DIAGEO

Annual Report 2017

2017 performance highlights

Volume
Reported movement ↓1.7%
Organic movement ↑1.1%

EU242.2m

2017	EU242.2m
2016	EU246.4m

Equivalent units (EU)

Net sales(i)
Reported movement ↑14.9%
Organic movement ↑4.3%

£12,050m

2017	£12,050m
2016	£10,485m

Operating profit
Reported movement ↑25.3%
Organic movement ↑5.6%

£3,559m

2017	£3,559m
2016	£2,841m

Net cash from operating activities
2017 increase of £584m
2017 free cash flow(ii) £2,663m ↑£566m

£3,132m

2017	£3,132m
2016	£2,548m

Earnings per share (eps)
Reported movement ↑18%
Eps before exceptional items(ii) movement ↑21%

106.0p

2017	106.0p
2016	89.5p

Total recommended dividend per share(iii)
↑ 5%

62.2p

2017	62.2p
2016	59.2p

Alcohol in society

264 programmes

2017	264
2016	335

Reach and impact of responsible drinking programmes

Health and safety

1.14Δ

2017	1.14Δ
2016	1.44

Lost-time accident frequency(iv)

Water efficiency(v)

4.96l/lΔ

2017	4.96l/lΔ
2016	5.13l/l

(i) Net sales are sales less excise duties. See definition on page 105. (ii) See definitions and reconciliations on page 55. (iii) Includes recommended final dividend of 38.5p. (iv) Per 1,000 full-time employees. (v) Data for the year ended 30 June 2016 has been restated in accordance with Diageo's environmental reporting methodologies. Δ Within PwC's independent limited assurance scope. For further detail and the reporting methodologies, see our Sustainability & Responsibility Performance Addendum 2017.

NORTH AMERICA

Volume
EU47.4m
Reported: ↑1%
Organic: ↑2%

Net sales(i)
£4,161m
Reported: ↑17%
Organic: ↑3%

Operating profit(ii)
£1,899m
Reported: ↑22%
Organic: ↑4%

Read more **p28 & 29**

EUROPE, RUSSIA AND TURKEY

Volume
EU44.4m
Reported: ↑1%
Organic: ↑3%

Net sales(i)
£2,824m
Reported: ↑11%
Organic: ↑5%

Operating profit(ii)
£936m
Reported: ↑17%
Organic: ↑8%

Read more **p30 & 31**

AFRICA

Volume
EU32.2m
Reported: ↑3%
Organic: ↑3%

Net sales(i)
£1,556m
Reported: ↑11%
Organic: ↑5%

Operating profit(ii)
£218m
Reported: ↑3%
Organic: ↑10%

Read more **p32 & 33**

LATIN AMERICA AND CARIBBEAN

Volume
EU21.1m
Reported: ↑2%
Organic: ↑2%

Net sales(i)
£1,044m
Reported: ↑21%
Organic: ↑9%

Operating profit(ii)
£250m
Reported: ↑26%
Organic: ↑15%

Read more **p34 & 35**

ASIA PACIFIC

Volume
EU97.1m
Reported: ↓6%
Organic: ↓1%

Net sales(i)
£2,419m
Reported: ↑17%
Organic: ↑3%

Operating profit(ii)
£487m
Reported: ↑23%
Organic: ↑4%

Read more **p36 & 37**

(i) Does not include corporate net sales of £46 million (2016 – £36 million). (ii) Excluding exceptional operating charges of £42 million (2016 – £167 million) and net corporate operating costs of £189 million (2016 – £150 million).

Diageo in 2017

Diageo is a global leader in beverage alcohol with an outstanding collection of brands across spirits and beer.

Our products are sold in more than 180 countries around the world. Our brands include Johnnie Walker, Crown Royal, J&B, Buchanan's and Windsor whiskies, Smirnoff, Cîroc and Ketel One vodkas, Captain Morgan, Baileys, Don Julio, Tanqueray and Guinness.

Our performance ambition is to be one of the best performing, most trusted and respected consumer products companies in the world.

We are proud of the brands we make and the enjoyment they give to millions. We are passionate about alcohol playing a positive role in society as part of a balanced lifestyle. This is central to our purpose to help people celebrate life.

Cover image: Diageo Cambus Cooperage, Scotland. Image inspired by a submission to our employee competition 'The Big Picture', by Graduate Trainee, Rory Slater. Rory's photo won the 'Proud of what we do' category. Each competition category celebrates one of Diageo's values.

For more information about Diageo, our people and our brands, visit **www.diageo.com**.

Visit Diageo's global responsible drinking resource, **www.DRINKiQ.com**, for information, initiatives, and ways to share best practice.

In addition, Diageo has prepared a Sustainability & Responsibility Performance Addendum 2017, which is available on **www.diageo.com**. It outlines further economic, social and environmental disclosures in line with the Global Reporting Initiative Sustainability G4 Guidelines and the United Nations Global Compact advanced reporting criteria.

Diageo is listed on both the London Stock Exchange (DGE) and the New York Stock Exchange (DEO).

This is the Annual Report 2017 of Diageo plc for the year ended 30 June 2017 and it is dated 27 July 2017. The Annual Report is made available to all shareholders on Diageo's website (**www.diageo.com**).

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 the terms 'group' and 'Diageo' refer to the company and its consolidated subsidiaries, except as the context otherwise requires.

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

Unless otherwise stated in this document, percentage movements refer to organic movements which are non-GAAP financial measures. For a definition of organic movement and reconciliations of non-GAAP measure to GAAP measures see page 52. Share, unless otherwise stated, refers to value share. Unless otherwise stated in this document, the percentage figures presented are reflective of a year-on-year comparison, namely 2016-2017, only.

The brand ranking information presented in this report, when comparing information with competitors, reflects data published by sources such as Impact Databank. Market data information and competitive set classifications are taken from independent industry sources in the markets in which Diageo operates.

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

Cautionary statement: this document contains 'forward-looking' statements. For our full cautionary statement, please see on page 159.

Contents

Our business model

Diageo is a global leader in beverage alcohol with iconic brands across spirits and beer. We truly understand the consumer and have world-class marketing and innovation skills to build powerful brands that play a positive role in society.

Our organisation is structured into a market-based business model, applying country-specific strategies to meet consumer and customer needs.

Our business model enables us to identify and act on consumer trends early and deliver sustainable performance.

We do this by identifying and executing against the most valuable growth opportunities, using our global expertise to supply our brands efficiently and effectively, and sourcing and producing locally where optimal to do so.

