling %	Euro %	Other
Cash and cash equivalents	£ million				
	£ million	%		%	%
	£ million	66	<u>%</u>	<u>%</u>	%

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

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.

In the year ended 30 June 2009, the group borrowed \$1,500 million (£909 million) in the form of a bond that matures in January 2014 with a coupon of 7.375% and 61,000 million (£855 million) in the form of a bond that matures in December 2014 with a coupon of 6.625%. A 6500 million (£427 million) medium term note, a \$400 million (£242 million) medium term note and a \$250 million (£152 million) medium term note were repaid.

When derivative transactions are undertaken with bank counterparties, Diageo 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

30 June

above a pre-determined threshold. At 30 June 2011, the collateral held under these agreements amounted to \$84 million (£52 million) and €44 million (£39 million) (2010 – \$80 million (£54 million) and €32 million (£26 million); 2009 – \$84 million (£51 million)).

The group had available undrawn committed bank facilities as follows:

	2011 £ million
Expiring within one year	
	//6
Expiring between one and two years	727
Expiring after two years	671
	2,174

Commitment fees are paid on the undrawn portion of these facilities. Borrowings under these facilities are 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. The committed bank facilities are subject to a single financial covenant, being a minimum interest cover ratio of two times (defined as the ratio of operating profit before exceptional items aggregated with share of associates' profits 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 notes 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 periods presented.

### Capital commitments

Diageo's subsidiary undertaking, EABL, of which Diageo owns 50.03%, has agreed to purchase SABMiller Africa BV's 20% equity stake in Kenya Breweries Limited (KBL) for cash consideration of the US dollar equivalent of 19.5 billion Kenyan shillings at completion (£136 million), subject to EABL disposing of its 20% equity stake in Tanzania Breweries Limited by way of a public offer.

Other capital commitments not provided for at 30 June 2011 are estimated at £148 million (2010 – £112 million; 2009 – £202 million). Diageo management believes that it has sufficient funding for its working capital requirements.

### Other contractual obligations

				Payments d	ue by period
As at 30 June 2011	Less than 1 year £ million	1-3 years £ million	3-5 years £ million	More than 5 years £ million	Total £ million
Long term debt obligations	1,337	2,404	1,696	2,512	7,949
Interest obligations	438	723	405	1,081	2,647
Credit support obligations	91	_	_	_	91
Operating leases	104	158	106	354	722
Finance leases	12	23	15	76	126
Deferred consideration payable	4	21	_	_	25
Purchase obligations	869	570	77	3	1,519
Provisions and other non-current payables	144	112	51	138	445
	2,999	4,011	2,350	4,164	13,524

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 at the last business day of the year ended 30 June 2011. 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, 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 £10 million in respect of vacant properties and £1 million for onerous contracts, which are included in operating leases and purchase obligations, respectively.

Potential income tax exposures included within corporate tax payable of £381 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 2012, are expected to be approximately £50 million. In addition, 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. The first payment was made in the year ended 30 June 2011. 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 £430 million in cash, to the UK Scheme. In addition, as part of thisS£th2 24 (n) Slan the companySreedSoSakeSo-sth217 (t) 20 (i) 19 (o) 16 (n) 2

# Diageo Annual Report 2011

### Other contractual obligations continued

This deficit funding arrangement is expected to result in additional annual contributions to the Irish Scheme of approximately €21 million (£19 million) over a period of 18 years from 2010, and provides for additional cash contributions into escrow of up to €188 million (£169 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. Annual contributions to the GrandMet Irish Pension Fund of €6 million (£5 million) were agreed with the Irish trustee for seven years in the year ended 30 June 2010. Contributions to other plans in the year ending 30 June 2012 are expected to be approximately £110 million.

Capital commitments at 30 June 2011 are excluded from the table above.

### Post balance sheet events

Since the year end the group has completed the purchase of 100% of the equity of Mey İçki, a 50% equity stake in Zacapa rum and an additional 4% equity stake in Quanxing. The aggregate consideration for these acquisitions amounted to £1.5 billion. As a result of the acquisition of Quanxing Diageo expects to make a mandatory tender offer to all the other shareholders of ShuiJingFang. Were all the other shareholders of ShuiJingFang to accept the tender offer the amount payable would be £606 million.

### 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 exchange 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. These policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk. The benchmarks, hedge cover 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.

### **Currency** risk

The group publishes its consolidated financial statements in sterling and conducts business in many foreign currencies. As a result, it is subject to foreign currency exchange risk due to exchange rate movements, which affect the group's transactions and the translation of the results and underlying net assets of its foreign operations. To manage the foreign exchange risk the group's treasury department 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 by using foreign currency spots, forwards, swaps and other financial derivatives. The board reviewed and approved a revised policy, applicable from 3 December 2010, to manage hedging of foreign exchange risk arising from net investment in foreign operations. The group's revised policy is, where a liquid foreign exchange market exists, to aim 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. The group's previous policy was to aim where a liquid foreign exchange market existed, to hedge currency exposure on its net investment in foreign operations by using net debt in foreign currencies and foreign currency spots, forwards, swaps and other financial derivatives and within the following percentage bands: 80% to 100% for US dollars and euros and 50% to 100% for other currencies. Exchange differences arising on the re-translation 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 board reviewed the group's transactional foreign exchange risk management policy and approved a revised policy on 1 October 2010. The group's revised policy is to aim to hedge 18 months forecast transactional foreign exchange rate risk in the three major currency pairs (US dollar/sterling, euro/sterling and euro/US dollar), up to 100% with a target range of between 75% and 100% once the relevant annual plan has been approved. In addition, at management's discretion, the group may decide to hedge other currencies for up to 18 months. The group's previous policy was to aim, for currencies in which there was an active market, to hedge between 60% and 100% of forecast transactional foreign exchange rate risk, for up to a maximum of 21 months forward, using foreign currency forward contracts with coverage levels increasing nearer to the forecast transaction date. 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.

### 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. For these calculations, net borrowings exclude interest rate related fair value adjustments. A template approved by the board specifies different duration guidelines and fixed/floating amortisation periods (time taken for the fixed element of debt to reduce to zero) depending on different interest rate environments. The majority of Diageo's existing interest rate derivatives are designated as hedges and these hedges are expected to be effective. Fair value of these derivatives is recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.

### Commodity price risk

The group is exposed to commodity price risk. The group primarily uses long term purchase contracts to secure prices with suppliers to protect against volatility in commodity prices.

### 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 minimises 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 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. Financial instruments are primarily transacted with major international financial institutions with a long term credit rating within the A band or better. The credit risk arising through the use of financial instruments for interest rate and currency 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, Diageo 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

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 trade and other receivables as the group has a large number of customers which are internationally dispersed.

### 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 facility terms from relationship banks to support commercial paper obligations.

### Insurance

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.

### **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 IFRS standards 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.

## Board of directors and company secretary



**Dr Fran\_ B Humer**Chairman,
Non-executive director 3\*
Swiss/Austrian (65)

Appointed chairman of Diageo plc in July 2008, having been a non-executive director since April 2005. He is also chairman of F. Ho mann-La Roche Ltd in Switzerland and chairman of INSEAD's board of directors. 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 o cer,
executive director 2\*
British (56)

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 o cer 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 Unilever PLC and a nonexecutive director of FedEx Corporation in the United States. He is also a member of the Business Advisory Group and chairman of the Scotch Whisky Association.



Deirdre Mahlan Chief nancial o cer, executive director<sup>2</sup> American (49)

Appointed chief nancial o cer and a director of Diageo plc in October 2010, prior to which she was deputy chief nancial o cer, Diageo plc, and before that head of tax and treasury. She joined the company in 2001, having held various senior nance positions in Joseph E Seagram & Sons Inc since 1992, having formerly been a senior manager with Pricewaterhouse. She is also a member of the Main Committee of the 100 Group of Finance Directors.



Lord Hollick of Notting Hill Senior non-executive director 13.4\*

British (66)

Appointed a non-executive director of Diageo plc in December 2001 and senior non-executive director and chairman of the remuneration committee in September 2004 He is a member of the supervisory boards of ProSiebenSat.1 Media AG and BMG Music Rights GmbH, both in Germany, a non-executive director of Honeywell International Inc in the United States, a partner of G P Bullhound and a founding trustee of the Institute of Public Policy Research. He was formerly chief executive of United Business Media plc, a partner of KKR and has held a number of other non-executive directorships. Lord Hollick will retire as a director of Diageo plc immediately after the AGM.



Peggy B Bru\_elius Non-executive director 1.3.4 Swedish (61)

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



Laurence M Danon Non-executive director 1.3.4 French (55)

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, Rhodia SA and TF1, all 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 o cer of France Printemps She was also a non-executive director of Experian Group



Lord Davies of Abersoch Non-executive director<sup>1,3,4</sup>

British (58)

Appointed a non-executive director of Diageo plc in September 2010. Lord Davies is a partner of Corsair Capital, non executive chairman of Pinebridge Investments Limited, a non-executive director of Bharti Airtel 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 Minister for Trade, Investment and Small Business for the UK Government between January 2009 and May 2010. Prior to this role, Lord Davies was Chairman of Standard Chartered PLC.



Betsy D Holden Non-executive director <sup>1,3,4</sup> American (55)

Appointed a non-executive director of Diageo plc in September 2009. She is a senior adviser to McKinsey & Company and holds non-executive directorships of MediaBank LLC, Tribune Company and Western Union Company, all 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 o cer of Kraft Foods Inc.



Philip G Scott
Non-executive director 1\*,3,4

# Diageo Annual Report 201

### **Executive committee**



Nicholas (Nick) Bla\_que\_ President, Diageo Africa<sup>2</sup> British (50)

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 o cer<sup>2</sup> British (44)

Appointed chief marketing o cer 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 Paci c2

Lebanese (51)

Appointed president, Diageo Asia Paci c 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 Procurement<sup>2</sup> British (54)

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 was previously a non-executive director of Brambles plc.



James (Jim) Grover Global Business Support director<sup>2</sup>

British (53)

Appointed Global Business Support director in February 2004, having been strategy director since December 1997. 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.



Ivan Mene<sub>+</sub>es

President, Diageo North America, chairman. Diageo Asia Paci c, chairman, Diageo Latin America and Caribbean<sup>2</sup> American (52)

Appointed president, North America, in January 2004, having been chief operating o cer, North America since July 2002. He was appointed chairman, Diageo Asia Paci c in October 2008 and chairman, Diageo Latin America and Caribbean in 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 North America and Whirlpool in Europe. He is also a non-executive director of Coach Inc., in the USA



John (Randy) Millian President, Diageo Latin America and Caribbean<sup>2</sup>

American (58)

Appointed president, having been managing director, Diageo Latin America and Caribbean since 2005, having ioined United Distillers & Vintners Brazil in 1995 as its managing director. 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 USA



Andrew Morgan

President, Diageo Europe<sup>2</sup> British (55)

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 o cer and president, New Business Ventures for Guinness United Distillers & Vintners and director, global strategy and innovation for United Distillers & Vintners.



Timothy (Tim) Proctor General counsel<sup>2</sup>

American/British (61)

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 thirteen years with Merck and six years with Glaxo Wellcome



Larry Schwart∠ President, Diageo USA<sup>2</sup> American (58)

Appointed president, Diageo USA in September 2008, prior to which he was president, Diageo North America key market hub, and president of Diageo's US spirits business. He joined the company in 2001, as president of Joseph E Seagram & Sons Inc, having held a variety of senior management positions with Seagram.



Gareth Williams

Human Resources director<sup>2</sup>

British (58)

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 ten years with Ford of Britain in a number of personnel and employee relations positions.



Ian Wright Corporate Relations director<sup>2</sup>

British (53)

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.

Stuart Fletcher, formerly president, Diageo International, encompassing the Africa, Latin America and Caribbean and GTME hubs, ceased to be an Executive Committee member on 30 June 2011, following an operating model review which made Africa and Latin America and Caribbean autonomous regions.

Ron Anderson, formerly chief customer o cer, also ceased to be an Executive Committee member on 30 June 2011.

Stuart and Ron both decided that this is the right moment for them to leave Diageo but stayed with the business into the rst half of the new nancial year to support the transition to the new operating model.

### Key to committees

2. Executive (comprising senior management)

### Directors' remuneration report

### Dear Shareholder

I am pleased to present the Directors' remuneration report for the year ended 30 June 2011 and highlight some of the key work of the remuneration committee during the nancial year.

We are committed to aligning executive remuneration with the creation of long term shareholder value. We believe that the majority of remuneration should be performance-related. We look carefully at risk management in an e ort to safeguard the company's and shareholders' long-term interests. We regularly assess executive remuneration arrangements against these objectives. During nancial year 2011, we addressed three main issues:

- A comprehensive analysis of the performance measures for the company's Performance Share Plan (PSP) to enhance alignment between reward and our medium-term strategic goals. This resulted in the introduction of two new nancial measures, organic net sales and organic operating margin improvement, to complement relative total shareholder return (TSR). The remuneration committee believes that the three equally-weighted measures that will apply to awards beginning in September 2011 will focus senior management even more strongly on the performance drivers that we expect will deliver the company's growth ambitions and drive long term shareholder value creation. More details on the outcome of this review are described later in this report under the section 'Remuneration review during the year ended 30 June 2011'.
- Increased and more stretching performance targets have been introduced for the adjusted earnings per share (EPS) measure under the Senior Executive Share Option Plan (SESOP) for awards being made in September 2011.
- A review of UK pension policy in light of recent changes to UK pension legislation, the impact of which has meant that the personal tax liability for long-serving executives could be substantially more than the value of the bene taccruing under their existing pension arrangements. In the course of this review, the remuneration committee has sought to take steps that protect the company's ability to attract and retain key talent in the business while maintaining cost neutrality.

The remuneration committee also reviewed base salaries for executives and senior management taking into account comparable companies, individual performance, and pay and employment conditions elsewhere in the company and concluded that it was appropriate to make modest increases following a pay freeze in the preceding scal year.

The company's nancial performance during nancial year 2011, as reported in the 'Business review', has delivered sustained positive results in terms of volume growth, price/mix, gross margin expansion and cash ow and has resulted in performance ahead of target for the short term incentive plan measures. The remuneration committee is, therefore, satis ed that the nancial year 2011 annual bonus outcomes for the executive directors described in the 'Remuneration summary' appropriately reflect these results and the value delivered for shareholders. Meanwhile, the performance shares that were due to vest in September 2010 lapsed in full upon failing the required TSR performance condition, and the awards due to vest in October 2011 will similarly lapse. This in part reflects the ongoing impact of recent currency volatility on the outcome for TSR measured in a common currency of US dollars (on a local currency basis returns for shareholder were above median against this group). By comparison, the company's consistent and strong TSR performance relative to the FTSE 100 can be seen in the performance graph on page 97. SESOP options for the corresponding periods vested in full in September 2010 upon exceeding the maximum adjusted EPS performance condition relative to the retail price index, while options will partially vest in October 2011 upon achieving compound annual growth in adjusted EPS of 7.6%, equivalent to a total of 24.5% growth over three years. The remuneration committee believes this level of return is appropriate given Diageo's ongoing delivery of growth while facing the challenges and opportunities characterised by the mixed performance of the global economy.

The following report provides further details about the reviews undertaken during the year ended 30 June 2011 and the reward outcomes for performance in that nancial year.

The remuneration committee has enjoyed full and constructive dialogue with shareholders during the nancial year, the outputs of which have positively influenced the committee's approach to the review of the PSP.

We look forward to receiving your support at the AGM in October 2011.

Lord Hollick of Notting Hill

Independent non-executive director and chairman of the remuneration committee

## Remuneration summary for the year ended 30 June 2011

### Base salary

With effect from 1 October 2010, the base salary for the chief executive officer was increased by 2% to £1,178,100. Prior to this, the last salary increase for the chief executive was in October 2008. The chief  $\,$  nancial o  $\,$  cer was appointed to the board on 1 October 2010 on a base salary of £575,000. She has not received a salary increase since her appointment.

### Governance

Board of directors and executive committee

## Directors' remuneration report

99 Corporate governance report

108 Directors' report

### Summary of salary reviews for executive directors

Percentage increase in year ended 30 June	2011	2010
D Mahlan (appointed 1 October 2010)	0%	_
NC Rose (retired from the board on 14 October 2010)	0%	0%
PS Walsh	2%	0%

### Annual incentive plan

In the year ended 30 June 2011, 80% of the short term incentive plan for executive directors was based on stretching nancial performance targets for net sales, pro tand free cash ow measures, and 20% on individual business objectives related to the delivery of ambitious strategic and operational targets. Net sales performance was ahead of target, while performance for pro t before exceptional items and tax was strongly ahead of target, and the company again delivered strong free cash ow results, substantially exceeding target. The remuneration committee also assessed performance against the individual business objectives and concluded that there had been above target performance against the operational and strategic goals set. The remuneration committee determined that awards under the annual incentive plan equivalent to 160% of salary as at 30 June 2011 for the chief executive and chief nancial o cer were appropriate given the performance delivered in the year. The award for the former chief nancial o cer was pro-rated to reflect service during the year and was equivalent to 77% of salary at retirement.

### Summary of short term incentive awards as a percentage of base salary for executive directors

Percentage award earned for year ended 30 June	2011	2010
D Mahlan (appointed 1 October 2010)	160%	
NC Rose (retired from the board on 14 October 2010)	77%	173%
PS Walsh	160%	171%

### Long term incentive plans

During the year ended 30 June 2011, the executive directors received option grants and were awarded performance shares in the range of 300% to 375% of their salaries. No award was made to

85

### Pensions

During the year, the executive directors, PS Walsh and NC Rose, participated in the UK Diageo Pension Scheme ('the UK Scheme'). which is a nal salary pension scheme. With e ect from 31 December 2010, NC Rose took early retirement from the company at the age of 53; his pension benefit was subject to actuarial reduction in line with the rules of the UK Scheme and was not augmented. Following the change to pension tax relief legislation, Mr Walsh opted out of future pension accrual as at 31 March 2011 and began to draw his pension on reaching age 56 (May 2011). This is in accordance with the company's general policy of 'exible pension access' whereby an individual, over the age of 55, may request to draw his retirement benefits whilst continuing in employment. All impacted individuals have this option. Mr Walsh's pension bene t was subject to actuarial reduction in line with the rules of the UK Scheme and was not augmented. Savings in the future service pension cost, as a result of no longer providing Mr Walsh with any further pension provision or supplement in lieu of pension, will more than o set the cost of giving him' exible pension access'. No cash supplement will be payable and no other element of remuneration will be increased in lieu of further pension accrual.

At 30 June 2011, NC Rose was receiving an annual pension of £334,000 and PS Walsh was receiving an annual pension of £558,000.

D Mahlan does not participate in the UK scheme but instead receives a cash supplement of 40% of base pay in lieu of pension provision.

In the event of death whilst in employment, a lump sum of four times base salary will be paid to the bene ciaries of the executive directors.

### Chairman and non-executive directors' remuneration for the year ended 30 June 2011

During the year, the annual fee payable to the chairman was increased to £500,000 per annum (a 25% increase). This is the first increase to have been applied to the chairman's fee since his appointment in July 2008. The remuneration committee reviewed the chairman's fee in the context of market practice, time commitment and the chairman's level of experience and performance, and determined that this increase was appropriate. The next review of fees is anticipated to take place in December 2012 with any changes expected to take e ect on 1 January 2013.

During the year, the base fee for non-executive directors was increased by 4% to £78,000 per annum. No increase was applied to fees for the committee chairmen or senior independent director. The next review of fees is anticipated to take place in December 2011 with any changes expected to take e ect on 1 January 2012.

### Governance

### The remuneration committee

The 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, 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.

The remuneration committee consists of Diageo's non-executive directors, all of whom are independent pursuant to the UK Corporate Governance Code: PB Bruzelius, LM Danon, Lord Davies (appointed 1 October 2010), BD Holden, Lord Hollick, PG Scott, HT Stitzer and PA Walker. Lord Hollick is chairman of the remuneration committee. The chairman of the board and the chief executive may, by invitation, attend remuneration committee meetings except when their own remuneration is discussed.

The remuneration committee met seven times during the year to consider, and approve, amongst other things:

- the structure of the annual incentive plan and awards, share-based grants and vesting for executive directors and the executive committee;
- approach to salary reviews for the executive directors and executive committee;
- the performance measures used in the company's long term incentive plans;
- a review of UK pension policy in light of pension legislation changes; and
- the directors' remuneration report for the year ended 30 June 2011.

Further information on meetings held and director attendance is disclosed in the corporate governance report. The remuneration committee's terms of reference are available at www.diageo.com and on request from the company secretary.

# Diageo Annual Report 2011

## Executive remuneration philosophy and principles

Alignment with strategy

### Governance

81 Board of directors and executive committee

83 Directors' remuneration report

99 Corporate governance report

Directors' report

### Risk management

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 speciegally. 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.

The plans in which Diageo's executive directors and senior management participate are designed to re ect the principles detailed below:

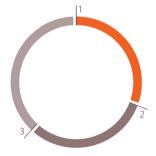
What	Why	How
Performance-related compensation	It in uences and supports performance and the creation of a high-performing organisation.	Short and long term incentives conditional upon achieving stretching performance targets.
Rewarding sustainable performance	It is at the heart of Diageo's corporate strategy and is vital to meeting investors' goals.	<ul> <li>A balanced mix of absolute and relative performance measures for short and long term incentives that re ect sustainable pro t and underlying nancial performance.</li> <li>Shareholding requirements that align the interests of senior executives with those of shareholders and that are a condition of full participation in share award and share option plans.</li> </ul>
Measuring performance over three years	It aligns with the time cycle over which management decisions are re ected in the creation of value in this business.	Long term incentives that comprise a combination of share option grants and share awards in each year and vary with three-year EPS, and, for awards made from September 2011, 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.	Base salary, benefits, pension, 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.	Reward levels considered against the total remuneration packages paid in the top 30 companies in the FTSE 100 by market capitalisation, excluding those in the nancial services sector. Total remuneration positioned between the median and upper quartile of this group, re ecting 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> <li>Targets that are within a sphere of direct influence and that align with the company's short and long term goals.</li> </ul>

### Fixed and variable remuneration

The balance between xed and variable elements of remuneration changes with performance. Based on expected values, the mix between xed and variable remuneration for executive directors is that for £100 of remuneration earned, £31 will be fixed remuneration and £69 will be performance-related remuneration, excluding pensions and other bene ts. This mix is illustrated in the following chart. The variable element may be higher or lower depending on the performance of the business.

### Executive directors' remuneration mix

- 1 Fixed base salary 31%
- 2 Variable short term 31%
- 3 Variable long term 38%



Directors' report

### Remuneration review during 2011

During the year ended 30 June 2011, the remuneration committee undertook a review of the performance tests for the Performance Share Plan (PSP) with a view to broadening the success factors against which management is incentivised and measured to enhance the alignment between reward and the company's medium-term strategic goals. This has coincided with the board's review of the company's strategic priorities for the next few years enabling the remuneration committee to apply performance measures to future awards that are expected to fully support the delivery of the company's growth ambitions and the long term creation of shareholder value, and at the same time ensure the plan design is sustainable for the medium to long term.