We aim to deliver returns for shareholders, while creating value for our customers and employees. In everything we do, we set out to make a positive contribution to society.

Global leader

Values
Passionate about customers and consumers; be the best; freedom to succeed; proud of what we do; valuing each other.

Broad portfolio
Across categories, brands and price points. Our markets draw on a portfolio of global and local brands to best meet their consumer and customer needs.

Global reach
180 countries; we have a leading position in the geographies that will generate most of the medium-term industry growth and have broad reach in key markets, the United States and Europe.

Our role in society
Passionate about ensuring alcohol plays a positive role in society. Increasing access to opportunity to support thriving communities and reducing our environmental impact.

Financial strength
Strong financial returns and consistent financial performance.

Efficient supply and procurement
High-quality manufacturing and environmental standards.

Brilliant execution
Cutting-edge consumer insights and marketing, scalable innovation, and valuable winning relationships with our customers through distribution and sales.

Strength through global reach and iconic brands

We build global brands alongside local stars. These brands have broad consumer appeal across geographies to meet demand now and in the future.

We produce
We are committed to efficient, sustainable production to the highest quality standards.

We innovate
Led by consumer insights, we unlock new opportunities through our recruit, re-recruit, disrupt approach.

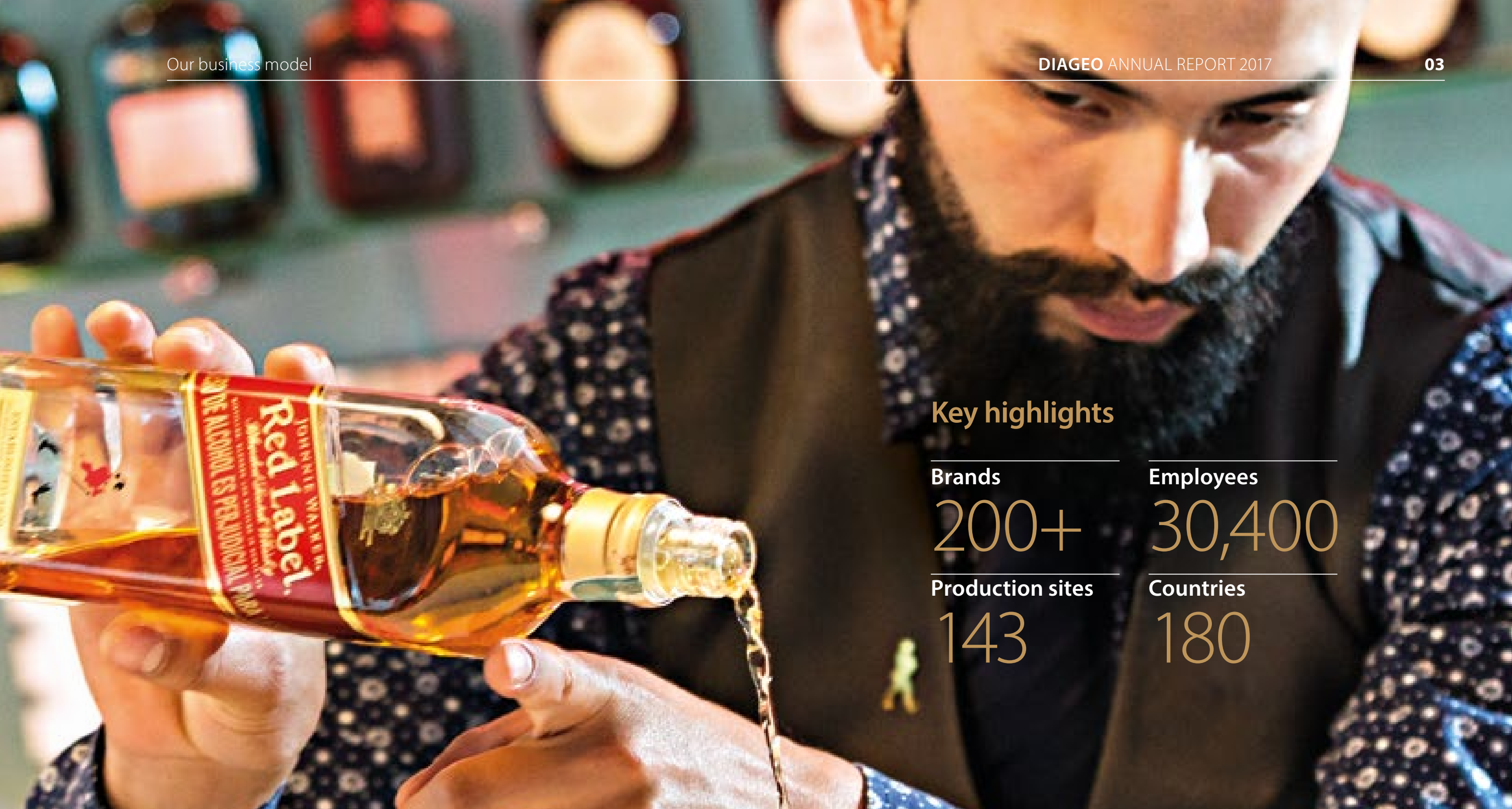
We market
We invest in world-class marketing to build our brands, focused on programmes which recruit and re-recruit consumers responsibly.

We sell
We work to extend our sales reach by ensuring our products are available where people want them and by delivering memorable consumer experiences.

Doing business the right way

For us, standards are everything, from how we produce and market our brands, to how we innovate and sell, and in governance and ethics as set out in our Code of Business Conduct.

Value creation: shareholder value; investment in



Key highlights

Brands	Employees
200+	30,400
Production sites	**Countries**
143	180

Agile business model

Market-based

— **Consumer insights:** Our in-market teams are able to identify trends more accurately and quickly, delivering more locally relevant solutions.

— **Portfolio strategy:** We have the flexibility to select the best portfolio of brands to capture the unique consumer opportunity in each market, and then to invest directly against the most valuable growth opportunities.

— **Supply resources:** Our markets are designated as import markets; import and third party production markets; or import and local-owned production markets.

Global functions

Our markets are supported by a global structure and shared services designed to drive efficiency, share best practice, impart knowledge and help build capability at a local level, as well as set the standards for governance of controls, compliance and ethics.

Our people

We want all our employees around the world to reach their full potential and play their part in the success of our business. To achieve this we have created a diverse and inclusive culture, with shared values and a common purpose.

the business; customer, employee and social value.