With effect from awards made in September 2011, the following changes to the performance measures will apply:

	From	То	Why
Governance	100% based		
81 Board of directors and executive committee	10070 00000		
83 Directors' remuneration report			
99 Corporate governance report			

89

support and the p	olicy governing their execution is	policy for executive directors  Diageo's executive directors participate, the remuneration strategy that they is detailed in the table below:
What	Why	How
Base salary	Reflects the value of the individual, their skills and experience, and performance.	<ul> <li>Reviewed annually with changes usually taking effect from 1 October.</li> <li>Benchmarked against the top 30 companies in the FTSE 100 by market capitalisation excluding those in the nancial services sector.</li> <li>Generally positioned at the median of the relevant market or, in exceptional circumstances, positioned above median if justined by the requirement to recruit or retain key executives.</li> </ul>
Annual incentive plan	Incentivises year on year delivery of short term performance goals.  Provides focus on key nancial metrics including pro t growth and cash performance.	<ul> <li>Targets set by reference to the annual operating plan.</li> <li>Level of award determined by Diageo's overall financial performance.</li> <li>Annual incentive plan awards based 80% on financial measures (net sales, prof and cash flow) and 20% on specific individual business objectives related to business strategy and operational targets.</li> <li>Up to 100% of salary earned for on target performance with a maximum of 200% of salary payable for outstanding performance.</li> </ul>
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> <li>A discretionary annual grant of market price share options subject to a performance test based on absolute annual compound growth in adjusted EF over three years.</li> <li>Stretching growth targets set annually by the remuneration committee.</li> <li>Maximum annual grant of 375% of salary.</li> <li>Threshold vesting level of 30% (October 2008 awards) and 25% (September 2009 awards onwards), with pro rata vesting up to 100% maximum.</li> <li>No re-test facility.</li> </ul>
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> <li>A discretionary annual award of shares subject to a three-year performance test.</li> <li>Maximum annual award of 375% of salary.</li> <li>Threshold vesting of 25% up to a maximum of 100%.</li> <li>Notional dividends accrue on awards, delivered as shares or cash at the discretion of the remuneration committee.</li> </ul> Performance conditions for awards made up to September 2010: <ul> <li>Based on TSR performance against a peer group of companies.</li> <li>Threshold vesting for median TSR performance (8th position), up to 100% vesting for achieving 2nd or above in the peer group.</li> </ul> Performance conditions for awards made from September 2011: <ul> <li>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.</li> <li>Threshold/pesting</li> </ul>

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Directors

Corporate governance report

report

remuneration

Directors' report

Board of directors and

executive committee

# Diageo Annual Report 201

### Base salary

The summary table on the previous page sets out the policy on base salary for the executive directors. Base salaries are generally determined with reference to the median of the relevant market for each role taking into account the experience and performance of the individual, the level and structure of remuneration for other employees and the external environment.

The table 'Summary of salary reviews for executive directors' in the section 'Remuneration summary for the year ended 30 June 2011' at the beginning of this report shows the salary increases that have been applied to the executive directors in the years ended 30 June 2011 and 30 June 2010.

After the year-end, the remuneration committee reviewed base salaries for senior management and agreed new salaries which will apply from 1 October 2011. The remuneration committee reviewed salaries for this population in the context of the importance of each role in delivering the company's strategy, the performance of the individual, and market positioning. The remuneration committee also considered the pay and employment conditions of the general employee population with a view to determining increases for senior management that are broadly aligned with the increases for other employees.

With effect from 1 October 2011, the base salary for the chief executive officer will increase by 4.5%, to £1,231,000. In determining this salary, the remuneration committee considered the importance of the chief executive o cer to the delivery of the company's key strategic goals and long term shareholder value creation, as well as his level of experience and performance. The remuneration committee also considered this increase in the context of an overall full-year budget increase of 3.5% for general staff and a collective agreement of 5.1% for negotiated groups in the UK. The remuneration committee additionally took into account historic increases for the chief executive of 0% and 2% in 2009 and 2010, respectively. On the basis of these considerations, the remuneration committee concluded that this salary level was appropriate.

The chief nancial o cer was appointed to the board on 1 October 2010. On her appointment, the chief financial officer's salary was initially set at below typical market levels for comparable roles recetting 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 also provides progression towards a market-competitive package in line with the company's policy on base salary positioning; with effect from 1 October 2011, the base salary for the chief financial officer will increase by 8.7%, to £625,000.

### Annual incentive plan

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 nancial performance at the nancial year end. The business results for the year ended 30 June 2011 are described in the Business review.

The targets for the year ended 30 June 2011 were a combination of measures including net sales, pro t before exceptional items and tax and free cash ow. These measures focus on key drivers of Diageo's growth strategy while supporting sustainability and the underlying nancial health of the company. The executive directors were also measured

against a set of individual business objectives (IBO) that were relevant to their speci carea of accountability. These were determined with reference to a set of collective business priorities that support the long term growth and sustainability of the business. Net sales results were ahead of target and pro tand cash ow targets were signi cantly exceeded. The remuneration committee assessed the performance of the chief executive and both the current and retired chief nancial o cers against their specific IBOs and concluded that the objectives were exceeded. The overall level of performance achieved resulted in an annual incentive plan award equating to 160% of base salary for both the chief executive and the chief nancial o cer. The pro-rated award for the former chief nancial o cer was equivalent to 77% of base salary. The actual awards received by the executive directors are shown in this report in the table 'Directors' remuneration for the year ended 30 June 2011'.

### Long term incentive plans (LTIPs)

Current 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 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 underlying measure of EPS is used to ensure that items such as exceptional items and 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 2011 SESOP awards and decided to increase their stretch to ensure that they remain aligned with long-term shareholder value creation.

81 Board of directors and executive committee

83 Directors' remuneration report

99 Corporate governance report

108 Directors' report performance conditions had been met and, if the remuneration committee determines, the time elapsed since the initial award or grant respectively.

### All employee share plans

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

### Share ownership

Senior executives are currently required to build up significant holdings of shares in Diageo from their own resources over a de ned period of time. Full participation in the share option and share award plans is conditional upon meeting this requirement. This policy re ects Diageo's belief that its most senior leaders should also be shareholders. The chief executive and chief nancial o cer are required to hold company shares equivalent to 300% and 250% of their base salary, respectively. The current status of their shareholding requirement is shown in the shareholding table in the remuneration summary at the beginning of this report.

### Pension provision

NC Rose and PS Walsh are members of the UK Scheme. D Mahlan is not a member of the UK Scheme and instead receives a cash supplement in lieu of pension provision equivalent to 40% of base pay. During the year, NC Rose and PS Walsh accrued pension rights a

## Chairman and non-executive directors – policy, terms, conditions and fees

Diageo's policy on chairman's and non-executive directors' fees is as follows:

- 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.

The chairman of the board, Dr FB Humer, commenced his appointment on 1 July 2008. Dr FB Humer has a letter of appointment for an initial ve-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 e ect 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. At this time, fees were reviewed in the light of market practice in large UK companies and anticipated workload, tasks and potential liabilities. As a result of this review, the annual fee payable to Dr FB Humer was increased to £500,000 (a 25% increase). 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 next review of the chairman's fee is anticipated to take place in December 2012 with any changes expected to take e ect on 1 January 2013.

Directors' remuneration report 99 Corporate governance report

Directors' report

Board of directors and executive committee

### Directors' remuneration for the year ended 30 June 2011

						2011	2010
	Base salary £000	Annual incentive plan £000	Share incentive plan £000	Cash in lieu of pension <sup>(b)</sup> £000	Other bene ts <sup>(c)</sup> £000	Total £000	Total £000
Emoluments							
Chairman – fees							
Dr FB Humer <sup>(a)</sup>	450				9	459	406
Executive directors							
D Mahlan (appointed 1 October 2010)	431	690	3	172	57	1,353	_
NC Rose (retired from the board on 14 October 2010)	194	518	3	_	17	732	1,872
PS Walsh	1,172	1,884	3	49	75	3,183	3,178
	1,797	3,092	9	221	149	5,268	5,050
Non-executive directors – fees							
PB Bruzelius	76	_	_	_	1	77	76
LM Danon	76	_	_	-	1	77	76
Lord Davies (appointed 1 October 2010)	64	_	_	-	1	65	-
BD Holden	76	_	_	_	1	77	63
Lord Hollick	111	_	_	_	1	112	111
PG Scott	101	_	_	_	1	102	101
HT Stitzer	76	_	_	_	1	77	76
PA Walker	76	_	_	_	1	77	76
Former non-executive directors – fees							
M Lilja (retired 14 October 2009)							21
	656				8	664	600
Total	2,903	3,092	9	221	166	6,391	6,056

Notes

<sup>(</sup>a) £180,000 of Dr FB Humer's remuneration in the year ended 30 June 2011 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.

<sup>(</sup>b) D Mahlan does not participate in the company's pension scheme and instead receives a monthly cash supplement equivalent to 40% of base pay. For the month of April 2011 (between opting out of future pension accrual and beginning to draw his pension under the company's general policy of 'flexible pension access', as described in the 'Remuneration Summary for the year ended 30 June 2011' section of this report), PS Walsh received a cash supplement in lieu of pension provision equivalent to 50% of base pay.

<sup>(</sup>c) Other benefits may include company car and driver, fuel, product allowance, financial counselling and medical

### 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 o  $\,$  ce during the year.

	UK option plan	30 June 2010 <sup>(b)</sup>	Granted	Exercised	30 June 2011 <sup>(c)</sup>	Option price in pence	Market price at date of exercise in pence	Date from which rst exercisable	Expiry date
D Mahlan	DSOP 1999 <sup>(d),(e)</sup>	49,576		(48,000)	1,576	815	1263	20 Sep 2008	20 Sep 2015
	DSOP 1999 <sup>(d),(e)</sup>	45,352		***************************************	45,352	930		19 Sep 2009	19 Sep 2016
	DSOP 1999 <sup>(d),(e)</sup>	37,560			37,560	1051		18 Sep 2010	18 Sep 2017
	DSOP 1999 <sup>(d),(e)</sup>	52,588			52,588	1035		16 Sep 2011	16 Sep 2018
	SESOP 2008 <sup>(e)</sup>	83,160	***************************************		83,160	952		17 Sep 2012	17 Sep 2019
	SESOP 2008	***************************************	199,652	***************************************	199,652	1080	***************************************	20 Sep 2013	20 Sep 2020
		268,236	199,652	(48,000)	419,888	***************************************	***************************************		
NC Rose	SESOP 1999	226,569			226,569	1051		18 Sep 2010	18 Sep 2017
	SESOP 2008 <sup>(a)</sup>	287,770			287,770	877		27 Oct 2011	27 Oct 2018
	SESOP 2008	265,099		***************************************	265,099	952		17 Sep 2012	17 Sep 2019
		779,438	_		779,438				
PS Walsh	SESOP 1999	270,553		(150,000)		759	1207	11 Oct 2005	11 Oct 2012
	SESOP 1999			(100,000)	20,553	759	1300	11 Oct 2005	11 Oct 2012
	SESOP 1999	455,521			455,521	815		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
	SAYE <sup>(e)</sup>	2,465		(2,465)	_	653	1147	01 Dec 2010	31 May 2011
	SESOP 2008 <sup>(a)</sup>	493,871			493,871	877		27 Oct 2011	27 Oct 2018
	SESOP 2008	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 <sup>(f)</sup>		1,617		1,617	941		01 Dec 2015	31 May 2016
		2,493,243	410,679	(252,465)	2,651,457				

### Notes

b) As at 1 October 2010 for D Mahlan.

The mid-market price for ordinary shares at 30 June 2011 was 1273 pence (2010 – 1060 pence; 15 August 2011 – 1189 pence). The highest mid-market price during the year was 1300 pence and the lowest mid-market price was 1032 pence.

<sup>(</sup>a) The performance condition in respect of this SESOP grant was measured after 30 June 2011. The compound annual growth in Diageo's EPS over the three years ended 30 June 2011 met the performance condition and 58% of these options will become exercisable in October 2011.

<sup>(</sup>c) As at 14 October 2010 for NC Rose. These awards were subject to pro-rating after the executive retired from the company to reflect time worked between the date of grant and the date of cessation of employment. The pro-rated balance will only vest to the extent that the performance condition is met at the end of the performance period.

<sup>(</sup>d) Options granted under the Diageo Executive Share Option Plan prior to the executive's appointment to the board.

<sup>(</sup>e) 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.

<sup>(</sup>f) Options granted under the UK savings-related share option scheme.

Directors' remuneration report 99 Corporate governance report

Directors' report

Board of directors and executive committee

### Directors' interests in PSP and TSR plan awards

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

	Performance period	Date of award	Interests at 30 June 2010 <sup>(g)</sup>		Awards made during year	Awards released during year			
			Target award <sup>(a)</sup>	Maximum award <sup>(b)</sup>	Maximum award <sup>(b)</sup>	Number of shares vested(c)	Number of shares lapsed	Market price at date of vesting in pence <sup>(d)</sup>	Interests at 30 June 2011 (e)(f)
D Mahlan <sup>(j)</sup>	2008 – 2011	27 Oct 08 <sup>(h),(k</sup>	27,056	27,056					27,056
	2009 – 2012	17 Sep 09 <sup>(k)</sup>	81,380	81,380					81,380
	2010 – 2013	20 Sep 10 <sup>(i)</sup>			167,964				167,964
			108,436	108,436	167,964				276,400
NC Rose	2007 – 2010	18 Sep 07	127,895	191,843			(127,895)	1091	
	2008 – 2011	27 Oct 08 <sup>(h)</sup>	194,321	194,321					194,321
	2009 – 2012	17 Sep 09	226,599	226,599					226,599
			548,815	612,763	_		(127,895)		420,920
PS Walsh	2007 – 2010	18 Sep 07	276,938	415,407		_	(276,938)	1091	_
	2008 – 2011	27 Oct 08 <sup>(h)</sup>	416,867	416,867					416,867
	2009 – 2012	17 Sep 09	486,111	486,111					486,111
	2010 – 2013	20 Sep 10 <sup>(i)</sup>			430,172				430,172
			1,179,916	1,318,385	430,172		(276,938)		1,333,150

#### Notes

(b) This number reflects the maximum

<sup>(</sup>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, 25% under the PSP and 35% under the TSR plan would be released for achieving position eight in the peer group. No shares would be released for achievement of position nine or below.

Notes

- (a) Whilst both NC Rose and PS Walsh accrued pension in the year as a result of additional months of pensionable service, this was offset by the early retirement reduction factors applied to the pension in accordance with the Rules of the UK Scheme and the fact that both directors commuted part of their pension for a tax free cash lump sum.
- (b) Part of the pension NC Rose receives is provided from the unfunded non-registered arrangement. As at 30 June 2011, the percentage of pension provided from this arrangement was 84% (2010 79%). PS Walsh does not receive any pension from this arrangement. In addition NC Rose received a tax free payment of £223,777 in respect of his benefits from the funded non-registered retirement benefits scheme.
- (c) The change in the transfer values during the year attributable to additional pensionable service and pay rises was an increase of £203,000 for NC Rose and £593,000 for PS Walsh. The change in the transfer values during the year as a result of both directors starting to receive their pension was an increase of £1,726,000 for NC Rose and an increase of £747,000 for PS Walsh. These increases reflect the change in the calculation method used when a member retires and the impact of the early retirement terms offered under the UK Scheme. These increases have been offset by the pension payments received to date and the fact both directors commuted part of their pension for a tax free cash lump sum resulting in a lower residual pension. The remainder of the change in the transfer values was mainly attributable to changes in market conditions and interest earned on the transfer value and changes in index-linked gilt markets over the year.
- (d) During the year, NC Rose made pension contributions of £20,190 (2010 £40,380) and PS Walsh made pension contributions of £52,668 (2010 £69,300).

# Diageo Annual Report 201

### Additional information

### Emoluments and share interests of senior management

The total emoluments for the year ended 30 June 2011 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 £21,636,952 (2010 – £21,116,825). The termination payments included in the total emoluments will be paid in September 2011 to two executive committee members and are made with respect to pay in lieu of notice and compensation for loss of 9408>22 90618

Other than disclosed in this report, no director had any interest, bene cial or non-bene cial, 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 signi cant to the business of the group and which was e ected by any member of the group during the nancial year, or which having been e ected during an earlier nancial 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 relative or spouse thereof, was a party. There is no signi cant outstanding indebtedness to the company from any directors

### Governance

Board of directors and executive committee

83 Directors' remuneration report

Corporate governance report

108 Directors' report

### Statutory and audit requirements

This report was approved by the board of directors, on 23 August 2011 and was signed on its behalf by Lord Hollick of Notting Hill 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.

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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 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 2011', 'Long term incentive plans', 'Directors' share options over ordinary shares', 'Directors' interests in PSP and TSR plan awards' and 'Executive directors' pension bene ts'. In addition, the following sections form part of the audited financial statements: 'Share and other interests' and 'Key management personnel related party transactions'.

Terms de ned in this remuneration report are used solely herein.

### De nitions

AGM – annual general meeting of shareholders. 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 nance charges.

Normal retirement age – for pension purposes this is age 62. 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 profit, calculated on a constant currency basis excluding the impact of exceptional items, acquisitions, in the year in which they arise, and disposals, divided by organic net sales.

**RPI** – the retail prices index is a UK government index that measures changes in cost of living.

**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.

### 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 2011.

Boards of directors are responsible for the governance of their companies, that is to say, the way in which companies are directed and controlled. The responsibilities of the board include setting the company's strategic aims and its values, providing the leadership to put them into e ect, 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 continue to believe that Diageo has a board with the appropriate balance of diverse skills, experience, independence and knowledge of the company to enable them to discharge these responsibilities e ectively. The description in this report of Diageo's corporate governance structures and procedures and of the work of the board and the executive committee is intended to give a sense of how this is approached.

The principal corporate governance rules applying to UK companies listed on the London Stock Exchange (LSE) for the year ended 30 June 2011 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 speci cally 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 are applied is described within this corporate governance report.



PD Tunnacli e Company Secretary

Directors'

report

remuneration

Corporate governance report

Directors' report

Board of directors and

executive committee

# Diageo Annual Report 201

### **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 signicant 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 bene cial 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 a UK non-executive directorship in Unilever PLC and a US non-executive directorship in FedEx Corporation. 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 and that the time commitment is not onerous as the meetings can be combined with other business trips to the United States. The chief nancial o cer, D Mahlan currently holds no non-executive directorships.

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 sucient 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 in uential individuals from a range of industries and countries. Their 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 the USA, which incorporated a specific North American business focus and involved visits to distributors and customers. In addition, an annual strategy conference with the full executive committee was held o site at which the group's strategy was reviewed in depth.

When directors are unable to attend a meeting, they are advised of the matters to be discussed and take 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 a airs with reference to the formal schedule of matters reserved for the board for decision. The schedule was last revised in June 2009.

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 citizenship, ethics and the environment; and pensions.

The Act sets out directors' general duties concerning con icts of interest and related matters. The board have agreed an approach and adopted guidelines for dealing with con icts of interest and have added responsibility for authorising con icts of interest to the schedule of matters reserved for the board. The board con rmed that it was aware of no situations that may or did give rise to con icts 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 notications of conicts 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 a airs.

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 bene to fits 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 a ecting 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 dierent aspects of the business.

In order to full I 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.

101

### 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 director of technical accounting

Directors'

report

remuneration

Corporate governance report

Directors' report

Board of directors and

executive committee

Diageo Annual Report 201

The audit committee assessed the ongoing enectiveness of the external auditor and audit process on the basis of meetings and a questionnaire-based internal review with nance, global audit and risk stand their 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 contraction 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 2011. 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 related and non-audit related services are analysed in note 3 (c) to the 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 and tax advice. The auditor was considered to be best placed to provide these services and was the provider that o ered 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 executive or non-executive directors, having regard to the balance and structure of the board and the required blend of skills and experience.

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 speci ed 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 reappointment 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 o ce. 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; the consideration of potential non-executive directors; and succession to the role of chief financial officer.

In respect of the appointment of Lord Davies to the board during the year, the recruitment process included the development of a candidate prole 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.

Diageo supports diversity within its board of directors, including gender diversity. Currently there are four female directors, out of a total of eleven 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 speciegoal 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 rejecting 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 and is making good progress towards this objective with 27% currently lling the 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 us 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 condent 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.

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: for the year ended 30 June 2011, North America, Europe, International and Asia Pacific markets, global supply and global functions. With e ect from 1 July 2011, the structure has been revised, as set out in the 'Business description' section of this annual report. 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. It met, fully, four times during the year, and spent most of its time discussing strategy, people, performance (including brands) and governance. Meetings were held in the USA, Russia, the UK and Hungary. 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.

### Filings assurance committee

Chaired by the chief nancial o cer 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 lings assurance committee, with the participation of the chief executive and chief nancial o cer, carried out an evaluation of the e ectiveness of the design and operation of disclosure controls and procedures. These are de ned as those controls and procedures designed to ensure that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarised and reported within speci ed time periods. As of the date of the evaluation, the chief executive and the chief nancial o cer concluded that the design and operation of these disclosure controls and procedures were e ective to ensure that information required to be disclosed in the reports that the company les or submits under the Exchange Act is accumulated and communicated to the manag

Diageo Annual Report 201

In addition, business units are required to self-assess the e ectiveness 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 mitigaNJEF

#### Governance

81 Board of directors and executive committee

84 Directors' remuneration report

Corporate governance report

108 Directors' report 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 nancial o cer, regional presidents and other identi able 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/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 con dence, 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 certi cation requirement for all management level employees to con rm compliance with the code of business conduct and to identify areas of possible non-compliance to the global compliance and ethics director. With the UK Bribery Act coming into force on 1 July 2011, the compliance and ethics director, together with group legal, reviewed the company's compliance and ethics programme and as a result of the review, no material changes to the compliance and ethics programme or planned workstreams were proposed.

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 nancial of cer.

The chief executive and chief nancial o cer 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 chief executive and chief nancial o cer are normally also present and available to take questions and the chairman reports on the meeting to the board.

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.

For the year ended 30 June 2011, 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 notication through the post, shareholders may elect to receive email notication that the documents are available to be accessed on the company's website. Shareholders can also choose to receive email notication 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 company also holds an annual presentation to the UK Shareholders' Association.

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. 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 million (2010 – £24.9 million). UK group companies made donations of £10.5 million (2010 – £12.0 million) to charitable organisations including £1.1 million (2010 – £1.1 million) to the Diageo Foundation and £7.7 million (2010 – £7.4 million) to the Thalidomide Trust. In the rest of the world, group companies made charitable donations of £17.5 million (2010 – £12.9 million) including £3.0 million to the Thalidomide Foundation Ltd in Australia (2010 – £nil).

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 £0.6 million during the year (2010 – £0.5 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 have not been calculated, as Diageo plc had no material trade creditors at 30 June 2011. The company's invoices for goods and services are settled by subsidiaries acting on behalf of the company.

### Going concern

The group's business activities together with signicant 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 above in the 'Business review' section of this annual report.

The directors con rm 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 nancial statements.

### Management's report on internal control over nancial reporting

Management, under the supervision of the chief executive and chief nancial o cer, is responsible for establishing and maintaining adequate control over the group's nancial reporting. Diageo's internal control over nancial 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 nancial 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 e ect on the nancial statements.

Management has assessed the e ectiveness 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 2011, internal control over nancial reporting was e ective.

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 e ectiveness 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 nancial reporting that have materially a ected or are reasonably likely to materially a ect the e ectiveness of internal control over nancial reporting.

KPMG Audit Plc, an independent registered public accounting rm, who also audit the group's consolidated nancial statements, has audited the e ectiveness of the group's internal control over nancial reporting, and has issued an unquali ed report thereon, which will be included in the company's Form 20-F filed with the SEC.

Directors'

report

remuneration

Corporate governance report

Directors' report

Board of directors and

executive committee

# Diageo Annual Report 2011

### Directors' responsibilities in respect of the annual report and nancial 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 nancial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company nancial statements for each nancial year. Under that law they are required to prepare the group financial statements in accordance with IFRS as adopted by 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 nancial 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 nancial 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 nancial statements giving a true and fair view are references to their achieving a fair presentation.

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

In preparing each of the group and parent company nancial 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 by the EU and 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 succient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the nancial position of the parent company and enable them to ensure that its nancial statements comply with the Companies Act 2006 and, as regard to group consolidated accounts, 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.

In addition, the directors are responsible for the maintenance and integrity of the corporate and nancial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of nancial statements may dier from legislation in other jurisdictions.

### 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, con rms that to the best of his or her knowledge:

- the consolidated financial statements contained in the Annual Report for the year ended 30 June 2011, 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, nancial 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
  2011 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 24 August 2011.

### 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 signi cant ways in which its corporate governance practices di er from those followed by US companies under NYSE listing standards.

Diageo believes the following to be the signi cant areas in which there are dierences 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 nonexecutive directors, as determined by a matively 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 8 of Diageo's 11 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.

Performance summary

Directors' attendance record at the annual general meeting, board meetings and board committee meetings, for the year ended 30 June 2011 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.

	 ***************************************	***************************************	 ***************************************	

Governance

81 Board of directors and executive committee

84 Directors' remuneration report

99 Corporate governance report

108 Directors' report The directors have pleasure in submitting their Annual Report for the year ended 30 June 2011.

#### **Annual General Meeting**

The AGM will be held at The Institution of Engineering and Technology, Savoy Place, London WC2R 0BL at 2.30pm on Wednesday, 19 October 2011.

#### Dividends

Diageo paid an interim dividend of 15.50 pence per ordinary share on 6 April 2011. The directors recommend a final dividend of 24.90 pence per ordinary share. Subject to approval by shareholders, the final dividend will be paid on 24 October 2011 to ordinary shareholders on the register on 9 September 2011. Payment to US ADR holders will be made on 28 October 2011. 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 3 October 2011.

#### **Directors**

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

In accordance with the UK Corporate Governance Code, all the directors retire by rotation at the AGM and o er themselves for re-election, with the exception of Lord Hollick and P Walker who will retire immediately after the AGM and will therefore not seek 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 2011 are given in the directors' remuneration report above.

#### **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 o ce at the date of approval of this directors' report conrm 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 the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's

#### 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.

#### Signi cantagreements – change of control

The following signi cantagreements 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 CV (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.

#### 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 for loss of o ce
Employment policies	Business description – Premium drinks – Employees
Events since 30 June 2011	Financial statements – note 35 Post balance sheet events
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 – Premium drinks – 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 2011 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 24 August 2011 and signed on its behalf by PD Tunnacli e, the company secretary.



## Independent auditor's report to the members of Diageo plc

We have audited the consolidated nancial statements of Diageo plc for the year ended 30 June 2011 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated balance sheet, the consolidated statement of changes in equity, the consolidated statement of cash, ows and the related notes. The nancial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and in respect of the separate opinion in relation to IFRS as issued by the International Accounting Standards Board (IASB), on terms that have been agreed with the company. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

#### Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement set out in the corporate governance report, the directors are responsible for the preparation of the consolidated. nancial statements and for being satis ed that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the consolidated. nancial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

#### Scope of the audit of the nancial statements

A description of the scope of an audit of nancial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

#### Opinion on nancial statements

In our opinion the consolidated nancial statements:

- give a true and fair view of the state of the group's affairs as at 30 June 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- · have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

#### Separate opinion in relation to IFRS as issued by the IASB

As explained in the accounting policies set out in the consolidated. nancial statements, the group, in addition to complying with its legal obligation to apply IFRS as adopted by the EU, has also applied IFRS as issued by the IASB. In our opinion, the consolidated nancial statements comply with IFRS as issued by the IASB.

#### Opinion on other matter prescribed by the Companies Act 2006

In our opinion:

• the information given in the directors' report for the financial year for which the consolidated financial statements are prepared is consistent with the consolidated financial statements; and

#### Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, set out in the corporate governance report, in relation to going concern; and
- the part of the corporate governance report relating to the company's compliance with the nine provisions of the UK Corporate Governance Code speçi ed for our review.

#### Other matter

We have reported separately on the parent company\_nancial statements of Diageo plc for the year ended 30 June 2011 and on the information in the directors' remuneration report that is described as having been audited.

#### Ian Starkey (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor

#### **Chartered Accountants**

KPMG Audit Plc 15 Canada Square London E14 5GL

# Diageo Annual Report 2011

### Consolidated income statement

N	otes	Year ended 30 June 2011 £ million	Year ended 30 June 2010 £ million	Year ended 30 June 2009 £ million
Sales	2	13,232	12,958	12,283
Excise duties	3	(3,296)	(3,178)	(2,972)
Net sales	2	9,936	9,780	9,311
Cost of sales	3,5	(4,010)	(4,099)	(3,893)
Gross pro t		5,926	5,681	5,418
Marketing	3	(1,538)	(1,419)	(1,327)
Other operating expenses	3,5	(1,793)	(1,688)	(1,673)
Operating pro t	2	2,595	2,574	2,418
Sale of businesses	5	(14)	(15)	-
Interest receivable	6	278	469	252
Interest payable	6	(647)	(844)	(768)
Other nance income	6	_	4	2
Other nance charges	6	(28)	(91)	(78)
Share of associates' pro ts after tax	7	176	142	164
Pro t before taxation		2,360	2,239	1,990
Taxation	8	(343)	(477)	(286)
Pro t from continuing operations		2,017	1,762	1,704
Discontinued operations	9		(19)	2
Pro t for the year		2,017	1,743	1,706
Attributable to:		<u></u>		
Equity shareholders of the parent company		1,900	1,629	1,605
Non-controlling interests		117	114	101
	_	2,017	1,743	1,706
Basic earnings per share	10			
Continuing operations		76.2p	66.3p	64.5p
Discontinued operations			q(8.0)	0.1p
		76.2p	65.5p	64.6p
Diluted earnings per share	10	***************************************	***************************************	***************************************
Continuing operations		76.0p	66.2p	64.3p
Discontinued operations			q(8.0)	0.1p
		76.0p	65.4p	64.4p

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

Auditor's report in respect of the Group 112

Financial statements

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

Accounting policies of the group

121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

1/6 Accounting policies of the company

178 Notes to the company nancial statements

# Consolidated statement of comprehensive income

N	otes	30 June 2011 £ million	30 June 2010 £ million	30 June 2009 £ million
Other comprehensive income				
Exchange differences on translation of foreign operations excluding borrowings		***************************************		
– group		(133)	494	684
– associates and non-controlling interests		93	37	246
Exchange differences on borrowings and derivative net investment hedges		(51)	(429)	(773)
Effective portion of changes in fair value of cash flow hedges				
– gains/(losses) taken to other comprehensive income		25	(27)	90
- transferred to income statement		56	(26)	(71)
Hyperin, ation adjustment		6	25	_
Fair value gains on available-for-sale investments		_	_	4
Net actuarial gain/(loss) on post employment plans	4	272	8	(1,007)
Tax on other comprehensive income	27	(65)	(16)	254
Other comprehensive income, net of tax, for the year		203	66	(573)
Pro t for the year		2,017		

Financial statements

112 Consolidated income statement

Auditor's report in respect of the Group

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

121 Notes to the consolidated nancial statements

Accounting policies of the group

Auditor's report in respect of the company

Accounting policies of the company

Company balance sheet

Notes to the company nancial statements

# Diageo Annual Report 2011

### Consolidated balance sheet

			30 June 2011		30 June 2010
	Notes	£ million	£ million	£ million	£ million
Non-current assets		***************************************			***************************************
Intangible assets	11	6,545		6,726	***************************************
Property, plant and equipment	12	2,552		2,404	***************************************
Biological assets	13	33		30	
Investments in associates	14	2,385		2,060	
Other investments	16	102		117	
Other receivables	18	118		115	
Other_ nancial assets	22	305		472	
Deferred tax assets	26	516		529	
Post employment bene t assets	4	60		49	
			12,616		12,502
Current assets					
Inventories	17	3,473		3,281	
Trade and other receivables	18	1,977		2,008	
Assets held for sale	19	38		112	
Other_nancial assets	22	89		98	
Cash and cash equivalents	20	1,584		1,453	
			7,161		6,952
Total assets			19,777		19,454
Current liabilities					
Borrowings and bank overdrafts	21	(1,447)		(587)	
Other nancial liabilities	22	(90)		(186)	
Trade and other payables	24	(2,838)		(2,615)	
Liabilities held for sale	19	(10)		(10)	-
Corporate tax payable	8	(381)	***************************************	(391)	
Provisions	25	(149)	***************************************	(155)	***************************************
			(4,915)		(3,944)
Non-current liabilities	•	***************************************	***************************************	***************************************	***************************************
Borrowings	21	(6,748)	***************************************	(8,177)	***************************************
Other_nancial liabilities	22	(147)	***************************************	(155)	***************************************
Other payables	24	(41)	•••••••••••••••••••••••••••••••••••••••	(76)	
Provisions	25	(266)	•••••••••••••••••••••••••••••••••••••••	(318)	
Deferred tax liabilities	26	(777)	***************************************	(744)	***************************************
Post employment bene t liabilities	4	(898)	***************************************	(1,254)	***************************************
			(8,877)		(10,724)
Total liabilities		***************************************	(13,792)	***************************************	(14,668)
Net assets		***************************************	5,985	***************************************	4,786
Equity		***************************************		•	
Called up share capital	28	797	***************************************	797	***************************************
Share premium	······································	1,343	***************************************	1,342	***************************************
Other reserves		3,300	***************************************	3,245	***************************************
Retained de cit		(195)	***************************************	(1,377)	***************************************
Equity attributable to equity shareholders of the parent company			5,245		4,007
Non-controlling interests			740		779
Total equity		***************************************	5,985		4,786

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

These consolidated nancial statements were approved by a duly appointed and authorised committee of the board of directors on 24 August 2011 and were signed on its behalf by PS Walsh and D Mahlan, directors.

# Consolidated statement of changes in equity

		Retained earnings/(de cit)									
	Share capital £ million	Share premium £ million	Capital redemption reserve £ million	Fair value, hedging and exchange reserve £ million	Own shares £ million	Other retained earnings £ million	Total £ million	Equity attributable to parent company shareholders £ million	Non- controlling interests £ million	Total equity £ million	
At 30 June 2008	816	1,342	3,127	34	(2,559)	703	(1,856)	3,463	670	4,133	
Total comprehensive income	_	_	_	99	_	841	841	940	193	1,133	
Employee share schemes	_	_	_	_	33	(8)	25	25	_	25	
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	_	_	_	_	_	(6)	(6)	(6)	_	(6)	
Own shares repurchased	(19)	_	19	_	184	(601)	(417)	(417)	_	(417)	
Dividends paid	_	_	_	_	_	(870)	(870)	(870)	(98)	(968)	
Acquisitions	_	_	_	_	_	_	_	_	(2)	(2)	
Acquisition adjustment	_	_	_	_	_	_	_	_	(58)	(58)	
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	
Dividends paid	_			_	_	(973)	(973)	(973)	(112)	(1,085)	
Acquisitions	_			_	_	_	_	_	20	20	
At 30 June 2011	797	1,343	3,146	154	(2,257)	2,062	(195)	5,245	740	5,985	

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

Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

Auditor's report in respect of the company

Accounting policies of the company

Notes to the company nancial statements

Company balance sheet

116

121 Notes to the consolidated nancial statements

### Consolidated statement of cash ows

	Year ended	30 June 2011	Year ended	30 June 2010	Year ended	30 June 2009
Notes	£ million	£ millior				
Cash						
					***************************************	
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Diageo Annus

### Accounting policies of the group

#### Basis of preparation

The consolidated 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. No reconciliation to US GAAP is included in the invariant statements in accordance with a rule adopted by the US Securities and Exchange Commission accepting. In nancial statements from foreign private issuers prepared in accordance with IFRS as issued by the IASB without that reconciliation.

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

The preparation of nancial 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.

#### Basis for preparation of nancial 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 nancial position of the group, its cash, ows, borrowings, borrowing facilities, commitments and the group's policies to manage its nancial risk are described in the Business review under 'Liquidity and capital resources', 'Contractual obligations' and 'Risk management'. Further information is disclosed in notes 21, 22 and 23 to the consolidated nancial statements.

At 30 June 2011 the group has cash and cash equivalents of £1,584 million and committed bank facilities of £2,174 million, with borrowings and bank overdrafts due within one year of £1,447 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. nancial 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 in ancial statements.

#### **Business combination**

The consolidated nancial 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 nancial policies of the subsidiary so as to obtain bene ts from its activities.

On the acquisition of a business, or of an interest in an associate or joint venture, fair values, rejecting conditions at the date of acquisition, are attributed to the net assets including identiable intangible assets and contingent liabilities acquired. Adjustments to fair values include those made to bring accounting policies into line with those of the group.

#### 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 speçied 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 operating pro t 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 bene t.

#### Share-based payments - employee bene ts

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 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 prot immediately. Shares of Diageo plc held by the company for the purpose of full lling obligations in respect of various employee share plans around the group are deducted from equity in the consolidated balance sheet. Any surplus or decit 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 bene ts

The group's principal pension funds are dened bene t plans. In addition, the group has dened contribution plans, unfunded post employment medical bene t liabilities and other unfunded dened bene t post employment liabilities. For dened bene t plans, the amount charged in the income statement is the cost of accruing pension bene ts promised to employees over the year, plus any fully vested bene t 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 difference between the fair value of the plans' assets and the present value of the plans' liabilities is disclosed as an asset or liability on the consolidated balance sheet. 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 de ned contribution plans are charged to operating pro t as incurred.

#### Capitalisation of nance costs

Finance costs 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 nance 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 nancial statements or on the face of the consolidated income statement.

#### Foreign currencies

Items included in the annotal 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 nancial statements are presented in sterling, which is the functional currency of the parent company.

The income statements and cash, ows 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 hypering ationary economies are adjusted to reject the changes in the purchasing power of the local market 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 forward, the impact of hedging is recognised, where permitted, under hedge accounting (refer to accounting policy for derivative nancial instruments).

#### Brands, goodwill and other intangible assets

When the cost of an acquisition exceeds the fair values attributable to the group's share of the net assets acquired, the difference is treated as purchased goodwill. Goodwill arising on acquisitions prior to 1 July 1998 was eliminated against reserves, and this goodwill has not been (n 152 (\$ 9046 \$ 9045 \$ 7 9054 \$ 9001 \$ 5 9055 \$ 9049 \$ 4 9046 \$ 9047 \$ 9042 \$ 9040 \$ 5 (2 904a \$ 5 (2 90413) 33 (.75 9055 \$ 9055 \$ 9055 \$ 9050 \$ 9040 \$

### Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

#### 117 Accounting policies of the group

Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

Notes to the company nancial statements

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 an anace lease. Assets held under nance 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 nancial 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 business is 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, ow 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 signicant injurence. 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 project. Investments in associates are reviewed for impairment at least annually or 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 value in use calculated as the present value of the group's share of the associate's future cash, ows or its fair market value. 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 costs. Cost is calculated on an actual usage basis for maturing inventories and on a rst in, rst out basis for other inventories.

#### Assets held for sale

Non-current assets and disposal groups are classied 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 classied as held for sale are measured at the lower of the fair value less selling costs and net book value.

#### Financial assets

*Trade receivables* are non-interest bearing and are stated at their nominal amount which is usually the original invoiced amount less any provisions made for bad and doubtful receivables. Estimated irrecoverable amounts are based on the ageing of the receivable balances and historical experience. Individual trade receivables are provided against when management deems them not to be fully collectable.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignic cantrisk 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 nancial assets are non-derivatives that are either designated in this category or not classie ed 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

**Borrowings** are initially measured at cost, which is equal to fair value at inception, and are subsequently measured at amortised cost. Any difference between the proceeds, net of transaction costs, and the settlement or redemption amount is recognised over the term of the borrowing using the effective interest rate method.

The fair value adjustments for all loans designated as hedged items in a fair value hedge are disclosed, as a netagor gure, separately. The fair value adjustment is calculated using a discounted cash, ow technique based on market data applied consistently for similar types of instruments.

Trade payables are non-interest bearing and are stated at their nominal value.

### Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

# Accounting policies of the group

# Notes to the consolidated nancial statements

Auditor's report in respect of the company

Company balance sheet

Accounting policies of the company

178 Notes to the company\_ nancial statements

#### Derivative nancial instruments

Derivative nancial instruments are carried at fair value that is calculated using a discounted cash, ow 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 management objective and strategy for undertaking the hedge transaction. This process includes linking all derivatives designated as hedges to specie cassets and liabilities or to specie 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 specient special crisk and qualities 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, ow hedges are used to hedge the foreign currency risk of highly probable future foreign currency cash, ows, 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 exchange 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 out, ow of economic bene 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 reject the current best estimate.

#### Taxation

Current tax is based on taxable prot 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.

# Notes to the consolidated nancial statements

#### 1. New accounting policies

(a) Adopted by the group The following accounting standards, amendments and interpretations, issued by the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC), are effective for the first time in the current in nancial year and have been adopted by the group with no impact on its consolidated results of innancial position:

Amendment to IAS 1 - Classi cation of the liability component of a convertible instrument

Amendment to IAS 7 - Classi cation of expenditures on unrecognised assets

Amendment to IAS 17 – Classi cation of leases of land and buildings

Amendment to IAS 27 – Consolidated and separate nancial statements

Amendment to IAS 32 – Financial instruments: presentation – Classi cation of rights issues

Amendment to IAS 36 - Cash generating units

Amendments to IAS 39 – Financial instruments: recognition and measurement

Amendment to IFRS 2 – Group cash-settled share-based payment transactions

Amendments to IFRS 3 – Business combinations

Amendment to IFRS 5 – Non-current assets held for sale and discontinued operations

Amendment to IFRS 8 – Segment information with respect to total assets

IFRIC 19 – Extinguishing nancial liabilities with equity instruments

(b) Not adopted by the group The following standards, amendments and interpretations, issued by the IASB or IFRIC and endorsed by the EU, unless stated otherwise, have not yet been adopted by the group. Unless stated otherwise, the standards or interpretations do not have to be adopted by the group until the year ending 30 June 2014 though the group may determine to adopt them earlier. The group does not currently believe the adoption of these standards or interpretations would have a material impact on the consolidated results of an ancial position of the group unless stated otherwise.

IFRS 9 – Financial instruments (not yet endorsed by the EU) removes the multiple classication and measurement models for in nancial assets required by IAS 39 and introduces a model that has only two classication categories: amortised cost and fair value. Classication is driven by the business model for managing the innancial assets and the contractual cash, low characteristics of the innancial assets. The accounting and presentation for innancial liabilities and for derecognising innancial instruments is relocated from IAS 39 without any signicant changes. The group is currently assessing the impact this standard would have on its consolidated results and innancial position of the group.

IFRS 10 – Consolidated nancial statements (not yet endorsed by the EU) replaces the guidance of control and consolidation in IAS 27 and SIC - 12 – Consolidation – special purpose entities. The core principle that a consolidated 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 (not yet endorsed by the EU) 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 protor net assets.

IFRS 12 – Disclosure of interests in other entities (not yet endorsed by the EU) requires enhanced disclosures of the nature, risks and effects associated with the group's interests in subsidiaries, associates, joint arrangements and unconsolidated structured entities.

IFRS 13 – Fair value measurement (not yet endorsed by the EU) explains how to measure fair value and aims to enhance fair value disclosures. The standard does not change the measurement of fair value but codi es it in one place.

Amendments to IAS 19 – Employee bene ts (not yet endorsed by the EU) changes a number of disclosure requirements for post employment arrangements and restricts the options currently available on how to account for de ned bene t pension plans. The most signicant 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 expects this change will result in an increase in nance costs but will not impact the group's net assets.

Amendment to IAS 1 – Presentation of nancial statements (effective for Diageo in the year ending 30 June 2012)

Limited scope amendment to IAS 12 – Income taxes (not yet endorsed by the EU)

IAS 24 (Revised) – Related party disclosures (effective for Diageo in the year ending 30 June 2012)

IAS 27 (Revised) – Separate nancial statements (not yet endorsed by the EU)

IAS 28 (Revised) – Associates and joint ventures (not yet endorsed by the EU)

Amendment to IAS 34 – Interim nancial reporting (effective for Diageo in the year ending 30 June 2012)

Amendment to IFRS 7 – Disclosure of the nancial e ect of the extent to which collateral and other credit enhancements mitigate credit risk (effective for Diageo in the year ending 30 June 2012)

# Auditor's report in respect of the Group 112 Consolidated

Financial statements

Consolidated income statement 113

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

117 Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

178 Notes to the company nancial statements

#### 1. New accounting policies continued

Amendment to IFRS 7 – Transfers of nancial assets (effective for Diageo in the year ending 30 June 2012)

Amendment to IFRIC 13 – Customer loyalty programmes (effective for Diageo in the year ending 30 June 2012)

Amendment to IFRIC 14 – IAS 19: The limit on de ned bene tassets, minimum funding requirements and their interaction (effective for Diageo in the year ending 30 June 2012)

#### 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, 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.

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 internal reporting provided to the chief operating decision maker, which has been identiful ed 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, International and Asia Paçi c. 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, in order to provide additional reconciling information, been allocated to the geographical segments. This gives an additional basis of presenting the group's performance and results on the basis of the location of third party customers. Corporate revenues and costs are in respect of central costs, including, nance, 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 prot before exceptional items is reported at budgeted exchange rates in line with internal reporting. For management reporting purposes the group measures the current year at, and restates the prior year net sales and operating prot to, the current year's budgeted exchange rates. These exchange rates are set prior to the inancial year as part of the inancial 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 2010 and 30 June 2009, respectively.

In addition, for management reporting purposes Diageo excludes the impact on net sales and operating pro to facquisitions 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 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	r the consol	idated inco	mestateme	ent – contin	uing opera	tions			
	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>
	<u></u>	<u></u>	<u> </u>	<u></u>	<u></u>				
	***************************************			***************************************	***************************************		***************************************		

Financial statements

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet
115
Consolidated statement of changes in equity
116
Consolidated statement of cash, ows

Accounting policies of the group

Notes to the consolidated nancial statements

Auditor's report in respect of the company 175 Company balance sheet

Accounting policies of the company

Notes to the company nancial statements

# Diageo Annual Report 201

#### 2. Segmental information continued

z. segmentariniorm	North America £ million	Europe £ million	Inter- national £ million	Asia Paci c £ million	Global Supply £ million	Eliminate inter- segment sales £ million	Total operating segments £ million	Corporate and other £ million	Total £ million
2010									
Sales	3,853	4,371	3,222	1,442	2,627	(2,627)	12,888	70	12,958
Net sales									
At budgeted exchange rates*	2,980	2,510	2,551	923	2,561	(2,460)	9,065	68	9,133
Acquisitions and disposals	47	9	7	_	_	_	63	_	63
Global Supply allocation	18	55	16	12	(101)	_	_	_	_
Retranslation to actual exchange rates	261	185	53	83	167	(167)	582	2	584
Net sales	3,306	2,759	2,627	1,018	2,627	(2,627)	9,710	70	9,780
Operating pro t/(loss)									
At budgeted exchange rates*	1,039	756	800	170	114	_	2,879	(180)	2,699
Acquisitions and disposals	(3)	1	(5)	(7)	_	_	(14)	_	(14)
Global Supply allocation	56	55	5	(2)	(114)	_	_	_	_
Retranslation to actual exchange rates	78	47	(29)	15			111	(45)	66
Operating pro t/(loss) before exceptional items	1,170	859	771	176	_	_	2,976	(225)	2,751
Exceptional items	(38)	(53)	(5)	(30)	(39)		(165)	(12)	(177)
Operating pro t/(loss)	1,132	806	766	146	(39)		2,811	(237)	2,574
Sale of businesses	***************************************	***************************************	***************************************	***************************************		***************************************	***************************************	***************************************	(15)
Net_ nance charges									(462)
Share of associates' pro ts after tax									
– Moët Hennessy									134
<ul> <li>Other associates</li> </ul>									8
Pro t before taxation			<u></u>						2,239
2009	2.050	4 270	2.002	12/0	2.252	(2.252)	12 200		10.000
Sales	3,858	4,279	2,803	1,268	2,353	(2,353)	12,208	75	12,283
Net sales	2.525	2.40/	10/4	0.21	0.175	(2.0/7)	7.024	70	7.00/
At budgeted exchange rates*	2,535	2,406	1,964	821	2,175	(2,067)	7,834	72	7,906
Acquisitions and disposals Global Supply allocation	129 22	5 57	3 15	14	(100)		138		138
Retranslation to actual exchange rates	604	282	304	74	(108)	(286)	1,264	3	1,267
Net sales	3,290	2,750	2,286	910	2,353	(2,353)	9,236	75	9,311
Operating pro t/(loss)	3,270	2,730				(2,555)	7,230		7,511
At budgeted exchange rates*	885	780	598	170	13		2,446	(139)	2,307
Acquisitions and disposals	46	(2)		-	-		44	(2)	42
Global Supply allocation	22	3	(3)	(9)	(13)				
Retranslation to actual					(10)	***************************************	***************************************	***************************************	***************************************
exchange rates	185	72	54	(2)			309	(70)	239
Operating pro t/(loss) before exceptional items	1,138	853	649	159			2,799	(211)	2,588
Exceptional items	(23)	(52)	(22)	(35)	(17)		(149)	(21)	(170)
Operating pro t/(loss)	1,115	801	627	124	(17)		2,650	(232)	2,418
Net nance charges Share of associates' pro ts after tax									(592)
– Moët Hennessy									151
– Other associates									13
Pro t before taxation									1,990

 $<sup>^{\</sup>star}\,\text{These items represent the IFRS\,8\,performance\,measures for the geographical\,and\,Global\,Supply\,segments}.$ 

<sup>(</sup>i) The segmental analysis of sales and operating prot/(loss) is based on the location of the third party customers.