Our strategy

Growth in the spirits category is being driven by population and income growth, and the increasing penetration of spirits in emerging markets. We aim to grow our participation in international premium spirits.

Our strategy is to support premiumisation in developed markets and increase our spirits participation in emerging markets through categories that give us access to the growing middle class consumer.

To support this, we participate in both beer and mainstream spirits selectively where it delivers organisational scale and distribution reach, allows consumers to access our brands at affordable price points and to shape responsible drinking trends in markets where international premium spirits is an emerging category.

Our broad portfolio means we have leading positions across many of our markets, enabling us to serve consumer occasions with our brands, across price points.

Everywhere we operate, we do so in a responsible and sustainable way.

Our strategy is delivered through

Six executional priorities

Keep premium core vibrant
Our premium core brands account for roughly two thirds of Diageo's net sales. Ensuring we have a vibrant premium core is therefore critical to our overall performance.

Increase participation in mainstream spirits
Mainstream spirits is a sizeable and growing opportunity. We have rapidly invested in mainstream spirits and now have a strong foundation from which to drive growth.

Continue to win in reserve
We build our reserve brands by ensuring they are available in the most influential accounts and build their reputation with the bartenders and consumers who set trends.

Drive innovation at scale
We build on our existing brands, fulfil new consumer occasions and create the brands of tomorrow with a focus on scale and speed.

Build an advantaged route to consumer
Consumers are at the heart of our business; using insights we ensure we understand where we invest our resources and that our brands show up consistently.

Embed productivity to drive out costs and invest in growth
We are focused on everyday efficiency, effectiveness and agility to reduce costs and create fuel for our growth.

Our strategy in action **pages 16 & 17.**

Our sustainability and responsibility priorities and our commitment to governance and ethics

Creating a positive role for alcohol in society
We are committed to alcohol playing a positive role in society with our work to tackle alcohol misuse alongside the industry. We remain focused on delivering the five Global Producers' Commitments[(i)] and our own stretching 2020 targets.

(i) For more information on the Beer, Wine and Spirits Producers' Commitments, visit **www.producerscommitments.org.**

Building thriving communities
We want to continue to make Diageo a great, safe and diverse place to work for our people. We want to build sustainable supply chains and create programmes that empower communities and individuals and increase their access to opportunity.

Reducing our environmental impact
We are dependent on the natural resources we share with the communities around us, and with the wider world. We are working to reduce our impact in the areas of water, carbon, packaging, and waste.

Highest standards of governance and ethics
We are constantly looking for ways to strengthen our culture of integrity to help our people make the right choices. For example, within 30 days of joining, all employees complete our Code of Business Conduct training, which sets out our commitment to conducting business in accordance with the laws and regulations to which our activities are subject, in a way that brings to life our purpose and values.

Our strategy in action **page 18.**

We measure progress against our strategy using the following financial and non-financial indicators

Outcomes of our strategy

1. Efficient growth
2. Consistent value creation
3. Credibility and trust
4. Motivated people

Organic net sales growth	1
Organic operating margin improvement	1
Earnings per share before exceptional items	1
Free cash flow	1
Return on average invested capital	2
Total shareholder return	2
Reach and impact of responsible drinking programmes	3 4
Health and safety	3 4
Water efficiency	1 3
Carbon emissions	1 3
Employee engagement index	3 4

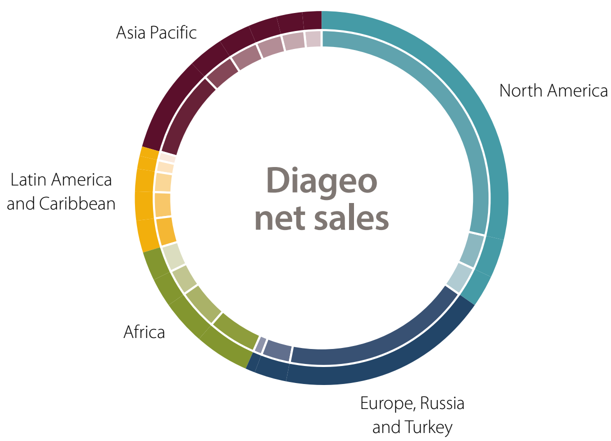
See our key performance indicators (KPIs) on **pages 8 & 9**

Our global reach

Diageo is the leading international spirits player in every region of the world. This regional profile provides us with exposure to the greatest consumer growth opportunities in our sector. We operate as a market-based business and have a presence in over 180 countries. We employ more than 30,400 talented people across our global business.

% Share of net sales by our markets[i]

Each of our markets is accountable for its own performance and for driving growth



(i) Based on reported net sales for the year ended 30 June 2017. Does not include corporate net sales of £46 million.

Our markets

- US Spirits
- Diageo Beer Company USA (DBC USA)
- Canada
- Europe
- Turkey
- Russia
- East Africa
- Africa Regional Markets (ARM)
- Nigeria
- South Africa
- Paraguay, Uruguay and Brazil (PUB)
- Mexico
- Central America and Caribbean (CCA)
- Andean (Colombia and Venezuela)
- Peru, Ecuador, Bolivia, Argentina, Chile (PEBAC)
- India
- Greater China
- Australia
- South East Asia
- North Asia
- Travel Retail Asia and Middle East

Diageo reports as five regions

% Share by region	North America	Europe, Russia and Turkey	Africa	Latin America and Caribbean	Asia Pacific
Volume (%)	19.6	18.3	13.3	8.7	40.1
Net sales[i] (%)	34.7	23.4	13.0	8.7	20.2
Operating profit before exceptional items[ii] (%)	50.1	24.7	5.8	6.6	12.8
Operating profit[iii] (%)	50.7	24.0	5.8	6.7	12.8
Number of responsible drinking programmes (%)	26.9	34.8	7.2	12.2	18.9
Water withdrawal (%)	11.1	39.4	37.7	1.4	10.4
Carbon emission[iv] (%)	7.9	42.3	37.7	2.6	9.5
Number of employees[v] (%)	9.2	36.5	16.3	9.1	28.9

(i) Does not include corporate net sales of £46 million. (ii) Excluding exceptional operating charges of £42 million (2016 – £167 million) and net corporate operating costs of £189 million (2016 – £150 million). (iii) Excluding net corporate operating costs of £189 million (2016 – £150 million). (iv) Excludes corporate offices which account for <2% of combined impacts. (v) Employees have been allocated to the region in which they reside.