<sup>(</sup>ii) The net sales, gures 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.

<sup>(</sup>iii) The group's net nance charges are managed centrally and are not attributable to individual operating segments.

(b) Other segmental information	١
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North America £ million	Europe £ million	Inter- national £ million	Asia Paci c £ million	Global Supply £ million	Corporate and other £ million	Total £ million
2	18	137	24	176	62	419
(3)	(16)	(76)	(22)	(129)	(40)	(286)
-	_	-	_	(27)	-	(27)
-	(39)	_	_	_	_	(39)
1	16	91	14	193	59	374
(3)	(16)	(68)	(20)	(143)	(41)	(291)
_	_	_	_	(44)	(2)	(46)
_	(35)	_	_	_	_	(35)
18	20	98	11	183	25	355
(28)	(17)	(70)	(18)	(113)	(36)	(282)
		(3)		(15)		(18)
	America £ million  2 (3)	America Europe £ million  2 18 (3) (16) (39)  1 16 (3) (16) (35) (35)	America £ million         Europe £ million         national £ million           2         18         137           (3)         (16)         (76)           -         -         -           -         (39)         -           1         16         91           (3)         (16)         (68)           -         -         -           -         (35)         -           18         20         98           (28)         (17)         (70)	America £ million         Europe £ million         national £ million         Paci c £ million           2         18         137         24           (3)         (16)         (76)         (22)           -         -         -         -           -         (39)         -         -           1         16         91         14           (3)         (16)         (68)         (20)           -         -         -         -           -         (35)         -         -           -         (35)         -         -           18         20         98         11           (28)         (17)         (70)         (18)	America £ million         Europe £ million         national £ million         Paci c £ million         Supply £ million           2         18         137         24         176           (3)         (16)         (76)         (22)         (129)           -         -         -         -         (27)           -         (39)         -         -         -           1         16         91         14         193           (3)         (16)         (68)         (20)         (143)           -         -         -         -         -           -         (35)         -         -         -           -         -         -         -         -           18         20         98         11         183           (28)         (17)         (70)         (18)         (113)	America £ million         Europe £ million         national £ million         Paci c £ million         Supply £ million         and other £ million           2         18         137         24         176         62           (3)         (16)         (76)         (22)         (129)         (40)           -         -         -         -         (27)         -           -         (39)         -         -         -         -           1         16         91         14         193         59           (3)         (16)         (68)         (20)         (143)         (41)           -         -         -         -         -         -           -         (35)         -         -         -         -           18         20         98         11         183         25           (28)         (17)         (70)         (18)         (113)         (36)

Capital expenditure represents the amount paid in the year. Due to a change in the organisational structure, capital expenditure and depreciation in respect of wine production in the United States were reported under Global Supply in the years ended 30 June 2011 and 30 June 2010 and for the year ended 30 June 2009 were reported under North America.

#### (c) Geographical information

Great Britain £ million	United States £ million	Nether- lands £ million	Rest of World £ million	Total £ million
1,669	3,581	45	7,937	13,232
1,226	3,150	2,196	5,163	11,735
1,680	3,615	46	7,617	12,958
1,122	3,348	2,327	4,655	11,452
1,577	3,615	38	7,053	12,283
1,203	3,086	2,230	4,349	10,868
	Britain	### States	Britain £ million £ million  1,669 3,581 45  1,226 3,150 2,196  1,680 3,615 46  1,122 3,348 2,327  1,577 3,615 38	Britain £ million         States £ million         lands £ million         World £ million           1,669         3,581         45         7,937           1,226         3,150         2,196         5,163           1,680         3,615         46         7,617           1,122         3,348         2,327         4,655           1,577         3,615         38         7,053

<sup>(</sup>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 £ million	Beer £ million	Wine £ million	 	

# Diageo Annual Report 2011

#### 3. Operating costs

	2011 £ million	2010 £ million	2009 £ million
Excise duties	3,296	3,178	2,972
Cost of sales	4,010	4,099	3,893
Marketing	1,538	1,419	1,327
Other operating expenses	1,793	1,688	1,673
	10,637	10,384	9,865
Comprising:			
Excise duties – Great Britain	839	820	747
– United States	525	542	564
– Other	1,932	1,816	1,661
Increase in inventories	(263)	(111)	(220)
Raw materials and consumables	2,227	2,099	1,993
Marketing	1,538	1,419	1,327
Other external charges (a)	2,164	2,165	2,236
Staff costs (note 4)	1,344	1,269	1,232
Depreciation, amortisation and impairment	352	372	300
Gains on disposal of property	(20)	(89)	(6)
Net foreign exchange losses	16	127	65
Other operating income	(17)	(45)	(34)
	10,637	10,384	9,865

(a) Other external charges Other external charges include operating lease rentals for plant and equipment of £19 million (2010 – £16 million; 2009 – £11 million), other operating lease rentals (mainly properties) of £87 million (2010 – £74 million; 2009 – £76 million), research and development expenditure of £17 million (2010 – £13 million; 2009 – £17 million) and maintenance and repairs of £106 million (2010 – £103 million; 2009 – £90 million).

(b) Exceptional operating items Included in the table above are exceptional operating items as follows:

	2011 £ million	2010 £ million	2009 £ million
Other external charges	160	100	70
Staff costs	64	82	82
Depreciation, amortisation and impairment			
Accelerated depreciation	27	46	18
Ursus impairment	39	35	_
Gain on disposal of property	(1)	(86)	_
	289	177	170

(c) Auditor fees The fees of the principal auditor of the group, KPMG Audit Plc, and its a liates were as follows:

	United Kingdom £ million	Rest of World £ million	2011 £ million	2010 £ million	2009 £ million
Audit of these nancial statements	0.8	0.3	1.1	1.0	1.0
Audit of_nancial statements of subsidiaries pursuant to legislation	2.1	3.6	5.7	5.6	5.5
Other services pursuant to legislation (1)	0.4	1.0	1.4	1.3	1.3
Total audit fees	3.3	4.9	8.2	7.9	7.8
Other services relevant to taxation (ii)	0.1	0.4	0.5	0.6	1.4
Audit related fees under SEC regulations (iii)	0.3	0.2	0.5	1.1	1.3
All other fees (iv)	0.5	0.4	0.9	0.4	0.7
	4.2	5.9	10.1	10.0	11.2

 $(i) \ \ Other services pursuant to legislation relate principally to reporting required under section 404 of the US Sarbanes-Oxley Acta.$ 

(ii) Other services relevant to taxation comprise principally tax compliance services and tax advice.

(iii) Audit-related fees under SEC regulations comprise the aggregate fees billed for assurance and related services including services in respect of due diligence and work performed in connection with registration statements.

(iv) All other fees relate principally to advisory services, including services in respect of accounting advice.

In addition to the amounts above, £0.1 million (2010 - £0.2 million; 2009 - £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 funds and benget plans were £0.1 million (2010 - £0.2 million; 2009 - £0.3 million).

## Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

Accounting policies of the group

121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

1/5 Company balance sheet

1/6 Accounting policies of the company

178
Notes to the company nancial statements

Performance summary

#### 4. Employees

	2011	2010	2009
North America	1,690	1,615	2,258
Europe	2,912	3,007	3,253
International	5,867	5,097	4,952
Asia Pačċ	2,705	2,636	2,668
Global Supply	7,802	8,171	8,116
Corporate and other	2,810	2,761	2,792
	23,786	23,287	24,039

5 IF BWFSBHF OVNCFS PG FNQMPZFFT PG UIF HSPVQ JODMVEJOH QBSU UJ Note that the supply resulting in the transfer of employees between the two constitutions of the US wine business were transferred from North America (Constitution).

Employees of corporate functions whose costs are charged to the operating segments, such as those in shared service operations. are included in ÔCorporate and otherÕ in the analysis above.

	2011 £ million	2010 £ million	2009 £ million
Aggregate remuneration			
Wages and salaries	1,122	1,070	1,063
Share-based incentive plans	34	31	31
EmployerÕs social security	85	82	73
EmployerÕs pension	104	91	68
Other post employment	(1)	(5)	(3)
	1,344	1,269	1,232

The costs of post employment be to share-based incentive plans have been included in the consolidated income statement GPS UIF ZFBS FOEFE +VOF BT GPMMPXT DPTU PG TBMFT b NJMMJPO FYQFOTFT b NJMMJPO NJMMJPO NJMMJPO ODMVEFE XJI 2009 £82 million) in respect of exceptional operating items.

&NQMPZFS T QFOTJPO DPTUT JODMVEF b NJMMJPO NJMMJPO representing contributions payable to these plans by the group at rate sesting the rules of the plans.

Retirement benets 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 this ded benet type and are funded by payments to separately administered funds or insurance companies. The principal plans are in the United Kingdom, Ireland, United States and Canada to large on employeesÕ length of service and average alary. All valuations were performed by independent actuaries using the projected unit method to determine pension costs. The most recent full valuations of the asiquid ned bene't pension plans were carried out BT GPMMPXT 60JUFE, JOHEPN PO \*SFMBOE PO BSDI %FDFNCFS dates used to calculate the disclosures in the consolidate dial statements are the respective balance sheet dates. In the United Kingdom, the UK Diageo Pension Schernelasalary dened benet 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 balarlored bene't pension plan).

The assets of the UK and Irish pension plans are held in separate funds 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 plants of 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 SchemeÕs trust documentation. As required by legislation one-third of all 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 chairman is a former employee of Diageo Ireland and is viewed as independent.

The group also operates a number of plans, primarily in the United States, which provide employees with post employment bene'ts in respect of medical costs. These plans are generally unfunded. In addition, there are a number of other plans which provide post employment ben'ets other than pensions and medical b'etse These plans are also included in other than pensions and medical b'etse These plans are also included in other than pensions and medical b'etse These plans are also included in other than pensions and medical b'etse These plans are also included in other than pensions and medical below.

# Diageo Annual Report 2011

#### 4. Employees continued

(a) The following weighted average assumptions were used to determine the group's decit/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 to 30 June are based on the assumptions disclosed as at the previous 30 June.

		United Kingdom				Ireland	United St		
	2011 %	2010 %	2009	2011 %	2010 %	2009	2011 %	2010 %	2009 %
Rate of general increase in salaries	4.9	4.6	4.6	4.2	4.0	4.4	6.2	5.6	5.6
Rate of increase to pensions in payment	3.8	3.6	3.7	2.3	2.1	2.1		-	-
Rate of increase to deferred pensions	3.6	3.3	3.4	2.2	2.0	2.0	_	_	_
Medical in, ation	n/a	n/a	n/a	n/a	n/a	n/a	8.5	9.0	8.8
Discount rate for plan liabilities	5.6	5.4	6.2	5.4	4.9	5.7	4.9	4.7	5.7
lŋ ation	3.6	3.3	3.4	2.2	2.0	2.0	2.2	1.6	1.6

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 in ation and 0.3 of a percentage point for age related promotional salary increases. The 2011 assumption for medical in ation in the United States reduces by 0.5% per year to 5% (2010 – 0.5% per year to 5%).

In assessing the group's post retirement liabilities, the mortality assumption for the UK Scheme (the largest plan) is based on the mortality experience of that plan. The mortality assumption is based on the CMI birth year tables with scaling factors based on the experience of the plan. The mortality assumption for the largest plan in Ireland 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.

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					
	2011 Age	2010 Age	2009 Age	2011 Age	2010 Age	2009 Age	
Retiring currently at age 65							
Male	86.2	86.0	85.3	85.7	85.6	85.5	
Female	87.8	87.7	86.7	88.3	88.2	88.1	
Currently aged 45, retiring at age 65							
Male	88.4	88.3	88.3	87.5	87.4	87.3	
Female	90.1	90.1	89.3	90.1	90.0	89.9	

(b) In respect of defined being it 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 2011 are set out below:

	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million
2011				
Operating pro t				
Current service cost	(59)	(19)	(32)	(110)
Past service gain	2	_	3	5
Gains on curtailments	2	4	3	9
Total charge to operating pro_t	(55)	(15)	(26)	(96)
Net credit/(charge) to other nance charges (note 6(b))	14	(4)	(13)	(3)
Charge before taxation	(41)	(19)	(39)	(99)
Consolidated statement of comprehensive income				
Actual return on post employment plan assets	575	37	63	675
Expected return on post employment plan assets	(242)	(70)	(27)	(339)
Actual return less expected return on post employment plan assets	333	(33)	36	336
Experience gains and losses arising on the plan liabilities	(49)	(14)	(11)	(74)
Changes in assumptions underlying the present value of the plan liabilities	(54)	67	7	20
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	_	_	(10)	(10)
Net actuarial gain recognisable in other comprehensive income	230	20	22	272

### Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

117 Accounting policies of the group

# Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

1/5 Company balance sheet

1/6 Accounting policies of the company

178 Notes to the company nancial statements

	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million
2010				
Operating pro t				
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 pro t	(28)	(22)	(30)	(80)
Net charge to other nance charges (note 6(b))	(21)	(12)	(14)	(47)
Charge before taxation	(49)	(34)	(44)	(127)
Consolidated statement of comprehensive income				
Actual return on post employment plan assets	566	164	18	748
Expected return on post employment plan assets	(217)	(68)	(28)	(313)
Actual return less expected return on post employment plan assets	349	96	(10)	435
Experience gains and losses arising on the plan liabilities	181	32	16	229
Changes in assumptions underlying the present value of the plan liabilities	(447)	(140)	(77)	(664)
Actuarial 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	_	2	6	8
Net actuarial gain/(loss) recognisable in other comprehensive income	83	(10)	(65)	8
2009				
Operating pro t		•••••••••••••••••••••••••••••••••••••••		
Current service cost	(54)	(16)	(29)	(99)
Past service cost		_	(2)	(2)
Gains on curtailments	12	21	8	41
Total (charge)/credit to operating pro_t	(42)	5	(23)	(60)
Net credit /(charge) to other_nance income (note 6(b))	11	_	(9)	2
(Charge)/credit before taxation	(31)	5	(32)	(58)
Consolidated statement of comprehensive income				
Actual return on post employment plan assets	(302)	(212)	(56)	(570)
Expected return on post employment plan assets	(259)	(85)	(32)	(376)
Actual return less expected return on post employment plan assets	(561)	(297)	(88)	(946)
Experience gains and losses arising on the plan liabilities	42	18	_	60
Changes in assumptions underlying the present value of the plan liabilities	(79)	(47)	(1)	(127)
Actuarial loss recognisable in the reconciliation of the assets and liabilities	(598)	(326)	(89)	(1,013)
Changes in the recognisable surplus of the plans with a surplus restriction		(2)	9	7
Impact of minimum funding requirement	_	_	(1)	(1)
Net actuarial loss recognisable in other comprehensive income	(598)	(328)	(81)	(1,007)
	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million
Total cumulative gain/(loss) recognised in other comprehensive income				
At 30 June 2008	558	45	(69)	534
Recognised in the year	(598)	(328)	(81)	(1,007)
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)

# Diageo Annual Report 2011

### 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:

	 	***************************************		***************************************	•·····	***************************************	***************************************	***************************************
Financial statements								
	 							<u> </u>
111 Auditor's report in	 			<u></u>				
respect of the Group	 ***************************************		***************************************		***************************************		***************************************	
112 Consolidated income statement								
113 Consolidated								
statement of comprehensive income	 	<u></u>	<u> </u>	<u></u>			<u> </u>	<u></u>
114 Consolidated								
balance sheet								
115 Consolidated							***************************************	
statement of	 							
changes in equity	 			•••••••••••••••••••••••••••••••••••••••				
116 Consolidated	 	***************************************				***************************************		
statement of	 	***************************************						***************************************
cash, ows	 ***************************************	***************************************	***************************************	***************************************		***************************************	***************************************	***************************************
117 Accounting policies of the group								
121 Notes to the consolidated nancial statements 174 Auditor's report in								
respect of the company								
175 Company balance sheet								
176 Accounting policies of the company								
178 Notes to the company nancial statements								
Diageo Ar								

2010

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 2011 are £324 million (2010 – £356 million; 2009 – £391 million) invested in hedge funds and £285 million (2010 – £247 million; 2009 – £191 million) invested in private equity. Included in other assets at 30 June 2011 are interest rate and in ation swaps, along with repurchase agreements for the UK plans, with a fair value gain in the UK plans of £173 million (2010 – £51 million gain; 2009 – £46 million loss) and a fair value loss in the Irish plans of £18 million (2010 – £61 million gain; 2009 – £11 million gain).

The asset classes include some cash holdings that are temporary. This cash is likely to be invested in the relevant asset class 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 £43 million (2010 – £27 million; 2009 – £35 million) in 'equities', £74 million (2010 – £36 million; 2009 – £152 million) in 'bonds' and £5 million (2010 – £30 million; 2009 – £11 million) in 'property'. Irish plan assets include temporary cash of £11 million (2010 – £10 million; 2009 – £7 million) in 'equities' and £26 million (2010 – £105 million; 2009 – £64 million) in 'bonds'.

Post employment bene t assets and liabilities are recognised in the consolidated balance sheet, depending on whether an individual plan is in surplus or de cit, as follows:

	£ million	£ million
Non-current assets	60	49
Non-current liabilities	(898)	(1,254)
	(838)	(1,205)

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 2011, to reject the additional risks associated with equities, expected long term rates of return on equities include a risk premium of 4% per year (2010 and 2009 – 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 using 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 special callocations to a variety of asset classes that are expected over the long term to deliver the target rate of return. Most investment strategies have signial cant 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 2011, approximately 33% (2010 - 33%; 2009 - 40%) of the UK Scheme's liabilities and approximately 37% (2010 - 38%; 2009 - 40%) of the Irish Scheme's liabilities were hedged against future movements in interest rates and in ation through the use of swaps.

The discount rate is based on the yields of high quality, exed income investments. For the UK pension plans, which represent approximately 65% 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 out, ows are similar to those of the plans. A similar process is used to determine the discount rate for the non-UK plans.

The percentages of investments at fair value held by the pension plans at 30 June 2011 and 30 June 2010, analysed by category, were as follows:

	United Kingdom ————————————————————————————————————	Ireland %	United States and other ————————————————————————————————————	Total 
2011			***************************************	
Equities	39	43	56	41
Bonds	38	51	33	40
Property	12	6	2	10
Other	11	_	9	9
	100	100	100	100
2010				
Equities	45	38	52	44
Bonds	36	50	36	39
Property	11	7	3	10
Other	8	5	9	7
	100	100	100	100

#### 4. Employees continued

(d) Movements in the present value of plan liabilities during the three years ended 30 June 2011:

	United Kingdom £ million	Ireland £ million	States and other £ million	Total £ million
Present value of plan liabilities				
At 30 June 2008	3,752	1,254	553	5,559
Exchange differences	_	97	83	180
Acquisition of businesses		_	16	16
Current service cost	54	16	29	99
Past service cost	<del>-</del>	_	2	2
Interest cost	248	85	41	374
Actuarial loss	37	29	1	67
Employee contributions	14	3	1	18
Bene ts paid	(172)	(76)	(52)	(300)
Curtailments	(12)	(21)	(8)	(41)
Settlements	<del>-</del>	_	(9)	(9)
At 30 June 2009	3,921	1,387	657	5,965
Exchange differences	<del>-</del>	(69)	73	4
Current service cost	49	19	31	99
Past service gain	(13)	_	_	(13)
Interest cost	238	80	42	360
Actuarial loss	266	108	61	435
Employee contributions	14	3	1	18
Bene ts paid	(188)	(84)	(51)	(323)
Curtailments	(8)	_	(1)	(9)
Settlements	_	3	(4)	(1)
Transfer from other payables		34		34
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
Benę ts paid	(189)	(83)	(47)	(319)
Curtailments	(2)	(4)	(3)	(9)
Settlements		(10)	(1)	(11)
At 30 June 2011		1,571	805	6,859

United

In the years ended 30 June 2011 and 30 June 2010 agreement was reached with a group of employees whereby part of their redundancy settlement, previously included in other payables, was settled by an enhanced pension entitlement. Cash contributions will be made by the group to the relevant pension funds for those obligations.

Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

Accounting policies of the group

121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

176 Accounting policies of the company

178 Notes to the company\_nancial statements

# Diageo Ai ii luai Repoi i zoi

#### 4. Employees continued

The group has also agreed a decit funding arrangement with the trustees of the Irish Scheme. This agreement results in the group contributing 21 million (£19 million) per annum over an 18 year period from 2010. The agreement also provides for additional cash contributions into escrow of up to 188 million (£169 million) if an equivalent reduction in the decit 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 exed and, oating charges over certain receivables of the group up to a value of 200 million (£180 million). In addition to the decit funding the group expects to make cash contributions of 27 million (£23 million) to the Irish Scheme in the year ending 30 June 2012.

The group also expects to make cash contributions of £90 million to all other post employment schemes in the year ending 30 June 2012.

## Financial statements

Auditor's report in respect of the Group

Consolidated income statement

112

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash, ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

1/5 Company balance sheet

176 Accounting policies of the company

178 Notes to the company, nancial statements

#### (g) History of experience gains and losses:

	2011 £ million	2010 £ million	2009 £ million	2008 £ million	2007 £ million
Actual return less expected return on post employment plan assets	336	435	(946)	(236)	244
Experience gains and losses arising on the plan liabilities	(74)	229	60	(54)	(110)
Changes in assumptions underlying the present value of the plan liabilities	20	(664)	(127)	272	189
Actuarial gain/(loss) recognisable in the reconciliation of the assets and liabilities	282	_	(1,013)	(18)	323

(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 signic cant assumptions, the following sensitivity analyses give an estimate of the potential impacts on the consolidated income statement for the year ended 30 June 2011 and on the consolidated balance sheet as at 30 June 2011:

Estimated impact on consolidated income statemen				ne statement
Operating pro t	Other nance charges £ million	Pro t before taxation £ million	Taxation £ million	Pro t for the year £ million
8	(4)	4	(1)	3
	56	56	(14)	42
		<u></u>		
(2)	(12)	(14)	3	(11)
8	22	30	(7)	23
		<u></u>		
(1)	(1)	(2)	1	(1)
	<u></u>	<u></u>	<u></u>	
1	1	2	(1)	1
	8 8 (2)	Operating pro t charges £ million  8 (4)  - 56  (2) (12)	Operating pro t charges taxation £ million  8 (4) 4  - 56 56  (2) (12) (14)	Operating

		Estimated impact on consolidated balance sheet		
	Net post employment bene t liabilities £ million	Net deferred tax assets £ million	Net assets £ million	
2011				
Effect of 0.5% increase in discount rate:				
Approximate decrease in post employment de cit	451	(111)	340	
Effect of one year increase in life expectancy:				
Approximate increase in post employment de cit	(219)	55	(164)	
Effect of 0.5% decrease in inflation:		<u></u>		
Approximate decrease in post employment de cit	387	(90)	297	
Effect of 1% increase in medical care inflation:				
Approximate increase in post employment de cit	(25)	7	(18)	
Effect of 1% decrease in medical care inflation:		<u></u>		
Approximate decrease in post employment de cit	20	(6)	14	

<sup>(</sup>i) Information on transactions between the group and its pension plans is given in note 32.

#### 5. Exceptional items

IAS 1 (Revised) – Presentation of nancial statements requires material items of income and expense to be disclosed separately. Exceptional items are items which, in managemei21 (a) 22 (n) 22'(t)naap(i)29.4(i)20 ,11 513.58209 (n21 (a) 22 (o) 20 () 75 (m) 21 (r) 12 () 20 ,) 21 (p) 12 (a) 2 (e) 2

# Diageo Annual Report 201

#### 5. Exceptional items continued

(a) During 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 is 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 will result in changes to the group's regional structure and the way it organises its central functions. The expected cost of the restructuring is approximately £160 million of which £77 million was incurred in the year ended 30 June 2011. The majority of the costs are in respect of staff redundancies but also include early termination of contracts and lease costs. Costs have been primarily incurred 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 eciencies.

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 has resulted in the closure of a distillery, two cooperages and a warehouse. The packaging plant at Kilmarnock is expected to close by June 2012. New investment is concentrated in the production sites in Leven in Fife and in Shieldhall near Glasgow. In the year ended 30 June 2010 operating pro\_t included an exceptional charge of £81 million in respect of redundancies and additional depreciation spread over the period to the date that the sites are closed. £11 million was incurred in the year ended 30 June 2011 primarily in respect of 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 with the production being moved to Delta Beverages in Woodbridge, Ontario and the restructuring of the Daventry distribution centre resulting in a charge of £12 million principally in respect of employee severance and a loss on disposal of property, plant and equipment. A gain of £3 million was realised in the year ended 30 June 2011 in respect of exed asset disposals.

In May 2011 the group announced the closure of the Menlo Park bottling plant in California and the specialty product building at the Relay plant in Maryland. The cost of closing the facilities is expected to be approximately \$43 million (£27 million) of which £16 million has been committed as at 30 June 2011. The costs include employee severance and additional depreciation spread over the period to the date that the facilities are closed. New investment will be made in the North American spirits supply chain over the next 18 months principally in the packaging plants at Plain eld in Illinois and Relay in Maryland.

(c) In the year ended 30 June 2008, operating pro tincluded an exceptional charge for the cost of restructuring the Irish brewing operations, which primarily comprised severance and associated costs. The charge for the three years ended 30 June 2011 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. These restructuring charges were included in the consolidated income statement in other operating expenses.

(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.

In June 2010 the group completed a sale and leaseback transaction of certain land and facilities located in the Napa Valley, California for \$260 million (£174 million). The land and facilities were purchased by a third party and leased back to the group for 20 years with Diageo holding options, exercisable at fair value, to extend the lease term up to a total of 80 years. Diageo remains the operator of the facilities under the lease agreement and retains the ownership of the brands, vines and grapes. 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 prot. The lease of the facilities is accounted for as an ance lease and the gain arising was included in accruals and deferred income.

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.

(f) In April 2011 Diageo Turkey availed itself of the restructuring of Turkey's public receivables law to settle its dispute with the Turkish customs authorities regarding duty payable on beverage alcohol products sold in the domestic channel in Turkey between 2001 and April 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. In addition, in June 2011 Diageo made an offer to settle a dispute with the Thai customs authorities in respect of the price of imported goods during the period from 1 July 2002 to 30 June 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 will represent a full and acceptance of the offer in Thailand).

(g) In the year ended 30 June 2011 an impairment loss of £39 million (2010 – £35 million) was charged to other operating expenses in respect of the Ursus brand. One of the principal markets for Ursus is Greece where the economy continued to suffer a significant downturn. The discount rate for Greece used by the group for impairment calculations was further increased due to a deterioration in the country's sovereign risk rating and the long term growth assumptions for Ursus were reduced due to a fall in demand which resulted in a full impairment of the brand value.

## Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

113 Consolidated statement of comprehensive income

114 Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

117 Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

1/6
Accounting policies of the company

Notes to the company nancial statements

(h) In the year ended 30 June 2011 Diageo charged \$19 million (£12 million) to exceptional items in respect of a settlement with the Securities and Exchange Commission (SEC) in the United States including legal fees of £2 million. This 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.

(i) In 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. In accordance with IFRS 3 (Revised) the difference between the market value of the equity owned prior to the acquisition of £21 million and the book value of the associate of £10 million was recognised in the consolidated income statement, resulting in a gain of £11 million which was included in sale of businesses.

(j) In the year ended 30 June 2009 Diageo agreed a number of settlements with tax authorities in relation to historic restructuring and transfer pricing issues. The associated legacy issues not agreed in the year ended 30 June 2009 were settled during the year ended 30 June 2011.

#### 6. Interest and other nance income and charges

	2011 £ million	2010 £ million	2009 £ million
(a) Net interest			
Interest receivable	183	188	102
Fair value gain on interest rate instruments	95	281	150
Total interest receivable	278	469	252
Interest payable on bank loans and overdrafts	(21)	(20)	(14)
Interest payable on nance leases	(5)	(1)	_
Interest payable on all other borrowings	(514)	(548)	(590)
Fair value loss on interest rate instruments	(107)	(275)	(164)
Total interest payable	(647)	(844)	(768)
	(369)	(375)	(516)
(b) Net other nance income and charges			
Net nance income in respect of post employment plans	_	_	2
Other nance income	_	4	_
Total other nance income		4	2
Net nance charge in respect of post employment plans	(3)	(47)	
Unwinding of discounts	(16)	(18)	(21)
Hyperin, ation adjustment	(9)	(16)	_
Other nance charges	_	_	(13)
Net exchange movements on short term intercompany loans	_	(10)	(33)
Net exchange movements on net borrowings not qualifying for hedge accounting	_	_	(11)
Total other nance charges	(28)	(91)	(78)
Net nance charges	(28)	(87)	(76)
Interest on post employment plan liabilities	(342)	(360)	(374)
Expected return on post employment plan assets	339	313	376
Net nance (charge)/income in respect of post employment plans	(3)	(47)	2

The amount of borrowing costs capitalised in the year ended 30 June 2011 was £4 million (2010 - £5 million; 2009 - £4 million). In December 2009 Venezuela

# Diageo Annual Report 201 i

#### 7. Associates

The group's share of profit after tax from associates was £176 million (2010 – £142 million; 2009 – £164 million).

The group's 34% share of operating prot and of prot for the year of Moët Hennessy was £273 million and £179 million, respectively (2010 – £229 million and £134 million, respectively; 2009 – £242 million and £151 million, respectively).

In the year ended 30 June 2011, the group received dividends from its associates of £138 million (2010 – £111 million; 2009 – £179 million), of which £131 million was received from Moët Hennessy (2010 – £98 million; 2009 – £161 million). These dividends included receipts of £51 million (2010 – £31 million; 2009 – £60 million) from Moët Hennessy in respect of amounts payable to the tax authorities.

Information on transactions between the group and its associates is given in note 32. Summarised nancial information for the group's investments in associates is presented below:

(a) Moët Hennessy Moët Hennessy prepares its. nancial statements under IFRS in euros to 31 December each year. Summary information for Moët Hennessy for the three years ended 30 June 2011 after adjustment to align Moët Hennessy's accounting policies and accounting periods with those of the group, translated at £1 =  $\leq$ 1.16 (2010 – £1 =  $\leq$ 1.13; 2009 – £1 =  $\leq$ 1.17), is set out below:

		2011		2010		2009
	€ million	£ million	million	£ million	million	£ million
Sales	3,353	2,891	2,935	2,597	2,892	2,472
Pro t for the year	610	526	446	395	518	443

Pro t for the year is after deducting amounts in respect of other non-controlling interests.

(b) Other associates For all of the group's investments in associates other than Moët Hennessy, summarised nancial information, aggregating 100% of the sales and results of each associate, is presented below:

	£ million	£ million	£ million
Sales	1,228	1,202	892
Pro t for the year	32	79	88

#### 8. Taxation

#### (a) Analysis of taxation charge in the year

	2011 £ million	2010 £ million	2009 £ million
Current tax			
Current year	450	354	400
Bene t of previously unrecognised tax losses	-	_	(56)
Adjustments in respect of prior years	(5)	(80)	(40)
	445	274	304
Deferred tax			
Origination and reversal of temporary differences	(13)	176	110
Bene t of previously unrecognised tax losses	-	(3)	_
Changes in tax rates	9	1	(17)
Adjustments in respect of prior years	(98)	29	(111)
	(102)	203	(18)
Taxation on pro t from continuing operations	343	477	286

Adjustments in respect of prior years for current tax comprise a UK tax charge of £2 million (2010 – £47 million credit; 2009 - £42 million credit) and an overseas tax credit of £7 million (2010 – £33 million credit; 2009 – £2 million charge).

	2011 £ million	2010 £ million	2009 £ million
Current tax			
United Kingdom	94	(57)	(72)
Overseas	351	331	376
	445	274	304
Deferred tax			
United Kingdom	(141)	29	(73)
Overseas	39	174	55
	(102)	203	(18)
Taxation on pro t from continuing operations	343	477	286

#### Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash, ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

Company balance sheet

Accounting policies of the company

Notes to the company. nancial statements

#### (b) Included in the taxation charge are the following exceptional tax credits:

	£ million	£ million	£ million
Tax on exceptional operating items	51	39	37
Tax on sale of businesses	3	10	-
Settlements agreed with tax authorities	66	_	155
	120	49	192

In the year ended 30 June 2011 the tax settlement comprised a current tax credit of £66 million. In the year ended 30 June 2009 the tax settlement of £155 million comprised a current tax credit of £99 million and a deferred tax credit of £56 million.

#### (c) Factors a ecting tax charge for the year

	£ million	£ million	£ million
Pro t from continuing operations before taxation	2,360	2,239	1,990
Notional charge at UK corporation tax rate of 27.5% (2010 and 2009 – 28%)	649	627	557
Elimination of notional tax on share of associates' prot safter tax	(48)	(38)	(45)
Differences in effective overseas tax rates	(16)	(3)	(4)
Items not chargeable	(197)	(172)	(211)
Items not deductible	164	116	213
Bene t of previously unrecognised tax losses	_	(3)	(56)
Bene t of previously unrecognised other deferred tax assets	(115)	-	(25)
Changes in tax rates	9	1	(17)
Adjustments in respect of prior years	(103)	(51)	(126)
Tax charge for the year	343	477	286

The group benents from the availability of tax amortisation on many of its principal brands and other intangible assets. 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 (2010 – £11, 2009 – £25 million) in respect of future amortisation.

#### (d) Factors that may a ect 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 £381 million (2010 – £391 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

In the past, the group has undergone signicant restructuring activity involving the acquisition and sale of material businesses and the transfer of businesses within the group. As a consequence of this restructuring activity, a number of potential tax exposures have arisen. In addition, as the group operates throughout the world, it faces a number of potential transfer pricing issues in many jurisdictions relating to goods, services and anancing. Having agreed further settlements during the year, as at 30 June 2011, the group has a liability (after applicable reliefs) of £33 million (2010 – £96 million) for these exposures, which is included in corporate tax payable in current liabilities. The group continues to have 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.

#### 9. Discontinued operations

Discontinued operations in the year ended 30 June 2010 comprised a charge of £19 million (£24 million less deferred tax of £5 million) in respect of the discounted value of anticipated future payments to new thalidomide claimants. Discontinued operations in the year ended 30 June 2009 represented an adjustment in respect of the Pillsbury business.

# Diageo Annual Report 2011

### 10. Earnings per share

To. Earthings per share	2011 £ million	2010 £ million	2009 £ million
Pro tattributable to equity shareholders			
Continuing operations	1,900	1,648	1,603
Discontinued operations	_	(19)	2
	1,900	1,629	1,605
	2011 million	2010 million	2009 million
Weighted average number of shares			
Shares in issue excluding own shares held	2,493	2,486	2,485
Dilutive potential ordinary shares	8	5	9
	2,501	2,491	2,494
Pence per share			
Continuing operations		***************************************	***************************************
– basic earnings	76.2p	66.3p	64.5p
– diluted earnings	76.0p	66.2p	64.3p
Continuing and discontinued operations		•••••••••••••••••••••••••••••••••••••••	***************************************
– basic earnings	76.2p	65.5p	64.6p
– diluted earnings	76.0p	65.4p	64.4p

### Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

178 Notes to the company\_nancial statements

2011

2010

(a) Brands are stated at fair value on acquisition. At 30 June 2011, the principal acquired brands, all of which are regarded as having indenite useful economic lives, are as follows:

Carrying amount of acquired brands	Principal markets	2011 £ million	2010 £ million
Johnnie Walker whisky	Global	625	625
Smirnoff vodka	Global	512	550
Captain Morgan	Global	746	801
Crown Royal whisky	United States	909	976
Windsor Premier whisky	Korea	506	475
Bell's whisky	Great Britain	179	179
Cacique rum	Spain	190	173
Seagram's 7 Crown whiskey	United States	139	149
Bushmills whiskey	United States	144	144
Seagram's VO whisky	United States	118	127
Gordon's gin	Great Britain	119	119
Old Parr whisky	Venezuela	111	109
Tanqueray gin	United States	74	79
Bundaberg rum	Australia	90	76
Nuvo liqueur	United States	58	62
Romana Sambuca liqueur	United States	53	57
White Horse whisky	Russia	53	53
Ursus vodka	Greece/United States	_	37
Other brands		179	179
		4,805	4,970

Capitalised brands are regarded as having indenite useful economic lives and are therefore not amortised. These brands are protected by trademarks, which are renewable indenitely, 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 indenite 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 indenite lives for accounting purposes.

(b) For the purposes of impairment testing, goodwill has been attributed to cash-generating units as follows:

	£ million	£ million
North America – United States	204	224
Europe – Ireland	45	46
– Southern Europe	72	66
– Russia and Eastern Europe	43	42
International – Africa	38	10
Other cash-generating units	16	12
	418	400

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.

- (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 indenite life for accounting purposes. The carrying value at 30 June 2011 was £1,118 million (2010 £1,200 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 £71 million (2010 £65 million) in respect of projects in the course of development. Amortisation of computer software is recognised in other operating expenses in the income statement.

Impairment testing To ensure that brands, goodwill and other intangibles with indentice 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 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, ows and terminal values calculated on the assumption that cash, ows continue in perpetuity at the long term growth rate of each country or region.

## Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash, ows

Accounting policies of the group

# Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

1/5 Company balance sheet

176 Accounting policies of the company

178 Notes to the company nancial statements

#### 11. Intangible assets continued

Cash, ows are forecast for each brand, other intangible and cash-generating unit for the next. nancial year in the group's annual nancial plan, which is approved by the board and rejects management's expectations of sales growth, operating costs and margin, based on past experience and external sources of information.

The discount rates used are calculated as the group's weighted average cost of capital with appropriate adjustment where necessary to reject the group's assessment of the specient risks relating to the relevant market or region. The long term growth rates applied at the end of the forecast period are taken as the real gross domestic product (GDP) growth rate of the country or region plus its injustion rate, based on a ve-year average adjusted to take into account expectations specient to the group. For goodwill, these assumptions are based on the cash-generating unition group of units to which the goodwill is allocated. For brands, they are based on a weighted average taking into account the country or countries where sales are generated. For the Ketel One vodka distribution rights, a discount rate of 10% (2010 - 10%) and a long term growth rate of 3.4% (2010 - 3.4%) have been used.

For some recently acquired intangible assets, management expects to achieve growth, driven by Diageo's sales, marketing and distribution expertise, which is in excess of the long term growth rates for the applicable countries or regions. In these circumstances, the cash, ow forecast is extended beyond the next nancial year by up to four years using a detailed plan.

The pre-tax discount rates and long term growth rates used for impairment testing are as follows:

		2011		2010	
	Pre-tax discount rate %	Long term growth rate %	Pre-tax discount rate %	Long term growth rate %	
Global brands	12	4.9	12	4.9	
North America – United States	13	3.4	13	3.4	
Europe – Great Britain	12	4.5	13	4.6	
– Ireland	15	2.9	9	2.9	
– Spain	15	2.9	14	2.9	
– Greece	25	1.8	19	1.8	
– Southern Europe	20	2.4	18	2.9	
– Russia	19	9.5	18	9.5	
– Eastern Europe	18	9.0	17	8.4	
International – Venezuela	67	28.7	74	30.3	
– Africa	25	11.7	29	12.0	
Asia Paçi c – Australia	14	4.5	13	4.5	
– Korea	13	7.1	13	7.1	

Any impairment writedowns idenţi ed are charged to other operating expenses in the income statement. In the year ended 30 June 2011, an impairment loss of £39 million (2010-£35 million; 2009-£nil) was charged to other operating expenses in respect of the Ursus brand. One of the principal markets for Ursus is Greece where the economy continued to suffer a significant downturn. The discount rate for Greece used by the group for impairment calculations was further increased due to a deterioration in the country's sovereign risk rating and the long term growth assumptions for Ursus were reduced due to a fall in demand which has resulted in a full impairment of the brand value.

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, ows, the discount rates applied to those cash, ows and the expected long term growth rates.

The table below shows the impairment charge that would be required if the assumptions in the calculation of their value in use were changed:

	1ppt	1ppt	5%
	increase	decrease in	decrease in
	in discount	long term	annual
	rate	growth rate	cash ows
	£ million	£ million	£ million
Brands – Bushmills	6	2	
– Cacique	4	16	28

Returnable

### 12. Property, plant and equipment

	Land and buildings £ million	Plant and equipment £ million	Fixtures and ttings £ million	Returnable bottles and crates £ million	Under construction £ million	Total £ million
Cost						***************************************
At 30 June 2009	1,067	1,995	202	309	209	3,782
Exchange differences	60	106	12	(1)	11	188
Acquisition of businesses	2	_	_	_	_	2
Other additions	24	90	6	41	228	389
Disposals	(63)	(51)	(30)	(11)	1	(154)
Transfers	12	131	13	13	(169)	-
Transfers to assets held for sale	(42)	(27)	(1)	_	_	(70)
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
Depreciation						
At 30 June 2009	249	871	132	204	_	1,456
Exchange differences	20	70	12	(4)	_	98
Depreciation charge for the year	40	173	19	24	_	256
Exceptional accelerated depreciation	5	41	_	_	_	46
Disposals	(9)	(47)	(30)	(10)	_	(96)
Transfers	15	(9)	(6)	_	_	_
Transfers to assets held for sale	(6)	(21)	_	_	_	(27)
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
Carrying amount						
At 30 June 2011	734	1,289	59	156	314	2,552
At 30 June 2010	746	1,166	75	137	280	2,404
At 30 June 2009	818	1,124	70	105	209	2,326

<sup>(</sup>a) The net book value of land and buildings comprises freeholds of £664 million (2010 – £679 million), long leaseholds of £25 million (2010 – £22 million) and short leaseholds of £45 million (2010 – £45 million). Depreciation was not charged on £101 million (2010 – £140 million) of land.

- (b) Included in the net book value of property, plant and equipment is £81 million in respect of assets held under nance leases (2010-£60 million); depreciation for the year on these assets was £6 million (2010-£3 million).
- (c) Transfers primarily represent assets brought into use during the year.
- (d) In the year ended 30 June 2011 the group had received government grants from the United States Virgin Islands government of £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 2009	37
Exchange differences	3
Harvested grapes transferred to inventories	(23)
Transfer to assets held for sale	(6)
Changes in fair value	19
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

Biological assets comprise grape vines and grapes on the vine. At 30 June 2011, these assets comprise approximately 1,878 hectares of vineyards, ranging from newly established vineyards to vineyards that are 92 years old.

### 14. Investments in associates

	Moët Hennessy £ million	Other associates £ million	Total £ million
Cost less provisions			
At 30 June 2009	1,810	231	2,041
Exchange differences	(48)	18	(30)
Additions	_	32	32
Share of retained pro ts/(losses)	67	(5)	62
Share of movements in other comprehensive income	(15)	_	(15)
Transfer to assets held for sale	_	(20)	(20)
Step acquisition of Nuvo	_	(10)	(10)
At 30 June 2010	1,814	246	2,060
Exchange differences	150	7	157
Additions	<del>-</del>	58	58
Share of retained pro ts/(losses)	48	(10)	38
Share of movements in other comprehensive income	72	_	72
At 30 June 2011	2,084	301	2,385

Investments in associates comprise the cost of shares, less goodwill written off on acquisitions prior to 1 July 1998 of £1,410 million (2010 – £1,256 million), plus the group's share of post acquisition reserves of £975 million (2010 – £804 million).

(a) Moët Hennessy Moët Hennessy prepares its. nancial statements under IFRS in euros to 31 December each year. A summary of Moët Hennessy's consolidated balance sheet as at 30 June 2011 and 30 June 2010, including acquisition fair value adjustments and translated at £1 = 1.11 (2010 – £1 = 1.22), is set out below:

		2011		2010
	€ million	£ million	million	£ million
Non-current assets	4,109	3,702	4,139	3,393
Current assets	5,522	4,975	5,279	4,327
Total assets	9,631	8,677	9,418	7,720
Current liabilities	(1,490)	(1,343)	(1,666)	(1,366)
Non-current liabilities	(1,338)	(1,205)	(1,242)	(1,018)
Total liabilities	(2,828)	(2,548)	(2,908)	(2,384)
Net assets	6,803	6,129	6,510	5,336

The 34% net investment in Moët Hennessy has been accounted for by aggregating the group's share of the net assets of Moët Hennessy with fair value adjustments on acquisition, principally in respect of Moët Hennessy's brands.

## Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash, ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

175 Company balance sheet

1/6 Accounting policies of the company

Notes to the company nancial statements

**(b)** Other associates For all of the group's investments in associates other than Moët Hennessy, summarise **q**. nancial information, aggregating 100% of the assets and liabilities of each associate, including acquisition fair value adjustments, is presented below:

	2011 £ million	2010 £ million
Non-current assets	715	637
Current assets	546	432
Total assets	1,261	1,069
Current liabilities	(259)	(349)
Non-current liabilities	(296)	(122)
Total liabilities	(555)	(471)
Net assets	706	598

Included in other associates is a 19% (2010 – 19%) effective interest held indirectly in Sichuan ShuiJingFang Co., Ltd. (ShuiJingFang), a manufacturer and distributor of Chinese white spirits, which is listed on the Shanghai Stock Exchange. At 30 June 2011, the carrying value of the group's interest in ShuiJingFang was £96 million (2010 – £96 million), while the quoted value, based on a share price of RMB22.42 (2010 – RMB18.41) was £201 million (2010 – £172 million). As at 15 August 2011, the share price of ShuiJingFang was RMB23.98 per share. Information on the increase in the group's effective interest in ShuiJingFang after 30 June 2011 is given in note 30.