Our brands

Our global reach is matched by our broad portfolio of international and local brands. Our portfolio plays across categories and price tiers, enabling us to participate where the consumer opportunity is greatest to support consistent, reliable growth.

We own two of the top five largest spirits brands in the world, Johnnie Walker and Smirnoff, and 20 of the world's top 100 spirits brands.

Using local market insights, our teams select the most relevant brands from our global portfolio to meet the consumer opportunity in their market. A selection of our brands are included in the table below.

Global giants(i)

Our business is built around our six biggest global brands.

Johnnie Walker Keep Walking
Smirnoff
Baileys
Captain Morgan
Tanqueray
Guinness

Local stars(ii)

Can be individual to any one market, and provide a platform for our business to grow.

Crown Royal
Yeni Raki
J&B
Buchanan's
Windsor
Grand Old Parr
Bundaberg
McDowell's No1
Ypióca
Shui Jing Fang
Black & White Blended Scotch Whisky

Reserve(iii)

Exceptional spirits brands at above-premium price points to capture the global luxury opportunity.

Johnnie Walker Blue Label
Johnnie Walker Gold Label Reserve
John Walker & Sons King George V
John Walker & Sons Private Collection
Lagavulin
The Singleton of Glen Ord
Cîroc
Ketel One Vodka
Tanqueray No Ten
Ron Zacapa
Don Julio
Bulleit Bourbon

Source: Impact Databank Value Ratings, May 2017. (i) Global giants represent 41% of Diageo net sales. (ii) Local stars represent 20% of Diageo net sales. (iii) Reserve represent 16% of Diageo net sales.

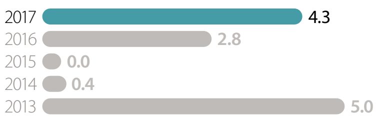
How we measure performance:

Key performance indicators

Financial ® 1

Organic net sales growth (%)

4.3%



Definition
Sales growth after deducting excise duties, excluding the impact of exchange rate movements, acquisitions and disposals.

Why we measure
This measure reflects our performance as the result of the choices made in terms of category and market participation, and Diageo's ability to build brand equity, increase prices and grow market share.

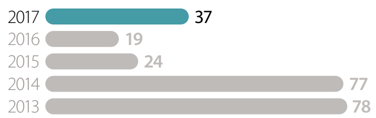
Performance
Organic net sales growth was driven by 1.1% volume growth and 3.2% positive price/mix. Overall, pricing is muted across many of our markets but mix remains strong.

More detail on **page 23**

Financial ® 1

Organic operating margin improvement (bps)

37bps



Definition
The percentage point movement in operating profit before exceptional items, divided by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.

Why we measure
The movement in operating margin measures the efficiency of the business. Consistent operating margin improvement is a business imperative, driven by investment choices, our focus on driving out costs across the business and improving mix.

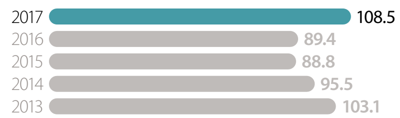
Performance
On an organic basis operating margin expanded 37bps driven by our productivity programme which enabled gross margin expansion, marketing efficiencies and overhead savings.

More detail on **page 23**

Financial ® 1

Earnings per share before exceptional items (pence)[i]

108.5p



Definition
Profit before exceptional items attributable to equity shareholders of the parent company, divided by the weighted average number of shares in issue.

Why we measure
Earnings per share reflects the profitability of the business and how effectively we finance our balance sheet. It is a key measure for our shareholders.

Performance
Eps before exceptional items increased 19.1 pence as favourable exchange, organic operating profit growth and higher income from associates more than offset the negative impact from higher tax charges and the exchange impact on reported tax.

More detail on **page 24**

Non-Financial 3 4

Alcohol in society (reach and impact of responsible drinking programmes)

264 programmes

Definition
Number of programmes supported by Diageo that aim to reduce harmful drinking.

Why we measure
We put our resources and skills into programmes that encourage a responsible attitude to alcohol and are effective in preventing and reducing alcohol misuse, and work with others to maximise impact. Evaluating the impact of our programmes is challenging, but essential in ensuring we properly address the risk of harm to consumers or communities.

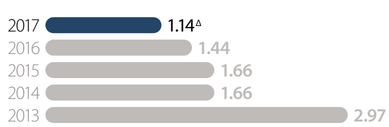
Performance
We supported fewer programmes than last year as we aimed to concentrate our efforts on those that will have the biggest impact on the issues we aim to address. We share case studies of how we evaluate the programmes on www.diageo.com. In 2017, 95% of our top 19[ii] countries evaluated their programmes, compared with 84% in 2016.

More detail on **page 41**

Non-Financial 3 4

Health and safety (lost-time accident frequency per 1,000 full-time employees)

1.14$^{\Delta}$



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

Why we measure
Safety is a basic human right: everyone has the right to work in a safe environment, and our Zero Harm safety philosophy is that everyone should go home safe, every day, everywhere.

Performance
LTAs were down 21% compared with 2016. We focused on markets in particular need of improvement, embedding compliance to our core standards and programmes, while maintaining strong performance in our more established markets. However, progress was overshadowed by the death of a contractor cleaner in India; our investigation showed that our protocols and procedures are the right ones, and we are working to ensure consistent compliance in all markets.

More detail on **page 44**

Non-Financial 1 3

Water efficiency[iii] (l/l)

4.96l/l$^{\Delta}$

Definition
Ratio of the amount of water required to produce one litre of packaged product.

Why we measure
Water is the main ingredient in all of our brands. To sustain production growth and respond to the growing global demand for water while scarcity increases, we aim to improve efficiency, minimising our water use particularly in water-stressed areas.

Performance
Water efficiency improved by 3.3% compared to 2016 and 40% versus our 2007 baseline, with particular progress in markets with sites in water-stressed locations.

More detail on **pages 48–49**

We use the following 11 key performance indicators (KPIs) to measure our financial and non-financial performance.

Our KPIs measure progress against our strategy. Our performance against our KPIs are explained below:

Relevance to strategy

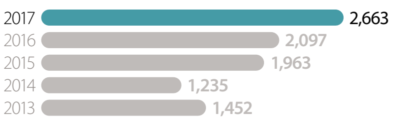
1. Efficient growth
2. Consistent value creation
3. Credibility and trust
4. Motivated people

Financial ® 1

Free cash flow

(£ million)

£2,663m



Definition
Free cash flow comprises the net cash flow from operating activities aggregated with the net cash received/paid for loans receivable and other investments, and the net cash cost paid for property, plant and equipment, and computer software.