#### 15. Investments in joint ventures

The group consolidates its attributable share of the results and net assets of joint ventures on a line-by-line basis, measured according to the terms of the arrangements. The group's principal joint ventures that are consolidated on a proportional basis 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

In addition, the group consolidates a number of other joint ventures based on the group's share of the prot is attributable to the group's brands. These companies are involved in the marketing and distribution of premium drinks in Europe, South Africa and the Far East.

Included in the consolidated. nancial statements are the following amounts that represent the group's interest in the results and assets and liabilities of joint ventures:

	2011	2010	2009
	£ million	£ million	£ million
Sales	615	568	579
Operating costs	(624)	(495)	(535)
(Loss)/pro t before tax	(9)	73	44

#### 16. Other investments

	Escrow account £ million	Loans and other £ million	Total £ million
Cost less provisions or fair value			
At 30 June 2009	144	87	231
Exchange differences	_	5	5
Additions	_	58	58
Repayments	_	(26)	(26)
Transfer to the UK Scheme	(147)	_	(147)
Fair value adjustments and provisions	3	(7)	(4)
At 30 June 2010		117	117
Exchange differences	_	3	3
Additions	_	22	22
Repayments	_	(23)	(23)
Fair value adjustments and provisions	_	(17)	(17)
At 30 June 2011		102	102

Loans and other include £63 million (2010 – £56 million; 2009 – £15 million) of loans to associates in South Africa and £29 million (2010 – £51 million; 2009 – £64 million) of loans to customers. Provision against loans and other was £28 million (2010 – £11 million; 2009 – £4 million).

#### 17. Inventories

	2011 £ million	2010 £ million
Raw materials and consumables	258	297
Work in progress	25	21
Maturing inventories	2,681	2,506
Finished goods and goods for resale	509	457
	3,473	3,281

2011

f million

2010

f million

Maturing inventories include whisky, rum and wines. The following amounts of inventories are expected to be utilised after more than one year:

	E IIIIIIOII	E IIIIIIOII
Raw materials and consumables	35	46
Maturing inventories	2,246	2,093
	2,281	2,139
Inventories are disclosed net of provisions for obsolescence, an analysis of which is as follows:	2011 <u>£</u> million	2010 £ million
Balance at beginning of the year	97	55
Exchange differences	(2)	3
Income statement charge	10	63
Utilised	(48)	(24)
	57	97

## Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash, ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

175 Company balance sheet

176 Accounting policies of the company

178 Notes to the company nancial statements

2011

2010

#### 18. Trade and other receivables

		2011		2010
	Current assets £ million	Non-current assets £ million	Current assets £ million	Non-current assets £ million
Trade receivables	1,501		1,495	
Other receivables	315	108	363	107
Prepayments and accrued income	161	10	150	8
	1,977	118	2,008	115

Current other receivables at 30 June 2011 includes £119 million (2010 - £123 million) deposited with China's securities depositary and clearing agency, Shanghai branch in connection with the acquisition of Quanxing (see note 30).

As at 30 June 2011 non-current other receivables includes £97 million (2010 – £92 million) in respect of the assessment of excise duties made by the Korean customs authorities (see note 31 (c)).

The aged analysis of trade receivables, net of provisions, is as follows:

···g	2011 £ million	2010 £ million
Not overdue	1,446	1,440
Overdue 1 – 30 days	21	27
Overdue 31 – 60 days	7	6
Overdue 61 – 90 days	3	3
Overdue 91 – 180 days	9	6
Overdue more than 180 days	15	13
	1,501	1,495

Trade and other receivables are disclosed net of provisions for bad and doubtful debts, an analysis of which is as follows:

	£ million	£ million
Balance at beginning of the year	61	54
Exchange differences	2	3
Income statement charge	10	16
Written off	(12)	(12)
	61	61

## 19. Assets and disposal groups held for sale

	£ million	£ million
Non-current assets	19	65
Current assets	19	47
Assets held for sale	38	112
Current liabilities	(10)	(6)
Non-current liabilities	_	(4)
Liabilities held for sale	(10)	(10)

The assets and disposal groups held for sale at 30 June 2011 comprise a non-strategic wine business in California and the group's investment in Tanzania Breweries Limited.

## 20. Cash and cash equivalents

	£ million	£ million
Cash at bank	563	630
Cash equivalents	1,021	823
	1,584	1,453

 $Cash\ equivalents\ comprise\ investments\ in\ money\ market\ deposits\ and\ term\ deposits\ with\ original\ maturities\ of\ three\ months\ or\ less.$ 

Financial statements

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet 115 Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

121
Notes to the consolidated nancial statements

Auditor's report in respect of the company

Accounting policies

of the company

company nancial statements

Notes to the

Company balance sheet

## Diageo Annual Report 2011

### 21. Borrowings and bank overdrafts

			interest		2010	
	Repayment date	Currency	rates %	2011 £ million	2010 £ million	
Bank overdrafts	On demand	Various	Various	12	55	
Bank and other loans	Various	Various	Various	103	106	
Credit support obligations	2011	Various	Various	91	80	
Guaranteed debentures 2011	2011	US dollar	9.0	186	_	
Guaranteed bonds 2011	2011	US dollar	3.875	_	333	
Guaranteed bonds 2012	2012	US dollar	5.125	373	_	
Guaranteed bonds 2012	2012	Euro	1.674	675	_	
Fair value adjustment to borrowings			***************************************	7	13	
Borrowings due within one year and bank overdrafts				1,447	587	
Guaranteed bonds 2012	2012	US dollar	5.125	_	399	
Guaranteed bonds 2012	2012	Euro	0.93	_	615	
Guaranteed bonds 2013	2013	US dollar	5.2	466	500	
Guaranteed bonds 2013	2013	US dollar	5.5	373	400	
Guaranteed bonds 2013	2013	Euro	5.5	1,035	941	
Guaranteed bonds 2014	2014	US dollar	7.375	502	540	
Guaranteed bonds 2014	2014	Euro	6.625	899	818	
Guaranteed bonds 2015	2015	US dollar	5.3	465	499	
Guaranteed bonds 2015	2015	US dollar	3.25	310	332	
Guaranteed bonds 2016	2016	US dollar	5.5	372	399	
Guaranteed bonds 2017	2017	US dollar	5.75	775	832	
Guaranteed bonds 2020	2020	US dollar	4.828	362	390	
Guaranteed bonds 2035	2035	US dollar	7.45	248	267	
Guaranteed bonds 2036	2036	US dollar	5.875	369	397	
Guaranteed debentures 2011	2011	US dollar	9.0	_	200	
Guaranteed debentures 2022	2022	US dollar	8.0	185	198	
Medium term notes	2018	US dollar	4.85	124	133	
Bank and other loans	Various	Various	Various	49	51	
Fair value adjustment to borrowings	_			214	266	
Borrowings due after one year	_			6,748	8,177	
Total borrowings before derivative nancial instruments				8,195	8,764	
Fair value of foreign currency forwards and swaps	Various	Various	Various	(182)	(227)	
Fair value of interest rate hedging instruments	Various	Various	Various	(58)	(191)	
Total borrowings after derivative nancial instruments				7,955	8,346	

Year end

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 ows. 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 bene to fit the other if the net valuations of the derivatives are above a pre-determined threshold. At 30 June 2011, the collateral held under these agreements amounted to \$84 million (£52 million) and  $\xi$ 44 million (£39 million) (2010 – \$80 million) (£54 million) and  $\xi$ 32 million) (£26 million)).

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection (see note 23). The average monthly net borrowings for the year were £7,227 million (2010 – £7,912 million). Based on average monthly net borrowings and interest charge, taking into account interest rate protection, the exective interest rate for the year was 4.9% (2010 – 4.8%; 2009 – 6.2%). For this calculation, net borrowings exclude interest rate related fair value adjustments and the interest charge excludes nance charges unrelated to net borrowings, the forward element on derivative nancial instruments and fair value adjustments to interest rate swaps and borrowings. The loans above are stated net of unamortised nance costs of £78 million (2010 – £84 million; 2009 – £12 million).

#### (a) Analysis of net borrowings

(a) A trial y 35 of the C Bottown ig 5	2011 £ million	2010 £ million
Bank overdrafts	(12)	(55)
Borrowings due within one year	(1,435)	(532)
Borrowings due after one year	(6,748)	(8,177)
Fair value of foreign currency forwards and swaps	182	227
Fair value of interest rate hedging instruments	58	191
Finance lease liabilities	(79)	(61)
Gross borrowings	(8,034)	(8,407)
O set by: Cash and cash equivalents	1,584	1,453
Net borrowings	(6,450)	(6,954)

£15 million (2010 – £56 million) of net borrowings due within one year and £26 million (2010 – £24 million) of net borrowings due after one year were secured on assets of the group.

Foreign currency forwards and swaps, interest rate hedging instruments and nance lease liabilities are included as appropriate

in other nancial assets and other nancial liabilities.

#### (b) Reconciliation of movement in net borrowings

	2011 £ million	2010 £ million
Net borrowings at beginning of the year	(6,954)	(7,419)
Increase in net cash and cash equivalents before exchange	242	568
Net decrease in loans	414	422
Change in net borrowings from cash ows	656	990
Exchange di erences on net borrowings	(17)	(429)
Borrowings acquired through acquisition of businesses	(22)	_
Other non-cash items	(113)	(96)
Net borrowings at end of the year	(6,450)	(6,954)

#### 22. Other nancial assets and liabilities

	Non- current assets	Current assets	Current liabilities	Non- current liabilities
2011	<u>£ million</u>	£ million	£ million	£ million
Derivative assets/(liabilities)			***************************************	
Designated in a cash ow hedge	177	44	(31)	(11)
Designated in a fair value hedge	66	2		(10)
Designated in a net investment hedge		13	(17)	
Not designated in a hedge relationship	62	30	(31)	(33)
	305	89	(79)	(54)
Non-derivative liabilities		***************************************	***************************************	***************************************
Deferred consideration payable	_	_	(4)	(21)
Finance lease liabilities	_	_	(7)	(72)
		_	(11)	(93)
Total other nancial assets/(liabilities)	305	89	(90)	(147)
2010				
Derivative assets/(liabilities)		***************************************	***************************************	***************************************
Designated in a cash ow hedge	252	46	(91)	(36)
Designated in a fair value hedge	187	8	_	(4)
Designated in a net investment hedge	_	33	(38)	_
Not designated in a hedge relationship	33	11	(48)	(35)
	472	98	(177)	(75)
Non-derivative liabilities				
Deferred consideration payable	_	_	(3)	(25)
Finance lease liabilities		_	(6)	(55)
			(9)	(80)
Total other nancial assets/(liabilities)	472	98	(186)	(155)

#### 22. Other nancial assets and liabilities continued

Finance lease liabilities are payable as follows:

Future minimum lease payments £ million	Future nance charges £ million	Present value of minimum lease payments £ million	Future minimum lease payments £ million	Future nance charges £ million	Present value of minimum lease payments £ million
(12)	5	(7)	(8)	2	(6)
(38)	16	(22)	(28)	16	(12)
(76)	26	(50)	(80)	37	(43)
(126)	47	(79)	(116)	55	(61)
	minimum lease payments	minimum lease nance payments charges £ million (12) 5 (38) 16	Future minimum lease nance payments charges payments £ million £ million £ million (12) 5 (7)	Future minimum lease         Future nance         value of minimum minimum         Future minimum minimum         Future minimum minimum           payments         charges         payments         payments         payments           £ million         £ million         £ million         £ million           (12)         5         (7)         (8)           (38)         16         (22)         (28)	Future minimum Future minimum Future minimum lease nance lease payments charges payments £ million £ million £ million £ million £ million £ million £ million (12) 5 (7) (8) 2

## Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows

117 Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

176 Accounting policies of the company

178 Notes to the company nancial statements

### 23. Financial instruments and risk management

Derivative nancial instruments are used to hedge exposure to uctuations 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 exchange rate and interest rate risks are managed by the group's treasury department. The treasury department uses a range of nancial 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 nance committee. This committee is described in the Corporate governance report. These policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk. The benchmarks, hedge cover and overall appropriateness of Diageo's risk management policies are reviewed by the board following, for example, signi cant business, strategic or accounting changes. The framework provides for limited de ned levels of exibility in execution to allow for the optimal application of the board-approved strategies. Transactions arising on the application of this exibility may give rise to exposures di erent from the de ned 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 2011 gains and losses on these transactions were not material.

The nance committee receives monthly reports on the activities of the treasury department, including any exposures dierent from the de ned benchmarks.

(a) Currency risk The group publishes its consolidated nancial statements in sterling and conducts business in many foreign currencies. As a result, it is subject to foreign currency exchange risk due to exchange rate movements, which will a ect the group's transactions and the translation of the results and underlying net assets of its foreign operations. To manage the foreign exchange risk the group's treasury department uses certain nancial instruments. Where hedge accounting is applied, hedges are documented and tested for hedge ectiveness on an ongoing basis. Diageo expects hedges entered into to continue to be ective and therefore does not expect the impact of ine ectiveness 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 uctuations in the sterling value of its foreign operations by designating net borrowings held in foreign currencies and by using foreign currency spots, forwards, swaps and other nancial derivatives. The board reviewed and approved a revised policy, applicable from 3 December 2010, to manage hedging of foreign exchange risk arising from net investment in foreign operations. The group's revised policy is, where a liquid foreign exchange market exists, 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 nancial 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. The group's previous policy where a liquid foreign exchange market existed, was to aim to hedge currency exposure on its net investment in foreign operations by using net debt in foreign currencies and foreign currency spots, forwards swaps and other nancial derivatives and within the following percentage bands: 80% to 100% for US dollars and euros and 50% to 100% for other currencies. As at 30 June 2011, these ratios were 89% and 87% for US dollars and euros, respectively, and 42% for other currencies.

Exchange di erences arising on the retranslation of foreign currency borrowings (including foreign currency forwards swaps and other nancial derivatives), to the extent that they are in an elective hedge relationship, are recognised in other comprehensive income to olive set exchange di erences on net investments in foreign operations. Exchange di erences on foreign currency borrowings not in a hedge relationship and any ine ectiveness are taken to the income statement.

Transaction exposure hedging The board reviewed the group's transactional foreign exchange risk management policy and approved a revised policy, on 1 October 2010. The group's revised policy is to aim to hedge 18 months forecast transactional foreign exchange rate risk in the three major currency pairs (US dollar/sterling, euro/sterling and euro/US dollar), up to 100%, with a target range of between 75% and 100% once the relevant annual plan has been approved. In addition, at management's discretion, the group may decide to hedge other currencies for up to 18 months. The group's previous policy was to seek, for currencies in which there was an active market, to hedge between 60% and 100% of forecast transactional foreign exchange rate risk, for up to a maximum of 21 months forward, using foreign currency forward contracts with coverage levels increasing nearer to the forecast transaction date. The excitive 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 a ects the income statement. Any line ectiveness 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 exective 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 a ects the income statement. Any inexectiveness is taken to the income statement.

At 30 June 2011, as a result of the net investment, transaction exposure and foreign currency debt cover outlined above, the group

### 23. Financial instruments and risk management continued

#### Analysis of sensitivities

0.5%	0.5%		
decrease	increase	10%	10%
			· ·
		5	of sterling
£ million	± million	± million	£ million
13	(13)	(29)	24
22	(22)	(731)	598
19	(19)	(33)	27
34	(33)	(739)	605
		decrease   increase   in interest   rates   £ million     13   (13)     22   (22)     19   (19)	decrease   increase   10%   weakening s of sterling   f million     13   (13)   (29)     22   (22)   (731)     19   (19)   (33)

(a) The group's foreign currency debt is used as a hedge of net investments in foreign operations and as such the translation of foreign net investments would mainly o set the foreign currency gains or losses on nancial instruments recognised in other comprehensive income.

(b) Impact on the consolidated statement of comprehensive income includes the impact on the income statement.

The above analysis considers the impact of all nancial instruments including nancial derivatives, cash and cash equivalents, borrowings and other nancial assets and liabilities.

#### (e) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in nancial loss to the group. Credit risk arises from cash balances (including bank deposits and cash and cash equivalents), derivative nancial instruments and credit exposures to customers, including outstanding loans, trade and other receivables, nancial guarantees and committed transactions. Credit risk is managed separately for nancial and business related credit exposures.

#### Financial credit risk

Diageo aims to minimise its nancial credit risk through the application of risk management policies approved and monitored by the board. Counterparties are limited to major banks and nancial institutions 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 signicant concentrations of credit risk. The board also decrease near the types of nancial instruments which may be transacted. Financial instruments are primarily transacted with major international nancial institutions with a long term credit rating within the A band or better. The credit risk arising through the use of nancial instruments for interest rate and currency 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, Diageo may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the bene to fithe 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 re-ecting market credit conditions.

#### Business related credit risk

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 trade and other receivables as the group has a large number of customers which are internationally dispersed.

The maximum credit risk exposure of the group's nancial assets was as follows:

	2011 £ million	£ million
Trade and other receivables (excluding taxes)	1,751	1,825
Accrued income	23	31
Assets held for sale	9	13
Cash and cash equivalents	1,584	1,453
Derivative nancial assets	200	334
Other investments	102	117
Total	3,669	3,773

Derivative nancial assets comprise the fair value of derivatives receivable from nancial institutions partly o set by cash collateral received.

## Financial statements

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

1/6 Accounting policies of the company

Notes to the company nancial statements

 $Cash \ and \ cash \ equivalents \ comprise \ cash \ in \ hand \ and \ deposits \ which \ are \ readily \ convertible \ to \ known \ amounts \ of \ cash \ and \ which \ are \ subject \ to \ insigni \ \ cant \ risk \ of \ changes \ in \ value \ and \ have \ an \ original \ maturity \ of \ three \ months \ or \ less \ at \ acquisition \ including \ money \ market \ deposits, \ commercial \ paper \ and \ investments.$ 

At 30 June 2011, approximately 13% and 17% of the group's trade receivables of £1,501 million are due from counterparties based in the United Kingdom and in the United States, respectively.

**(f) Liquidity risk** Liquidity risk is the risk that Diageo may encounter in meeting its obligations associated with nancial liabilities that are settled by delivering cash or other nancial assets. The group's policy with regard to the expected maturity prole 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 facility terms from relationship banks to support commercial paper obligations.

Maturity of cash ows for nancial liabilities by year of repayment

		 				***************************************
***************************************	***************************************	 ***************************************		***************************************	***************************************	***************************************
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### 23. Financial instruments and risk management continued

Maturity of cash ows for nancial assets by year of repayment

	Interest rate swaps £ million	cross currency swaps cash in ow £ million	cross currency swaps cash out ow £ million	Other £ million	Total £ million
2011					
After ve years	(35)	1,204	(998)	54	225
From four to ve years	(3)	42	(34)	4	9
From three to four years	18	42	(34)	5	31
From two to three years	30	42	(34)	6	44
From one to two years	64	42	(34)	39	111
Due after one year	74	1,372	(1,134)	108	420
Due within one year	79	42	(34)	1,869	1,956
	153	1,414	(1,168)	1,977	2,376
2010					
After ve years	(8)	1,336	(1,034)	85	379
From four to ve years	15	46	(34)	1	28
From three to four years	23	46	(34)	1	36
From two to three years	57	46	(34)	2	71
From one to two years	80	46	(34)	143	235
Due after one year	167	1,520	(1,170)	232	749
Due within one year	98	46	(34)	1,790	1,900
	265	1,566	(1,204)	2,022	2,649

Other nancial assets primarily consist of trade receivables and foreign currency forwards and swaps. Amounts are shown on an undiscounted basis. Where interest payments are on a oating rate basis, rates of each cash ow until maturity of the instruments are calculated based on the forward yield curve at the last business day of the years ended 30 June 2011 and 30 June 2010.

(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 ow risk from a change in interest rates or foreign exchange rates (cash ow 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 e ectiveness on a prospective and retrospective basis. Methods for testing e ectiveness include dollar o set, critical terms, regression analysis, hypothetical derivative method and volatility reduction.

Loss on fair value hedging instruments for the year was £8 million (2010 – £163 million gain) and the gain on the hedged items attributable to the hedged risks was £19 million (2010 – £163 million loss).

In respect of cash  $^{\circ}$  ow hedging instruments, gains of £25 million (2010 – £27 million losses) have been recognised in other comprehensive income due to changes in fair value. A loss of £2 million and a loss of £54 million have been transferred out of other comprehensive income to other operating expenses and to other nance charges, respectively, in the year (2010 – £47 million loss and a gain of £73 million have been transferred out of other comprehensive income to other operating expenses and to other nance income, respectively).

With respect to hedges of forecast transactions and the cash ow risk from a change in interest rates, based on year end interest and foreign exchange rates, balances related to cash ow hedged items at 30 June 2011 will a ect the income statement in 2012 and 2013 by £11 million and £2 million, respectively. With respect to hedges of the cash ow 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 a ect 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 taken to the income statement is expected to o set against the foreign exchange retranslation and the interest on the cross currency swaps in each of the years.

Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

1/6 Accounting policies of the company

178 Notes to the company nancial statements *Cash ow and net investment hedges* The following table shows the contractual maturities of the notional designated transactions, cross currency interest rate swaps and derivative net investment hedging instruments:

			ercentage of total			
	Purchase £ million	Sell £ million	Total £ million	US dollar %	Euro %	Year ending 30 June
2011						
Transaction	550	1,316	1,866	51	31	2012
Transaction	155	466	621	65	35	2013
Total transaction hedges	705	1,782	2,487	55	32	2012-2013
Cross currency interest rate swaps	373		373	100	_	2017
Cross currency interest rate swaps	373	_	373	100	_	2037
Total cross currency interest rate swaps	746		746	100	_	2017-2037
Net investment hedging instruments	1,921	895	2,816	65	8	2012
2010				***************************************		
Transaction	693	1,741	2,434	44	30	2011
Transaction	443	969	1,412	48	30	2012
Total transaction hedges	1,136	2,710	3,846	45	30	2011-2012
Cross currency interest rate swaps	400		400	100	_	2017
Cross currency interest rate swaps	400	_	400	100	_	2037
Total cross currency interest rate swaps	800		800	100	_	2017-2037
Net investment hedging instruments	3,295	2,464	5,759	62	14	2011

(h) Fair value measurements The disclosures about fair value measurements of nancial 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.

The group maintains policies and procedures to value instruments using the most relevant data available. If multiple inputs that fall into dierent 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 nancial liabilities at fair value

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### 23. Financial instruments and risk management continued

The movements in level 3 instruments, measured on a recurring basis, are as follows:

The movement annover of the training measured of the recurring basis, are as relieves.	Derivative liabilities £ million	Other nancial liabilities £ million	Total level 3 instruments £ million
At 30 June 2009	(40)		(40)
Deferred consideration payable	_	(26)	(26)
Net gains/(losses) included in the consolidated statement of comprehensive income <sup>(a)</sup>	17	(2)	15
At 30 June 2010	(23)	(28)	(51)
Net gains included in the consolidated statement of comprehensive income <sup>(a)</sup>	8	3	11
At 30 June 2011	(15)	(25)	(40)

(a) Including gains/(losses) included in the income statement.

(i) Total nancial assets and liabilities The table below sets out the group's accounting classication of each class of nancial assets and liabilities, and their fair values.

	Instruments in a hedge relationship <sup>(1)</sup> £ million	Other instruments at fair value <sup>(ii)</sup> £ million	Cash and cash equivalents £ million	Available for sale £ million	Loans and receivables £ million	Financial liabilities at amortised cost £ million	Total carrying value £ million	Fair value £ million
2011								
Cash and cash equivalents	_	_	1,584	_	_	_	1,584	1,584
Bank overdrafts	_	_	_	_	_	(12)	(12)	(12)
Borrowings due within one year	(255)	_	_	_	_	(1,180)	(1,435)	(1,439)
Borrowings due after one year	(3,128)	_	_	_	_	(3,620)	(6,748)	(7,344)
Derivative assets	302	92	_	_	_	_	394	394
Derivative liabilities	(69)	(64)	_	_	_	_	(133)	(133)
Other assets	_	_	_	4	1,872	_	1,876	1,876
Other liabilities	_	(25)	_	_	_	(2,363)	(2,388)	(2,388)
	(3,150)	3	1,584	4	1,872	(7,175)	(6,862)	(7,462)
2010								
Cash and cash equivalents	_	_	1,453	_	_	_	1,453	1,453
Bank overdrafts	_	_	_	_	_	(55)	(55)	(55)
Borrowings due within one year	(346)	_	_	_	_	(186)	(532)	(526)
Borrowings due after one year	(4,080)	_	_	_	_	(4,097)	(8,177)	(8,892)
Derivative assets	526	44	_	_	_	_	570	570
Derivative liabilities	(169)	(83)	_	_	_	_	(252)	(252)
Other assets	_	_	_	4	1,982	_	1,986	1,986
Other liabilities	_	(28)	_	_	_	(2,247)	(2,275)	(2,275)
	(4,069)	(67)	1,453	4	1,982	(6,585)	(7,282)	(7,991)

<sup>(</sup>i) Includes borrowings designated as hedged items in fair value hedging relationships with respect to interest rate risks. (ii) Derivative nancial instruments not designated in hedging relationships.

## Financial statements

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

178 Notes to the company nancial statements All derivative nancial instruments not in a hedge relationship are classied as trading derivatives with fair value changes recorded in the income statement. The group does not use derivatives for speculative purposes. All transactions in derivative nancial 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 nancial instruments are estimated by discounting the future contractual cash ows using the appropriate yield curves at the last business day of the years ended 30 June each year. As at 30 June 2011 and 30 June 2010, the carrying values of cash and cash equivalents, bank overdrafts, other nancial assets and liabilities were considered to approximate fair values.

Fairvalue hedging relationships Certain borrowings due within and after one year are part of qualifying fair value interest rate hedging relationships. Accordingly, there is a fair value adjustment for these liabilities with respect to the hedged interest rate risk, with changes being recognised in the income statement, as disclosed in note 23(g). The group has not designated any non-derivative nancial assets or liabilities at fair value.

#### (j) Analysis of cash and cash equivalents by currency

		2011		2010
	£ million	%	£ million	%
US dollar	1,058	66	844	58
Euro	56	4	118	8
Sterling	123	8	69	5
Other	347	22	422	29
Cash and cash equivalents	1,584	100	1,453	100

#### (k) Analysis of gross borrowings by currency

		2011		2010
	£ million	%	£ million	%
US dollar	(3,689)	46	(3,864)	46
Euro	(1,990)	25	(1,840)	22
Sterling	(1,776)	22	(1,690)	20
Korean won	(174)	2	(316)	4
Other	(405)	5	(697)	8
Gross borrowings	(8,034)	100	(8,407)	100

The analysis of group's gross borrowings above includes the impact of foreign currency forwards and swaps.

#### (I) Analysis of net borrowings by interest rate pro le

		2011		2010
	£ million	%	£ million	%
Fixed rate	(3,752)	58	(3,391)	49
Floating rate	(2,722)	42	(3,766)	54
Interest free	5	_	64	(1)
Impact of nancial derivatives and fair value adjustments	19	_	139	(2)
Net borrowings	(6,450)	100	(6,954)	100

The split of xed and oating rate net borrowings above includes the impact of interest rate hedging instruments.

Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

### 23. Financial instruments and risk management continued

(m) Portfolio of interest rate derivative instruments

	Receive xed notional £ million	Pay xed notional £ million	Weighted average xed interest rate %	Weighted	
	***************************************	***************************************	***************************************	***************************************	
	***************************************	***************************************		***************************************	***************************************
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Accounting policies of the group Notes to the

consolidated nancial statements

Auditor's report in respect of the company

Company balance sheet

Accounting policies of the company

Notes to the company nancial statements

Provisions by their nature are subject to uncertainties with respect to the timing and outcomes of future events.

- (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. An additional provision of £24 million was created in the year ended 30 June 2010 in respect of anticipated future payments to new thalidomide claimants. It is expected that the additional provision will be utilised over the period of the commitment, up to 2030.
- (b) Included in provision for onerous contracts at 30 June 2010 was £68 million in respect of the discounted value of an onerous supply contract arising on the acquisition of the Seagram spirits and wine business on 21 December 2001. This provision is being utilised over the 10-year duration of the contract. The provision includes a termination amount which will be payable in the seven months ending 31 January 2012. The amount payable of £51 million at 30 June 2011 has been included in other payables.
- (c) The group is undergoing a number of restructuring programmes, which involve the rationalisation of 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 in the year ending 30 June 2012.
- (d) The vacant property provision is based on the estimated discounted rental shortfall over the terms of the leases up to 2031.
- (e) Other provisions include £42 million (2010 £47 million) in respect of employee deferred compensation plans which will be utilised when employees leave or retire from 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 £ million	Intangible assets £ million	Post employment plans £ million	Tax losses £ million	Other temporary di erences £ million	Total £ million
At 30 June 2009	(217)	(359)	348	53	247	72
Exchange di erences	(12)	(94)	8	1	7	(90)
Recognised in income – continuing operations	40	(148)	(51)	(42)	(2)	(203)
Recognised in income – discontinued operations	_	_	_	_	5	5
Recognised in other comprehensive income	_	_	_	_	3	3
Step acquisition of Nuvo	_	(2)	_	_	_	(2)
At 30 June 2010	(189)	(603)	305	12	260	(215)
Exchange di erences	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)

Deferred tax on other temporary dierences includes items such as the thalidomide provision, restructuring provisions, share-based payments and intra group sales of products.

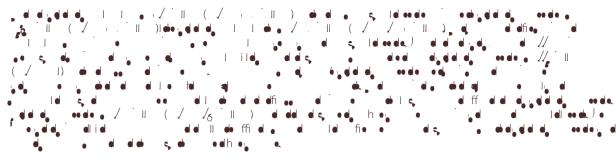
After o setting deferred tax assets and liabilities where appropriate within territories, the net deferred tax liability comprises:

	2011	2010
	£ million	£ million
Deferred tax assets	516	529
Deferred tax liabilities	(777)	(744)
	(261)	(215)

Financial statements

121 Notes to the consolidated nancial statements

#### 26. Deferred tax assets and liabilities continued



		2011		1
	Tax losses £ million	Other £ million	- 1 ee eb	./
વર ુવી લી લી	317	623	16,	<u> </u>
0 d c, , d,	(204)	(33)	(/ , )	(/ /)
	113	590		( ,



## 27. Tax on other comprehensive income

						£ milli		·	·    **
	s, di <sub>e</sub> ffel d						8	(/)	1,
ffd	d	• 5 4	• 1	d .	• fl 🔩 🕁		7)	1	
d	\$	• •	1 d	I	•		6)		
Tax o	n other cor	nprehensive	income			(6	5)	(/1)	

## 28. Share capital and reserves

(a) Allotted and fully paid share capital – ordinary shares of  $28^{101}\!/_{108}$  pence each

	of shares million	value £ million
. • 6	6	6/1
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de e de did	( )	(6)
At 30 June 2011, 30 June 2010 and at 30 June 2009	2,754	797

Number

Nominal



### 28. Share capital and reserves continued

(e) 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 during the year. Movements in shares are as follows:

		es and options d by employee share trusts	repu	Treasury shares urchased under ck programmes	hedging	sury shares for share scheme to employees	To	Total own shares	
	Number of shares million	Purchase consideration £ million	Number of shares million	Purchase consideration £ million		Purchase/(sale) consideration £ million	Number of shares million	consideration	
At 30 June 2008	26	218	259	2,135	20	206	305	2,559	
Share trust arrangements	(3)	(30)	_	_	_	_	(3)	(30)	
Shares purchased	_	_	_	_	6	63	6	63	
Shares cancelled	_	_	(30)	(247)	_	_	(30)	(247)	
Shares transferred	_	_	(6)	(47)	6	47	_	_	
Shares used to satisfy options	_	_	_	_	_	(3)	_	(3)	
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	

At 30 June 2011, employee share trusts funded by the group held shares in the company as follows: 9 million ordinary shares held in respect of long term incentive plans for executive directors and senior executives and 2 million ordinary shares held in respect of grants under UK, Irish and US savings-related share option schemes. The market value of these shares at 30 June 2011 was £144 million (2010 – 15 million shares, market value £159 million; 2009 – 23 million shares, market value £197 million). Dividends are waived on all shares in the company owned by the employee share trusts.

During the year ended 30 June 2011, the company purchased 6 million ordinary shares, with an aggregate nominal value of £2 million, representing approximately 0.3% of the issued ordinary share capital (excluding treasury shares), to be held as treasury shares (2010 – nil shares and £nil; 2009 – 6 million shares, aggregate nominal value £2 million, 0.3% of issued share capital (excluding treasury shares)). These shares have not been cancelled but are deducted from shareholders' equity. Dividends are waived on these shares.

During the years ended 30 June 2011 and 30 June 2010, no cancellation of ordinary shares held as treasury shares was carried out (2009 – 30 million shares, aggregate nominal value £8 million). The company utilised 4 million ordinary shares held as treasury shares, with an aggregate nominal value of £1 million, to satisfy options exercised by employees during the year (2010 – 3 million shares, nominal value of £1 million; 2009 – 0.3 million shares, nominal value of £0.1 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 nancial assets.

Financial	
statemen	ts

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

Notes to the company nancial statements

2010

2011

(f) Dividends
Amounts recognised as distributions to equity shareholders in the year

	£ million	£ million	£ million
Amounts recognised as distributions to equity shareholders in the year			
Final dividend for the year ended 30 June 2010			
23.50 pence per share (2009 – 22.20 pence; 2008 – 21.15 pence)	586	551	527
Interim dividend for the year ended 30 June 2011			***************************************
15.50 pence per share (2010 – 14.60 pence; 2009 – 13.90 pence)		363	345
	973	914	872
Adjustment in respect of prior year dividends	_	_	(2)
	973	914	870
Proposed nal dividend for the year ended 30 June 2011			
24.90 pence per share (2010 – 23.50 pence; 2009 – 22.20 pence)	621	586	550

The proposed nal dividend was approved by the board of directors on 24 August 2011. 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 nancial statements. There are no corporate tax consequences arising from this treatment.

(a) Acquisition adjustment In the year ended 30 June 2009 an adjustment was made to reduce both goodwill and non-controlling interests by £58 million in respect of the acquisition in the year ended 30 June 2008 of the distribution rights for Ketel One vodka products.

### 29. Cash generated from operations

3	2011		2010		2009	
	£ million					
Pro t for the year	2,017		1,743		1,706	
Discontinued operations	_		19		(2)	
Taxation	343		477		286	
Share of associates' pro ts after tax	(176)		(142)		(164)	
Net interest and net other nance charges	397		462		592	
Loss on sale of businesses	14	***************************************	15	***************************************	_	***************************************
Operating pro t		2,595		2,574		2,418
Increase in inventories	(204)		(104)	***************************************	(236)	***************************************
Decrease in trade and other receivables	62	••••••	69	•••••••••••••••••••••••••••••••••••••••	193	
Increase/(decrease) in trade and other payables and provisions	30	***************************************	369		(210)	***************************************
Net movement in working capital		(112)		334		(253)
Depreciation, amortisation and impairment	***************************************	352	***************************************	372	***************************************	300
Dividend income	***************************************	138	***************************************	111	***************************************	179
Other items	***************************************	(94)	***************************************	(207)	***************************************	10
Cash generated from operations		2,879		3,184		2,654

In the consolidated statement of cash ows, cash generated from operations is stated after £259 million (2010 – £145 million; 2009 – £53 million) of cash out ows in respect of exceptional operating items.

In the calculation of cash generated from operations, Other items include £119 million of cash contributions to post employment schemes in excess of the income statement charge (2010 - £114 million higher contributions; 2009 - £68 million higher contributions) and gains on sale of property of £20 million (2010 - £89 million; 2009 - £6 million) partly o set by the fair value charge in respect of share-based incentive plans of £34 million (2010 and 2009 – £31 million).

30.

#### Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows

Accounting policies of the group

## 121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

175 Company balance sheet

176 Accounting policies of the company

Notes to the company nancial statements

Diageo Annual Report 2011

#### 2009 acquisitions

Stirrings On 16 June 2009, Diageo acquired the remaining 80% of equity in Stirrings LLC for £6 million and provided £7 million as deferred consideration payable. The value of the acquired brand was recognised by a fair value adjustment on acquisition of £8 million. Goodwill of £10 million arose as a result of expected synergies from combining distribution networks and administrative functions. Diageo initially acquired a 20% equity stake for £5 million in the year ended 30 June 2007.

Smirnov On 17 December 2008, Diageo purchased for £35 million the remaining 25% stake in the company that owns the Smirnov brand. Diageo initially acquired a 75% stake for £28 million in the year ended 30 June 2007, with an agreement to acquire the remaining 25% at fair value. Net assets acquired at fair value were £17 million with goodwill of £26 million arising on the acquisition. On acquiring the nal 25% interest, additional goodwill of £13 million was recognised.

DHN Drinks On 1 May 2008, a venture, DHN Drinks, was formed between Diageo, Heineken and Namibia Breweries Limited (NBL) to market their combined beer, cider and ready to drink businesses in South Africa. Diageo and Heineken each own 42.25% of DHN Drinks and NBL own 15.5%. Diageo equity accounts for this investment. The cost of this acquisition in the year ended 30 June 2008 was £43 million. An additional investment of £18 million was made in the year ended 30 June 2011 (2010 – £29 million; 2009 – £3 million).

**Sedibeng** In the year ended 30 June 2009, Diageo recognised a cost of £19 million in respect of its agreement with Heineken to construct the Sedibeng brewery and bottling plant in South Africa.

#### Acquisitions after 30 June 2011

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 consideration of \$225 million (£140 million) (including \$35 million of deferred compensation). ILG has a put option to sell the remaining 50% equity stake exercisable from 2016 calculated on a pro t multiple. 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 will consolidate the results of RCP. The calculation of the impact of the acquisition on Diageo's consolidated balance sheet is provisional and is expected to increase Diageo's intangible assets by approximately £200 million, inventories by £20 million and property, plant and equipment by £7 million. In addition an ancial liability of approximately £87 million will be established for the put option exercisable by ILG. Directly attributable transaction costs of £3 million have been charged to other external charges in the year ended 30 June 2011. The impact of the Zacapa acquisition on the group's protis not expected to be material.

Quanxing 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 RMB 140 million (£13 million). The acquisition of the 4% equity stake brings 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. Diageo has become the indirect largest shareholder of Shui Jing Fang and, in accordance with Chinese takeover regulations, subject to securing the approval of the China Securities Regulatory Commission (CSRC), expects to make a mandatory tender o er to all the other shareholders of ShuiJingFang. The tender o er is expected to be completed by the end of the calendar year. Were all other ShuiJingFang shareholders to accept the tender o er, the amount payable would be RMB 6.3 billion (£606 million). As required by Chinese law, 20% of the maximum consideration payable under the tender o er (£119 million) was deposited with China's securities depositary and clearing agency, Shanghai branch in the year ended 30 June 2010. Diageo also made a capital contribution to Quanxing of £8 million in the year ended 30 June 2010. 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. The fair value of the net assets of Quanxing on the date of acquisition are provisionally estimated at £403 million comprising the company's 39.7% equity stake in ShuiJingFang of £380 million, cash of £6 million, receivables due from Diageo of £11 million, other receivables of £8 million and trade payables and accruals of £2 million. As a result of Quanxing becoming a subsidiary of the group, a provisional gain of approximately £70 million is expected to arise on the dierence between the book value of the equity owned prior to the transaction and the market value on the day of completion. Directly attributable transaction costs of £8 million have been charged to other external charges in the year ended 30 June 2011 (2010 – £7 million).

Mey çki On 23 August 2011, having received the necessary regulatory clearances, Diageo completed the acquisition of Mey çki Sanayi VE Ticaret A.S. (Mey çki) from TPG Capital and the Actera group. The Turkish Competition Authority clearance is conditional upon the subsequent disposal of the Mey çki brands Hare liqueur and Maestro gin. Diageo anticipates that these disposals will be completed in the year ending 30 June 2012. Mey çki is the leading producer and distributor of raki in Turkey and also owns other brands including vodka and wine brands. Mey çki will be fully consolidated and transforms Diageo's existing position in this fast growing spirits market. In the year ended 31 December 2010 Mey çki had net sales of TRL 766 million. The enterprise value for the acquisition is \$2.1 billion (£1.3 billion). The fair value assessment has not been completed and information on the net assets acquired has not been disclosed as the acquisition was completed a day prior to the nancial statements being signed. Directly attributable transaction costs of £7 million have been charged to other external charges in the year ended 30 June 2011.

Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

113 Consolidated statement of comprehensive income

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

nancial statements

121 Notes to the consolidated

Auditor's report in respect of the company

176 Accounting policies of the company

178 Notes to the company nancial

175 Company balance sheet

114 Consolidated balance sheet

116

# Diageo Annual Report 2011

#### 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 nancial statements.

**Associates** Transactions between the group and its associates were as follows:

- Group sales include sales to associates of £46 million (2010 £74 million; 2009 £60 million) and operating costs include purchases from associates of £17 million (2010 £19 million; 2009 £12 million).
- At 30 June 2011, group payables included £8 million payable to associates (2010 £9 million; 2009 £8 million). Group receivables included £2 million receivable from associates at 30 June 2010 (2009 £16 million).

Additions to property, plant and equipment in the year ended 30 June 2009 include a warehouse acquired from Moët Hennessy for £16 million, and inventories at 30 June 2011 include maturing inventories of £38 million (2010 – £31 million) purchased from Moët Hennessy. Additions to loans include £22 million (2010 – £56 million) of loans to associates in South Africa, comprising £17 million to DHN Drinks (2010 – £30 million) and £5 million (2010 – £25 million) to Sedibeng Brewery. In the year ended 30 June 2011 an £18 million loan to DHN Drinks was converted to equity (2010 – £19 million). In the year ended 30 June 2010 a £1 million loan was made to Namibia Breweries Limited and an £8 million equity contribution to Quanxing.

Other disclosures in respect of associates are included in note 7 and note 14.

Joint ventures Transactions between the group and its joint ventures were as follows:

- Group sales include sales to joint ventures of £5 million (2010 £5 million; 2009 £5 million) and operating costs include purchases from joint ventures of £21 million (2010 – £17 million; 2009 – £17 million).
- At 30 June 2011, group receivables included £7 million receivable from joint ventures (2010 £7 million) and group payables included £3 million payable to joint ventures (2010 £2 million).

**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'.

	2011 £ million	2010 £ million	2009 £ million
Salaries and short term employee bene ts	20	21	12
Non-executive directors' fees	1	1	1
Share-based payments	10	10	10
Other long term bene ts	_	_	1
Post employment bene ts	4	4	3
Termination bene ts	1	_	_
	36	36	27

Non-executive directors do not receive share-based payments or post employment bene ts.

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 £18 million (2010 - £28 million; 2009 - £14 million).

#### 33. Commitments

Capital expenditure Commitments for expenditure on property, plant and equipment not provided for in these consolidated nancial statements are estimated at £148 million (2010 – £112 million).

**Operating lease commitments** The minimum lease rentals to be paid under non-cancellable leases, principally in respect of properties, are as follows:

proper treat, are as removed.	2011 £ million	2010 £ million
Payments falling due:		
Within one year	104	95
Between one and two years	84	81
Between two and three years	74	66
Between three and four years	57	58
Between four and ve years	49	50
After ve years	354	322
	722	672

There are no signic cant 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 £44 million (2010 – £57 million), of which £9 million (2010 – £11 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.

#### **Purchase commitments**

Diageo's subsidiary undertaking, EABL, of which Diageo owns 50.03%, has agreed to the purchase of SABMiller Africa BV's 20% equity stake in Kenya Breweries Limited (KBL) for cash consideration of the US dollar equivalent of 19.5 billion Kenyan shillings at completion

## Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

116 Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

178 Notes to the company nancial statements

#### 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 2011 by principal plan is as follows:

	2011 £ million	2010 £ million	2009 £ million
Executive share option plans			
Diageo executive long term incentive plan	2	1	_
Diageo senior executive share option plan	2	3	3
Diageo executive share option plan	4	7	11
Savings plans	4	5	5
Executive share award plans			
Diageo executive long term incentive plan	7	1	_
Performance share plan	11	10	9
Discretionary incentive plan	4	4	3
	34	31	31

The fair value charge includes £4 million of exceptional operating costs (2010 – £1 million; 2009 – £2 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 (DSOP). 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 satis ed, although the top 70 senior executives are required to hold 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 the market value at the time of grant. Options granted under this scheme may normally be exercised between three and 10 years after the date granted but only to the extent that a performance condition is satis ed. 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 2010 grant, targets were set at 3% to 7% compound annual growth in adjusted EPS. The proportion of options that can be exercised depends on the extent to which the EPS growth targets have been met. For the 2010 grant, the exercise range is 25% for threshold performance up to 100% for achieving 7% or more compound annual growth in adjusted EPS. Re-testing of the performance condition is not permitted. US executives are granted options over the company's ADSs.

#### 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 ve 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 the time of the option grant.

- (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 12 months after grant at a price equivalent to 85% of the market value of the ADSs at the time of the option grant.
- (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 o ered the opportunity to purchase Diageo shares or share units and receive matching shares or share units subject to continued employment. Plan rules permit exibility 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 ve shares and receive one free.

### 34. Employee share compensation continued

(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 ve years after grant. The option exercise price was set at a discount to the market value at the time of grant, 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 di erent 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 two performance tests. 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 rst 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 nancial performance, typically measured by improvement in an adjusted EPS measure. 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 the rst awards were granted in March 2010 to a small number of senior executives. No payment is made for awards. Awards over shares or ADSs are granted under the plan, normally in the form of conditional rights to receive shares or ADSs. Awards vest over a three to ve-year period with performance criteria varying by employee.

In certain markets DELTIP, 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.

For the three years ended 30 June 2011, 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:

## Financial statements

111 Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

Consolidated statement of cash ows

Accounting policies of the group

#### 121 Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

176
Accounting policies of the company

178 Notes to the company nancial statements

Performance summary

**Business description** 

	Executive share option plans	Savings plans	Executive share award plans
2011			
Weighted average assumptions			
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			
Weighted average assumptions			***************************************
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
2009			
Weighted average assumptions			***************************************
Risk free interest rate	4.2%	4.0%	3.6%
Expected life of the options	60 months	43 months	36 months
Expected volatility	14%	15%	_
Dividend yield	4.2%	4.2%	4.2%
Weighted average exercise price	992p	816p	_
Weighted average share price	987p	906p	902p
Weighted average fair value of options/awards granted in the year	132p	159p	428p
Number of options/awards granted in the year	10.9 million	3.0 million	3.1 million
Fair value of all options/awards granted in the year	£14 million	£5 million	£13 million

The risk free interest rate is based on the UK treasury coupon strips in e ect 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.

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.

## Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

113 Consolidated statement of comprehensive income

114 Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows (ii) 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.

(iii) 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.

#### 35. Post balance sheet events

On 5 July 2011 Diageo completed the acquisition of a 50% equity controlling stake in Rum Creations Products Inc, the owner of the Zacapa rum brand, from Industrias Licoreras de Guatemala.

On 14 July 2011, Diageo acquired an additional 4% equity stake in Quanxing from Chengdu Yingsheng Investment Holding Co., Ltd becoming the indirect largest shareholder of ShuiJingFang. In accordance with Chinese takeover regulations, Diageo expects to make a mandatory tender o er to all other shareholders of ShuiJingFang. The tender o er is expected to be completed by the end of the calendar year.