Why we measure
Free cash flow is a key indicator of the financial management of the business and reflects the cash generated by the business to fund payments to our shareholders and acquisitions.

Performance
Improvement was driven by favourable exchange, higher organic operating profit growth and favourable working capital movement, driven by improvement in debtor collection, partially offset by higher tax payments.

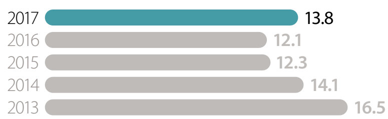
More detail on **page 24**

Financial 2

Return on average invested capital

(ROIC) (%)

13.8%



Definition
Profit before finance charges and exceptional items attributable to equity shareholders divided by average invested capital. Invested capital comprises net assets aggregated with exceptional restructuring costs and goodwill at the date of transition to IFRS, excluding post employment liabilities, net borrowings and non-controlling interests.

Why we measure
ROIC is used by management to assess the return obtained from the group's asset base. Improving ROIC builds financial strength to enable Diageo to attain its financial objectives.

Performance
Favourable exchange and organic operating profit growth resulted in an increase in ROIC, partially offset by higher tax charges.

More detail on **page 24**

Financial ® 2

Total shareholder return

(%)

12%

Definition
Percentage growth in the value of a Diageo share (assuming all dividends and capital distributions are re-invested).

Why we measure
Diageo's Directors have a fiduciary responsibility to maximise long-term value for shareholders. We also monitor our relative TSR performance against our peers.

Performance
Diageo delivered total shareholder return of 12% as dividends paid increased by 5% and share price increased driven by underlying business improvement and exchange.

Non-Financial 1 3

Carbon emissions(iii)

(1,000 tonnes CO_2e)

634Δ

Definition
Absolute volume of carbon emissions, in 1,000 tonnes.

Why we measure
Carbon emissions are a key element of Diageo's, and our industry's, environmental impact. Reducing our carbon emissions is a significant part of our efforts to mitigate climate change, positioning us well for a future low-carbon economy, while creating energy efficiencies and savings now.

Performance
Carbon emissions reduced by 5.6% in 2017, and by 40% against the 2007 baseline despite increased production volumes.

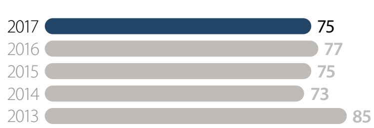
More detail on **pages 49–50**

Non-Financial 3 4

Employee engagement index

(%)

75%



Definition
Measured through our Values Survey; includes metrics for employee satisfaction, loyalty, advocacy and pride.

Why we measure
Employee engagement is a key enabler of our strategy and performance. The survey allows us to measure, quantitatively and qualitatively, how far employees believe we are living our values. The results inform our ways of working, engagement strategies and leadership development.

Performance
93% of our people participated in our Values Survey (23,043 of the 24,733 invited). 75% were identified as engaged, a drop of 2% as discussed on page 45. 89% declared themselves proud to work for Diageo, up 1% on 2016.

More detail on **pages 45–46**

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

See our Directors' remuneration report from **page 68** for more detail.

(i) For reward purposes this measure is further adjusted for the impact of exchange rates and other factors not controlled by management, to ensure focus on our underlying performance drivers.

(ii) The top 19 countries are those with the highest net sales.

(iii) In accordance with Diageo's environmental reporting methodologies and WRI/WBCSD GHG Protocol, data for each of the four years in the period ended 30 June 2016 has been restated.

Δ Within PwC's limited assurance scope. See page 158 for further details.

Chairman's statement

"Diageo has a rich heritage, quality brands, creativity, talented people and a commitment to delivering growth responsibly. On joining the Diageo Board in July 2016, and subsequently becoming Chairman in January 2017, I found Diageo to be a company in transformation, focused on the consumer."

Javier Ferrán, Chairman

Recommended final dividend per share
38.5p ↑5%
2016: 36.6p

Total dividend per share[(i)]
62.2p ↑5%
2016: 59.2p

Total shareholder return (%)
12%
2016: 17%

(i) Includes recommended final dividend.

Good progress

It is an honour to serve as Chairman of Diageo. This year saw good progress towards our ambition to become one of the best performing, most trusted and respected consumer products companies in the world.

I would like to thank Ivan, our Chief Executive, the Executive team and all Diageo employees globally who worked to deliver this year's performance. The commitment of all our people around the world to living our values and purpose – to celebrate life every day, everywhere – is one of the many reasons the company is performing well.

Opportunity for growth

Diageo is a global leader in an attractive industry, and has a strong footprint in developed markets that complements our position in emerging markets. Our opportunity for growth is supported by premiumisation and demographics. As incomes continue to grow, international premium spirits will become available to more than 730 million new consumers over the next decade. Additionally, we will see significant growth in the population of legal purchase age consumers, half of whom will come from India and Africa. Our portfolio of brands, and the balance inherent in our geographic footprint, means we are well placed to take advantage of these opportunities today and in the future.

Diageo has a clear strategy, and during the past year, the Executive Committee led by Ivan and our market teams have continued to make strong progress with broad based growth across regions, and global, local and reserve brands.

Value creation

We are committed to delivering sustainable value for our shareholders. In the first year into our medium term guidance we have delivered a strong sets of results that reported progress against all efficient growth and value creation KPIs. Ivan will cover our efficient growth KPIs in his statement.

Looking to our value creation KPIs, return on invested capital (ROIC) was up 175bps to 13.8% and total shareholder return was 12%.

Our aim is to maintain dividend cover (the ratio of basic earnings per share before exceptional items to dividend per share) in the range of 1.8 to 2.2 times. The recommended final dividend is 38.5 pence per share, an increase of 5% consistent with the interim dividend. This brings the full year dividend to 62.2 pence per share. We continue to expect to maintain dividend increases at roughly a mid-single digit rate until cover is back in range. Subject to shareholder approval the final dividend will be paid to UK holders on 5 October 2017. Payment to US ADR holders will be made on 11 October 2017.

On 26 July 2017, the Board approved a share buyback programme of up to £1.5 billion in financial year 2018, following three years of consistently improving cash flow generation.

Business environment

Diageo continues to manage and respond to geopolitical volatility around the world. Negotiations on the UK's exit from the European Union, a shift in emphasis in US trade policy and a broader resurgence of economic nationalism create uncertainty for business. However, our leadership position in many markets, and the work we have done to improve business agility, means we are more resilient and better positioned to navigate and respond to changes in the external operating environment. Our experience in working with governments and other stakeholders to support global trade, develop local value chains, empower communities and promote responsible drinking, means we have a strong platform to protect and unlock growth in the markets in which we operate.