On 23 August 2011, having received the necessary regulatory clearances, Diageo completed the acquisition of Mey çki Sanayi VE Ticaret A.S. (Mey çki) from TPG Capital and the Actera group. The Turkish Competition Authority clearance is conditional upon the subsequent disposal of the Mey çki brands Hare liqueur and Maestro gin. Diageo anticipates that these disposals will be completed in the year ending 30 June 2012. Mey çki is the leading producer and distributor of raki in Turkey and also owns other brands including vodka and wine brands. Mey çki will be fully consolidated and transforms Diageo's existing position in this fast growing spirits market. See note 30 for further details of these acquisitions.

Financial

statements

Consolidated

Consolidated statement of

income

comprehensive

Consolidated

balance sheet

Consolidated

statement of changes in equity

Consolidated

statement of

Accounting policies of the group

nancial statements

cash ows

121 Notes to the consolidated

Auditor's report in

income statement

respect of the Group

Diageo Annual Report 2011

We have audited the parent company nancial statements of Diageo plc for the year ended 30 June 2011 which comprise the company balance sheet and related notes. The nancial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

#### Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibilities statement set out in the corporate governance report, the directors are responsible for the preparation of the parent company nancial statements and for being satis ed that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the parent company nancial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

#### Scope of the audit of the nancial statements

A description of the scope of an audit of nancial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

#### Opinion on nancial statements

In our opinion the parent company nancial statements:

- give a true and fair view of the state of the company's affairs as at 30 June 2011;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

#### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the parent company nancial statements.

#### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

#### Other matter

We have reported separately on the consolidated nancial statements of Diageo plc for the year ended 30 June 2011.

#### Ian Starkey (Senior Statutory Auditor)

for and on behalf of KPMG Audit Plc, Statutory Auditor

#### **Chartered Accountants**

KPMG Audit Plc 15 Canada Square London E14 5GL

## Auditor's report in respect of the company 175

175 Company balance sheet

176 Accounting policies of the company

Notes to the company nancial statements

## Company balance sheet

			30 June 2011		30 June 2010
	Notes	£ million	£ million	£ million	£ million
Fixed assets					
Investments	3		27,023		27,289
Current assets					***************************************
Debtors – due within one year		***************************************	***************************************	***************************************	***************************************
Amounts owed by group undertakings		26	•••••••••••••••••••••••••••••••••••••••	134	***************************************
Financial assets	4	_	•••••••••••••••••••••••••••••••••••••••	8	
Other debtors		70	•••••••••••••••••••••••••••••••••••••••	79	***************************************
Debtors – due after one year		***************************************	***************************************	***************************************	***************************************
Financial assets	4	334	***************************************	466	***************************************
Cash at bank		16	***************************************	7	***************************************
			446		694
Creditors – due within one year		***************************************	***************************************	***************************************	***************************************
Financial liabilities	4	(1)	***************************************	(8)	***************************************
Other liabilities		(61)	•••••••••••••••••••••••••••••••••••••••	(50)	
			(62)		(58)
Net current assets		***************************************	384	***************************************	636
Total assets less current liabilities		***************************************	27,407	***************************************	27,925
Creditors – due after one year		***************************************	***************************************	***************************************	***************************************
Amounts owed to group undertakings		(10,303)	***************************************	(9,954)	***************************************
Financial liabilities	4	(332)	***************************************	(470)	***************************************
Other creditors		(9)	***************************************	(9)	***************************************
			(10,644)		(10,433)
Provisions for liabilities and charges	5	***************************************	(153)		(168)
Net assets before post employment liabilities		***************************************	16,610		17,324
Post employment liabilities		***************************************	(4)		(4)
Net assets			16,606	***************************************	17,320
Capital and reserves		***************************************		***************************************	
Called up share capital		***************************************	797	***************************************	797
Share premium		***************************************	1,343	***************************************	1,342
Merger reserve			9,161		9,161
Other reserves	•		3,146		3,146
Pro t and loss account	•		2,159		2,874
Shareholders' funds	6		16,606	***************************************	17,320

The accompanying notes are an integral part of these parent company nancial statements.

These nancial statements were approved by a duly appointed and authorised committee of the board of directors on 24 August 2011 and were signed on its behalf by PS Walsh and D Mahlan, directors.

Company registration number No. 23307

## Accounting policies of the company

#### Basis of preparation

The nancial statements are prepared on a going concern basis under the historical cost convention, modi ed to include revaluations to fair value of certain nancial instruments, in accordance with the Companies Act 2006 and UK GAAP.

By virtue of section 408 of the Companies Act 2006 the company is exempt from presenting a pro t and loss account and disclosing employee numbers and state costs. The company has taken advantage of the exemption from preparing a cash ow statement under the provisions of FRS 1 (Revised 1996) and the exemption contained in FRS 8 and has not separately disclosed transactions with wholly owned subsidiary undertakings.

The following paragraphs describe the signicant accounting policies under UK GAAP, which have been consistently applied.

#### Investments

Investments in subsidiaries are stated at their historical cost (i.e. the fair value of the consideration given by the company) less, where appropriate, impairment provisions for any permanent decrease in value.

The carrying amounts of the company's investments are reviewed at each reporting date to determine whether there is an indication of impairment. If such an indication exists, then the asset's recoverable amount is estimated. Losses are recognised in prot or loss and receted in an allowance against the carrying value. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through protor loss.

#### Dividends paid and received

The interim dividend is included in the nancial statements in the year in which it is approved by the directors, and the nal dividend in the year in which it is approved by shareholders at the annual general meeting. Dividends received are included in the nancial statements in the year in which they are receivable.

#### Share-based payments - employee bene ts

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 to the prot and loss account over the vesting period. For equity settled shares the credit is included in reserves whereas for cash settled share-based payments a liability is recognised in the balance sheet, measured initially at the fair 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 prot and loss account. Cancellations of share options are treated as an acceleration of the vesting period and any outstanding charge is recognised immediately in the prot and loss account. Shares of Diageo place held by the company for the purpose offul lling obligations in respect of various employee share plans around the group are deducted from reserves in the balance sheet. Any surplus or decit arising on the sale of the Diageo place shares held by the company are included as a movement in reserves. Where the company grants options over its own shares to the employees of its subsidiaries it recognises an increase in the cost of investment in its subsidiaries equivalent to the equity settled share-based payment charge recognised in its subsidiary's nancial statements with the corresponding credit being recognised directly in reserves.

#### Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at closing rates at the balance sheet date.

#### Pensions and other post employment bene ts

Diageo operates a number of de ned bene t pension plans. It is not possible to allocate the assets and liabilities of these pension plans between individual companies and therefore the company accounts for them as de ned contribution plans. Contributions payable in respect of de ned contribution plans are charged to operating pro t as incurred. Details of the UK Diageo Pension Scheme are provided in the consolidated nancial statements.

The company operates a number of post employment bene  $\,$ t plans which are unfunded. For these plans, the amount charged in the pro  $\,$ t and loss account is equivalent to the expected increase in the plans' liabilities over the year. Any changes in the liabilities over the year due to changes in assumptions or experience within the plans are recognised in shareholders' equity. The liability recognised on the balance sheet represents the present value of the obligations under the plans, net of related deferred tax.

#### Taxation

Tax is provided at the amounts expected to be paid applying tax rates that have been enacted or substantively enacted by the balance sheet date.

Full provision for deferred tax is made for timing dierences between the recognition of gains and losses in the nancial statements and their recognition in tax computations, using appropriate tax rates. The company does not discount these balances. Deferred tax assets are only recognised to the extent that it is more likely than not that they will be recovered. No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries or associates where no commitment has been made to remit such earnings.

## Financial statements

Auditor's report in respect of the Group

Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

115 Consolidated statement of changes in equity

116 Consolidated statement of cash ows

Accounting policies of the group

Notes to the consolidated nancial statements

174 Auditor's report in respect of the company

175 Company balance sheet

#### 176 Accounting policies of the company

178 Notes to the company nancial statements

#### Financial instruments

The company's accounting policies for nancial instruments under UK GAAP, namely FRS 25 – Financial instruments: presentation, FRS 26 – Financial instruments: measurement and FRS 29 – Financial instruments: disclosures, are the same as the group's accounting policies under IFRS, namely IAS 32 – Financial instruments: presentation, IAS 39 – Financial instruments: recognition and measurement and IFRS 7 – Financial instruments: disclosures. Derivative nancial instruments are recognised in the balance sheet at fair value calculated using discounted cash ow techniques based on market data applied consistently for similar types of instruments. Changes in the fair value of derivatives are reported in the income statement. As consolidated nancial information has been disclosed under IFRS 7 in note 23 to the consolidated nancial statements, the parent company is exempt from the disclosure requirements of FRS 29.

#### **Provisions**

Provisions are liabilities of uncertain timing or amount. A provision is recognised if, as a result of a past event, the company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an out ow of economic bene to set legal or constructive obligation. Provisions are calculated on a discounted basis, where the dierence from the original undiscounted provision is material. The carrying amounts of provisions are reviewed at each balance sheet date and adjusted to recent the current best estimate.

Financial statements

Auditor's report in respect of the Group

112 Consolidated income statement

113 Consolidated statement of comprehensive income

115 Consolidated statement of changes in equity

Consolidated statement of cash ows

121 Notes to the consolidated

Accounting policies of the group

nancial statements

Auditor's report in respect of the company

175 Company balance sheet

176

114 Consolidated balance sheet

116

## Diageo Annual Report 2011

### 5. Provisions for liabilities and charges

	Thalidomide £ million	properties £ million	provisions £ million
At 30 June 2010	167	1	168
Exchange di erences	3	_	3
Provision used during the year	(9)	_	(9)
Provision transferred to another group company	(17)	_	(17)
Unwinding of discounts	8	_	8
At 30 June 2011	152	1	153

Provisions by their nature are subject to uncertainties with respect to the timing and outcomes of future events.

(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. An additional provision of £24 million was created in the year ended 30 June 2010 in respect of anticipated future payments to new thalidomide claimants. During the year ended 30 June 2011 £17 million of the provision established in 2010 was transferred to another group company in respect of anticipated future payments in that territory.

(b) The vacant property provision is based on the estimated discounted rental shortfall over the terms of the leases up to 2031.

### 6. Shareholders' funds

					Pro tan		loss account	t
	Share capital £ million	Share premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Own shares £ million	Other £ million	Total £ million	Total shareholders' funds £ million
At 30 June 2010	797	1,342	9,161	3,146	(2,251)	5,125	2,874	17,320
Pro t for the year	_	_	_	_	***************************************	233	233	233
Employee share schemes	_	_	-	_	(4)	(5)	(9)	(9)
Share-based incentive plans	_	_	_	_	-	34	34	34
Shares issued	_	1	_	_	_	_	-	1
Dividends paid	_	_	_	_	_	(973)	(973)	(973)
At 30 June 2011	797	1,343	9,161	3,146	(2,255)	4,414	2,159	16,606
(a) Allotted and fully paid share conits	l ordinarych	oros of 20101	/ nonco	a a b				
(a) Allotted and fully paid share capita	ii – Oruiriai y Sri	ai es ui 28°°7	<sub>108</sub> pence e	eacri			Number of shares million	Nominal value £ million
At 30 June 2011 and 30 June 2010							2,754	797

**(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 £0.4 million (2010 – 0.1 million shares, nominal value less than £0.1 million, consideration £0.4 million).

**(c)** Merger reserve On the acquisition of a business, or of an interest in an associate, fair values, re-ecting conditions at the date of acquisition, are attributed to the net assets acquired. Where merger relief is applicable under the UK Companies Acts, the di-erence between the fair value of the business acquired and the nominal value of shares issued as purchase consideration is treated as a merger reserve.

### Financial statements

111 Auditor's report in respect of the Group

112 Consolidated income statement

Consolidated statement of comprehensive income

Consolidated balance sheet

Consolidated statement of changes in equity

116 Consolidated statement of cash ows

117 Accounting policies of the group

121 Notes to the consolidated nancial statements

Auditor's report in respect of the company

175 Company balance sheet

Accounting policies of the company

178 Notes to the company nancial statements

### 6. Shareholders' funds continued

(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, and share options held as treasury shares for hedging share scheme grants provided to employees during the year. Movements in shares are as follows:

	Own shares held by employees share trusts		Treasury shares repurchased under buyback programmes		Treasury shares for hedging share scheme grants to employees		Total own shares	
	Number of shares million	Purchase consideration £ million	Number of shares million	Purchase consideration £ million	Number of shares million	Purchase consideration £ million	Number of shares million	Purchase consideration £ million
At 30 June 2010	14	151	223	1,841	26	259	263	2,251
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	10	127	223	1,841	28	287	261	2,255

At 30 June 2011, own shares comprised: 10 million ordinary shares, with an aggregate nominal value of £3 million, held by employee share trusts (2010 - 14 million shares, nominal value £4 million); 223 million ordinary shares, with an aggregate nominal value of £65 million, repurchased and held as treasury shares (2010 - 223 million shares, nominal value £65 million); and 28 million ordinary shares, with an aggregate nominal value of £8 million, held as treasury shares for hedging share scheme grants (2010 - 26 million shares, nominal value £8 million).

Dividends are waived on all shares in the company owned by the employee share trusts.

During the year ended 30 June 2011, the company purchased 6 million ordinary shares, with an aggregate nominal value of £2 million, representing approximately 0.3% of the issued ordinary share capital (excluding treasury shares), to be held as treasury shares (2010 – nil shares purchased). These shares have not been cancelled, but are deducted from shareholders' equity. Dividends are waived on these shares.

During the year ended 30 June 2011, the company utilised 4 million ordinary shares held as treasury shares, with an aggregate nominal value of £1 million to satisfy options exercised by employees during the year (2010 – 3 million shares, nominal value £1 million).

### 7. Contingent liabilities

The company has guaranteed certain borrowings of subsidiaries which at 30 June 2011 amounted to £7,719 million (2010 - £8,193 million) and certain lease payment obligations until June 2030 of £304 million (2010 - £289 million). The company has also provided irrevocable guarantees relating to the liabilities of certain of its Irish and Dutch subsidiaries. In addition, the company has provided a quarantee to the Guinness Ireland Group Pension Scheme.

The companies listed below include those which principally a ect the prot sand assets of the group. The operating companies listed below may carry on the business described in the countries listed in conjunction with their subsidiaries and other group companies. A full list of subsidiaries and joint ventures, all of which are consolidated on an appropriate basis, will be included in the company's next annual return, the company having made use of the exemption in Section 410 of the Companies Act 2006.

	Country of incorporation	Country of operation	Percentage of equity owned	Business description		
Subsidiaries	- Incorporation	орегалоп		Business description		
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) Direcs

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implementation has led to an incremental increase of at least 5%\* in sales for both the customer and Diageo

## 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 15 August 2011, the following substantial interests (3% or more) in the company's ordinary share capital (voting securities) had been notified to the company.

Shareholder	Number of ordinary shares	ordinary share capital (excluding treasury shares	Date of notification of interest
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 15 August 2011, 538,987,240 ordinary shares, including those held through ADSs, were held by approximately 2,623 holders (including American Depositary Receipt (ADR) holders) with registered addresses in the United States, representing approximately 22% of the outstanding ordinary shares (excluding treasury shares). At such date, 134,578,110 ADSs were held by 1,950 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 London Stock Exchange (the Exchange) and on the Dublin and Paris Stock Exchanges. Diageo plc American Depositary Shares (ADSs), representing four Diageo plc ordinary shares each, are listed on the New York Stock Exchange (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.

Only member firms of the Exchange 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 eliqible for deferred publication.

The Markets in Financial Instruments Directive (MiFID) repealed the Investment Services Directive (ISD) on 1 November 2007. It replaced the worked principal agreement basis 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. Diageo ordinary shares have an ADT of £80 million. The ADT for each equity security is calculated as the yearly turnover divided by the number of trading days, excluding negotiated trades (i.e. those trades privately negotiated but executed within the exchange).

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.

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 ord	Per ordinary share		Per ADS		
	High pence	Low	High \$	Low \$		
Year ended 30 June						
2007	1094	895	86.79	65.83		
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		
Three months ended						
September 2009	996	867	64.44	56.42		
December 2009	1090	947	69.66	60.71		
March 2010	1116	1000	70.92	62.87		
June 2010	1160	1025	71.99	59.22		
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		
2011 monthly						
January	1258	1197	79.96	74.38		
February			***************************************			
			***************************************	***************************************		
		-				

Additional information for shareholders

183 Share capital

184 American depository shares

Articles of association

191 Independent Assurance Report of KPMG Audit Plc to Diageo plc

IBC Glossary of terms and US equivalents

### 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 15 August 2011. 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. 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 quarantee, security or indemnity in respect of obligations or liabilities incurred for the benefit of Diageo, (b) giving any quarantee, 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 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.

Additional information for shareholders

183 Share capital

184 American depository shares

#### 185 Articles of association

191 Independent Assurance Report of KPMG Audit Plc to Diageo plc

Glossary of terms and US equivalents

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
- 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

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 offer or 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 2010, 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.

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 251 million ordinary shares during the period up to the next Annual General Meeting. The minimum price which must be paid for such shares is  $28^{101}/_{108}$  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.

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 latest Annual Report, 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 classification of the holders of the holde

- a dealer in a de
- a trader in sec. a trader in sec. ark-to-market method of accounting for securities holdings;
- a tax-exempt organis
- a life insurance company;
- a person liable for alternative minimum tax;
- a person that actually or constructively owns 10% or

### Additional information for shareholders

Share capital 184

American depository shares

### Articles of association

191 Independent Assurance Report of KPMG Audit Plc to Diageo plc

Glossary of terms and US equivalents

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.

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, your ordinary shares or ADSs will be treated as stock in a PFIC if we were a PFIC at any time during your holding period in your 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

Additional information for shareholders

Share capital

184 American depository shares

Articles of association

191 Independent Assurance Report of KPMG Audit Plc to Diageo plc

Glossary of terms and US equivalents

# Independent Assurance Report of KPMG Audit Plc to Diageo plc

KPMG Audit Plc was engaged by the directors of Diageo plc ('Diageo') to provide limited assurance over selected sustainability information on page 31 marked with the symbol (\*) contained within Diageo's Annual Report for the year ended 30 June 2011.

This independent assurance report is made solely to Diageo in accordance with the terms of our engagement. Our work has been undertaken so that we might state to Diageo those matters that we have been engaged to state in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than Diageo for our work, for this independent assurance report, or for the conclusions we have reached.

### Responsibilities

The directors of Diageo are responsible for preparing the Annual Report and the information and statements within it. They are responsible for identification of stakeholders and material issues, for defining objectives with respect to sustainability performance, and for establishing and maintaining appropriate performance management and internal control systems from which reported information is derived.

Our responsibility is to express our conclusions in relation to the scope which is set out below.

### Assurance scope

#### Selected sustainability information

Reliability of performance data for each of the years ended 30 June 2009, 2010 and 2011 marked with the symbol (\*) on page 31 of the Annual Report.

### Level of assurance

assurance

#### Reporting and assurance criteria

Diageo's Environmental Reporting Guidelines for the selected sustainability information available on the Diageo website (www.diageoreports.com/sr/environmental-guidelines/). Diageo's Environmental Reporting Guidelines for:

- greenhouse gases are based on the World Resources Institute/World Business Council for Sustainable Development Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard, Revised Edition (otherwise referred as the WRI GHG protocol); and
- water consumption are based on the Global Reporting Initiative (GRI) G3 Reporting Guidelines.

The scope of Diageo's reporting that is subject to assurance, i.e. the subject matter, was determined by Diageo in accordance with the materiality principles as defined by the GRI.

The extent of evidence-gathering procedures for a limited assurance engagement is less than for a reasonable assurance engagement. Therefore, a limited assurance opinion provides a lower level of assurance than a reasonable assurance opinion.

### Inherent limitations

Non-financial performance information is subject to more inherent limitations than financial information, given the characteristics of the subject matter and the methods used for determining such information. The absence of a significant body of established practice on which to draw allows for the selection of different but acceptable measurement techniques which can result in materially different measurements and can impact comparability. The precision of different measurement techniques may also vary. Furthermore, the nature and methods used to determine such information, as well as the measurement criteria and the precision thereof, may change over time. It is important to read the selected sustainability information contained within the Annual Report in the context of Diageo's Environmental Reporting Guidelines available on the Diageo website (www.diageoreports.com/sr/environmental-quidelines/).

In particular, inherent limitations affect the conversion of electricity and fuel usage to carbon emissions data. Conversion of electricity and fuel usage to carbon emissions data is based upon, inter alia, emission factors derived by independent third parties as explained in Diageo's Environmental Reporting Guidelines. Our assurance work has not included challenging the scientific work undertaken by independent third parties when calculating these emission factors.

### Basis of our work

We conducted our work in accordance with ISAE 3000¹, which establishes the ethical and competence requirements for non-financial auditors. We conducted our engagement with a multidisciplinary and appropriately qualified team, experienced in non-financial assurance. The team included specialists in auditing environmental and financial information and with experience in similar engagements.

### Our independence

ISAE 3000 requires that the practitioner complies with the requirements of Parts A and B of the Code of Ethics for Professional Accountants <sup>2</sup>, which requires, among other requirements, that the assurance provider be independent of the assurance client, including not being involved in writing the Annual Report. The Code also includes detailed requirements for practitioners regarding integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. KPMG Audit Plc has systems and processes in place to monitor compliance with the Code and to prevent conflicts regarding independence. Our independence with the client is reviewed on an annual basis.

### Work performed

We planned and performed our work to obtain all the evidence, information and explanations that we considered necessary in relation to the above scope. Our work included, but was not limited to, the following evidence based procedures which are further explained below:

- At group level we:
- Evaluated the suitability of reporting systems against the WRI GHG Protocol, the GRI Reporting Guidelines and Diageo Internal Reporting requirements:
- Conducted interviews with management and other personnel at Diageo to obtain an understanding of the data collection process, information flows and the systems and controls used to generate, aggregate and report the environmental data;
- Reviewed measurements, calculations, supporting information, quality controls systems, and procedures which support the environmental data for each of the years ended 30 June 2009, 2010 and 2011. Our work included the application of the appropriate CO<sub>2</sub> emission factors for all sites;
- At site level:
- We tested data from fourteen different sites covering between 39% and 63% of the data for each data set over the three year period 1 July 2008 to 30 June 2011.
- Our testing was undertaken over a period of two financial years (year ended 30 June 2010 and year ended 30 June 2011). In the year ended 30 June 2010 we visited twelve sites.
- In the year ended 30 June 2011 we visited seven sites. We also undertook desk-based reviews of the data sets for three sites.
- The sites were selected based on their risk factors and levels of materiality, e.g. contribution to Group CO<sub>n</sub> emissions, size, and location.

### Conclusion

Based on the procedures performed, as described above, nothing has come to our attention to suggest that the selected sustainability information, marked with the symbol (\*), on page 31 of the Annual Report for the year ended 30 June 2011, is not fairly stated, in all material respects in accordance with Diageo's Environmental Reporting Guidelines.

### lan Starkey for and on behalf of KPMG Audit Plc

Chartered Accountants London 24 August 2011

- 1 International Standard on Assurance Engagements 3000: Assurance engagements other than audits or reviews of historical information, issued by the International Auditing and Assurance Standards Board.
- 2 ISAE 3000 was issued by the International Ethics Standards Board for Accountants (the IESBA Code).

# Diageo Annual Report 2011

Additional information for shareholders

183 Share capital

184 American depository shares

185 Articles of association

191 Independent Assurance Report of KPMG Audit Plc to Diageo plc

IBC Glossary of terms and US equivalents

# Glossary of terms and US equivalents

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