Our role in society

Doing business in a way we can be proud of has always been a priority for Diageo. Our aim is to create value beyond the significant economic contribution we make to communities.

Diageo's approach is based on three sustainability and responsibility priorities, which are the most material to the business and our stakeholders:

- Creating a positive role for alcohol in society
- Building thriving communities
- Reducing our environmental impact

Alcohol is an established part of how many people socialise and celebrate life in many societies around the world, and we are proud that our brands are chosen for these occasions. Diageo works with governments, partners and other stakeholders all around the world to target specific issues such as drink driving, underage drinking or heavy episodic drinking, with programmes that aim to change behaviour and reduce harm.

Programmes such as Learning for Life, which creates opportunities for training and careers in the hospitality industry, and Plan W in Asia, which empowers women through learning, both support our alcohol in society agenda and demonstrate our commitment to supporting the communities in which we operate. We have even more scope to have a positive impact, through the full value chain of our business, which connects us to millions of people through the sourcing, making and selling of our products.

Our supply chain work is a crucial element in ensuring that we are environmentally sustainable as a business and play our part in addressing climate change. We have made significant progress over recent years in reducing the environmental impact of our operations and our supply chain on water, greenhouse gas emissions, waste and packaging.

We are clear on the behaviours and values we expect all employees to live by. This year, every employee in the business did refresher training on our Code of Business Conduct, to aid us all in making the right decisions, each and every day.

Diversity

Diversity helps our business to grow. At Diageo we respect the unique contribution each person makes to our business. I am particularly proud that Diageo has focused on achieving greater diversity at the most senior level. 40% of our Board members and 40% of our Executive Committee are women. Diageo's Executive Committee is a team of highly successful men and women who represent six different nationalities, speak multiple languages and have lived and worked across the globe in their careers to date. This year, Diageo was ranked 10th out of more than 3,000 companies from around the world in Equileap's Gender Equality Global Report and Ranking. We are proud of this achievement and are continuing to increase the representation of women in our senior leadership, towards our target of 35% by 2020.

Board changes

At the end of December 2016, Franz Humer retired from the Board after almost 12 years of service. I would once again like to thank Franz for his leadership and assistance in a smooth transition. Under his chairmanship, Diageo's share price grew 128% and he stepped down with the company on a sound footing for the future.

In September 2016, following her appointment as GSK CEO, Emma Walmsley stood down from the Board. Emma joined our Board as a Non-Executive Director in January 2016 and I would like to thank Emma sincerely for her contribution to the Board during this time.

Philip Scott stood down from his role as Chair of Diageo's Audit Committee in December 2016, and after almost 10 years of service will retire from the Board at the 2017 AGM. Alan Stewart was appointed Chair of Diageo's Audit Committee, effective 1 January 2017. Alan's experience in retail, travel and banking, as well as his background in accountancy and financial management, will serve Diageo well in this important role.

In July 2017, Ursula Burns' appointment to the Board as a Non-Executive Director was announced, effective April 2018. Ursula's significant and senior expertise in corporate services, manufacturing and product development will be a valuable addition to the Board. I look forward to welcoming Ursula.

Looking ahead

Diageo made good progress this year. The Board is confident that the company has the right strategy, leadership and culture to deliver on its full potential. The commitment of the Board and the Executive team remains unwavering in pursuit of delivering value for all stakeholders.

Javier Ferrán
Chairman

Chief Executive's statement

"We continue to build a stronger, more consistent, better performing company. We are delivering against our strategy and this is coming through in our performance. We built on the improved performance we announced last year."

Ivan Menezes, Chief Executive

Performance review

We delivered organic net sales up 4.3%, driven by organic volume up 1.1% and strong price mix with broad based growth across categories and regions. Organic operating margin expanded by 37bps driven by our global productivity programme and positive mix.

Reported net sales and operating profit were up 15% and 25% respectively, reflecting favourable exchange and accelerated organic growth. Operating profit grew 5.6% on an organic basis.

All regions delivered organic net sales growth and we reported broad based growth across all categories, except vodka. Our global giant brands delivered organic net sales up 3%, with Johnnie Walker, Captain Morgan, Baileys and Tanqueray in growth in every region. Smirnoff organic net sales were down 1%, still challenged in a competitive vodka category in the US, and Guinness organic net sales were flat, impacted by weakness in Nigeria and Kenya.

Earnings per share before exceptional items was up significantly at 21% driven by exchange benefits, organic growth and higher associate income.

Our focus on cash conversion and working capital contributed to deliver free cash flow at £2.7 billion, up £566 million in the year. Our cash conversion continues to be strong at 107%.

A year of progress

We made good progress against the three focus areas we identified for the year: US spirits, scotch and India. Organic net sales growth in US spirits, scotch and India were 3.4%, 4.7% and 1.9% respectively. I am pleased with the momentum we built in the scotch category during the year, and, in the US, share gains were achieved in all key categories, except vodka. In India, we experienced a challenging environment with demonetisation and the Supreme Court ruling, banning sales by outlets near highways.

When I laid out our Performance Ambition, the most important change I wanted to drive was to put the consumer at the heart of the business – and we have made great progress:

Volume movement	Organic volume movement	Net sales movement	Organic net sales movement	Operating profit movement	Organic operating profit movement
↓1.7%	↑1.1%	↑14.9%	↑4.3%	↑25.3%	↑5.6%
2016: ↑0.1%	2016: ↑1.3%	2016: ↓3.0%	2016: ↑2.8%	2016: ↑1.6%	2016: ↑3.5%

- We are better equipped to win at the moment of choice – with increased outlet coverage and better sales execution
- Our work on gathering improved insight and measurement is enabling us to make better, more informed decisions, and sets us up well for the future
- We are a more agile organisation – simpler and quicker – able to adapt more quickly to changing consumer trends
- We bring an efficiency mindset to everything we do

This progress builds on the strength we have in our portfolio of iconic brands and our track record in innovation. I am proud that our brands won 66 awards at the 2017 San Francisco World Spirits Competition, more than a third of which were Gold or Double Gold. This not only included great recognition for established brands such as Buchanan's Special Reserve, Johnnie Walker Green Label and Lagavulin 16 Year Old, but also for innovations such as our premium Irish whiskey Roe & Co, launched to consumers in Europe this year.

As we grow our business, our priority is to invest behind organic growth. We also look for bolt-on acquisitions that will deliver attractive returns and expand our leadership position. For example, in June 2017, we announced the acquisition of Casamigos, the fastest growing super-premium tequila brand in the US. This is an exciting opportunity for us to strengthen our participation in the US tequila category, as well as expand the brand internationally. The transaction is expected to close in the second half of calendar 2017, subject to regulatory clearances. In addition, Distill Ventures, the Diageo-backed and funded accelerator programme for entrepreneurs, offers us the opportunity to invest in nascent brands with growth potential.

2017 net sales by category (%)

Scotch	**25%**	Ready to drink	**6%**
Beer	**16%**	IMFL Whisky	**5%**
Vodka	**12%**	Liqueurs	**5%**
North American Whisk(e)y	**9%**	Gin	**3%**
		Tequila	**2%**
Rum	**7%**	Other	**10%**

Productivity programme on track

Diageo delivers operating margins that are among the highest in our peer group. Investment in our business remains our number one value creator. By focusing on costs and efficiency, our productivity programme is aiding this investment, creating the fuel to build our brands, innovate and strengthen our route to consumer.

We are pleased with the progress we have made with our productivity programme. This enabled us to increase our marketing spend in the US in the second half of this financial year. In financial year 2018, we are committed to increasing investment further in the US and also in scotch, as we seek to sustain our mid-single digit organic net sales growth. The progress we have made also allowed us to announce in July 2017 that we had raised our productivity goal, over the three years ending 30 June 2019, to £700 million with two-thirds being reinvested in the business.

Our role in society

A crucial component of our business strategy is ensuring that we continue to make a positive contribution to society. Our Chairman, Javier, in his statement, sets out our approach and I am pleased that we have reported further progress against our 2020 sustainability and responsibility targets.

Ensuring alcohol has a positive role in society as part of a balanced lifestyle is vitally important to everyone at Diageo. We are committed to tackling alcohol misuse, including through our implementation of the Global Beer, Wine and Spirits Producers' Commitments to Reduce Harmful Drinking, a partnership of the world's largest alcohol companies coming together to take action.

We continue to improve the ways we measure and manage the programmes we support. We supported fewer alcohol in society programmes than last year as we aimed to concentrate our efforts on those that will have the biggest impact on the issues we aim to address. As with our marketing work, the focus on evaluating the impact of our programmes is sharpening our capacity to deliver real benefits at scale, often through partnerships with other stakeholders.

This year, for example, we began our two year partnership with the UN Institute for Training and Research (UNITAR) aimed at reducing death and injuries from traffic accidents in more than 60 countries, with a focus on those with the highest road traffic death rates. Together we ran road safety workshops in Mexico, Nigeria, South Africa and South Korea. We also introduced a virtual reality experience called 'Decisions'. This experience places viewers in the front seat of a drink driving accident and shows how one wrong decision can have devastating consequences. Johnnie Walker also published a 360° 'Decisions' video online which has been viewed more than 14 million times. This supports the brand's Join The Pact initiative, which has so far attracted 3.1 million pledges to never drink and drive, and has delivered around 1.8 million kilometres of safe rides home.

This year we continued our longstanding commitment to give consumers information to make informed choices. In March 2017, we developed a new, mobile friendly e-learning version of our DRINKiQ training, which has helped us surpass our target of reaching one million adults with training materials that will enable them to become responsible drinking ambassadors.

Employee safety continues to be an every day priority for us. We are focused on markets in particular need of improvement, embedding compliance to our core standards and programmes. We continue to make good progress on our environmental KPIs, improving on carbon and water efficiency by 6% and 3% respectively.

Our people

I am very proud of Diageo's culture. As I travel around the business, I am always energised by the passion our people have for our strategy and for delivering our Performance Ambition. I would like to thank everyone at Diageo for their commitment and hard work during the year. The strong connection my 30,400 colleagues have to Diageo and our brands, purpose and values is evident in our annual employee survey results. Our people are highly engaged, which provides a strong platform to amplify our purpose and drive enhanced performance.

Outlook

Today, Diageo is a great blend of every day efficiency and investment for growth in our brands. I am pleased with our progress in more disciplined execution and the improved agility we have across the business. Our increased productivity goal underpins an improved organic operating margin expansion objective of 175bps over the three years ending 30 June 2019. The expectation of mid-single digit organic net sales growth in the same period continues. We feel confident about building on the positive momentum in the business as we continue to progress towards achieving our Performance Ambition.

Ivan Menezes
Chief Executive

Market dynamics

The global beverage alcohol market is profitable and growing. An estimated six billion[(i)] equivalent units of alcohol are sold each year, generating £300 billion[(i)] of net sales. High levels of regulation combined with the increasing expectations of consumers and other stakeholders create a complex operating environment. We are well placed to navigate this operating environment and to create opportunities for Diageo to succeed.

A market that is diverse, profitable and growing[(ii)]

Industry growth is well supported by robust macro and consumer trends:

- We currently expect 500 million new legal purchase age consumers to come to the market over the next decade – India and Africa will account for half of this
- Around 730 million more consumers will be able to afford international style spirits, over the next decade, with 85% of this growth coming from emerging markets
- Spirits penetration in many emerging markets is still low when compared to developed markets

Alcohol is an established part of how many people socialise and celebrate life. How alcohol is consumed is often deeply rooted in local tastes and customs, which can vary as widely as the cultures and conditions in which people live. Understanding this diversity while anticipating and shaping trends is key to winning in the marketplace.

Our ability to use insight and measurement to drive brand performance means we can activate the best brands to meet consumers' local tastes and preferences.

Developed market opportunities

While populations in developed markets are typically stable or growing more slowly than those in emerging markets, overall levels of disposable income are higher. Many consumers seek to drink 'better, not more' as they aim to develop their tastes while maintaining a balanced lifestyle, and are prepared to pay a premium for high-quality brands with heritage and provenance. Our international spirits, and within them our reserve portfolio, offer these consumers brands that connect with them and share their values.

Emerging market opportunities

The global growth in the number of people of legal purchasing age is largely driven by population growth in emerging markets. An increasingly wealthy middle class in these markets also presents opportunities to offer consumers premium products. Emerging markets also contain a large proportion of the world's informal alcohol market, estimated to account for 25% of alcohol sales globally[(iii)], which presents risks to consumers' health as well as impacting overall tax revenues. Mainstream spirits is an important opportunity, providing consumers access to safe, branded products at affordable price points, as they aspire to progress to international premium brands.

Operating in a volatile environment

Like all consumer goods businesses, we continue to operate in a global economy subject to political instability and sudden changes to economic variables. Diageo's global scale provides a natural hedge against individual market volatility. We can respond quickly to local dynamics through our market-based business model. Our increased emphasis on local sourcing, including local bottling, helps us manage risk and plan contingencies. We are building a stronger business through our focus on productivity.

(i) Diageo estimates. (ii) Euromonitor 2015, internal analysis. (iii) World Health Organization.

Earning trust and respect

Delivering measurable social and environmental benefits is intrinsic to commercial efforts to drive performance. Our 2020 targets focus on the areas that are most material to us and our stakeholders, and are aligned to the UN's Global Goals. At the same time, we seek ways for our individual brands to act as catalysts for creating positive social impacts – not only because this is the right way to do business, but because we want consumers to recognise the purpose that has underpinned many of our brands for generations.

Creating a positive role for alcohol in society

The beverage alcohol industry is one of the most highly regulated in the world, and that regulation varies widely between countries and jurisdictions. Diageo complies with all laws and regulations, wherever we operate, as a minimum requirement, and we advocate effective, evidence-based alcohol policies as described on page 41 of this report.

While legal and regulatory requirements are a vital part of the operating context for beverage alcohol companies, alcohol itself plays a much broader role in society and culture, and has been part of celebrations around the world for centuries. The majority of people who choose to enjoy alcohol do so moderately and responsibly, but all alcohol companies must recognise that the misuse of alcohol can be harmful to individuals and society, and that preventing this is important to the long-term future of the industry as well as for the individuals concerned and their communities. Creating a positive role for alcohol in society through partnerships, industry collaboration and our own initiatives has always been a priority for us, and we continue to put skills and resources into programmes that prevent and reduce alcohol misuse, raise awareness, and change negative attitudes and behaviour.

Industry collaboration and partnerships to reduce harmful drinking

We are one of 12 global producers of beer, wine and spirits which in 2013 started a set of commitments designed to support Member States' implementation of the World Health Organization's (WHO) global strategy to Reduce the Harmful Use of Alcohol.

We also work beyond our industry, forming partnerships with governments, law enforcement agencies, educators and civil society to support campaigns to reduce harmful drinking.

At the same time, we advocate against measures that are not based on evidence or which could have unintended consequences. This includes policies that inadvertently push consumers towards unregulated or illicit alcohol, which can be a risk to public health.

Building thriving communities

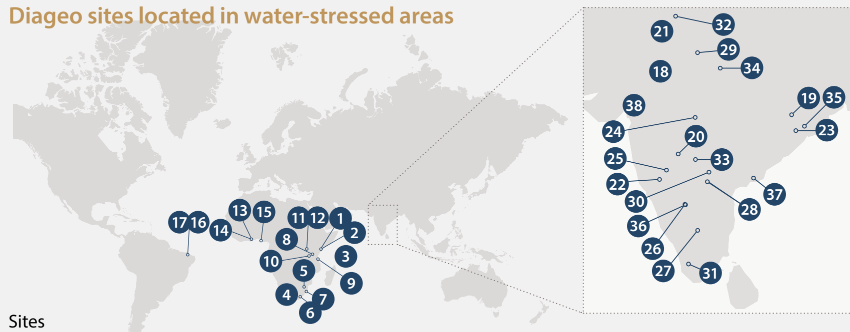
Our value chains are a critical component of our operating environment, supporting both supply networks and markets. We aim to strengthen them by contributing to the prosperity and resilience of the communities in which we work. As well as the contribution we make through direct and indirect employment and taxes, our sustainable development strategy aims to leverage the economic and social impact of our entire value chain. Human rights is a key focus, while important initiatives include local sourcing, particularly in Africa where we aim to source 80% of agricultural materials locally by 2020.

Water and the environment

Businesses that rely on agricultural raw materials are exposed to a variety of environmental issues, including those associated with climate change. These issues may be felt directly, or indirectly as a result of their impact on the wider value chain and associated communities. For beverage alcohol companies like ours, water scarcity is particularly important, as water is our main ingredient.

We have a clearly defined environmental strategy that includes programmes to reduce greenhouse gas emissions and water use throughout our value chain. Our Water Blueprint defines our approach to water stewardship and focuses specifically on stewardship in the water-stressed areas shown in the map above. This includes improving our water efficiency, replenishing water used, managing water quality and helping farmers improve water management in agriculture.

Diageo sites located in water-stressed areas



Sites

1 Kenya Brewing, Nairobi
2 East Africa Maltings, Nairobi
3 Seybrew, Seychelles
4 SA Cider, South Africa
5 Phelindaba Brewery, South Africa
6 Butterworth Brewery, South Africa
7 Khangela Brewery, South Africa
8 Moshi, Tanzania
9 Dar es Salaam, Tanzania
10 Mwanza, Tanzania
11 UBL, Kampala, Uganda
12 IDU, Kampala, Uganda
13 Accra, Achimota, Ghana
14 Kumasi, Kaasi, Ghana
15 Ogba, Lagos, Nigeria
16 Paraipaba, Ceará, Brazil
17 Agricultural lands, Ceará, Brazil

India
18 Alwar, Rajasthan
19 Asansol, West Bengal
20 Aurangabad, Maharashtra
21 Baddi, Himachal Pradesh
22 Baramati, Maharashtra
23 Bhadrakali, West Bengal
24 Bhopal, Madhya Pradesh
25 Four Seasons Winery, Maharashtra
26 Hospet, Karnataka
27 Kumbalgodu, Karnataka
28 Malkajgiri, Telangana
29 Meerut, Uttar Pradesh
30 Nacharam, Telangana
31 Palakkad, Kerala
32 Pathankot, Punjab
33 Pioneer, Maharashtra
34 Rosa, Uttar Pradesh
35 Serampore, West Bengal
36 Sovereign, Karnataka
37 Tern, Andhra Pradesh
38 Udaipur, Rajasthan

Examples of our strategic responses

Reserve – mass luxury

Luxury is increasingly becoming accessible to everyone. Modern luxury speaks to globalisation and pride in local culture. We call this trend mass luxury, and have identified that it presents 78% of our reserve growth opportunity to 2020. To deliver against this we reached more outlets and consumers this year, and nearly doubled our presence in the biggest cities around the world.

Innovation – holistic lifestyle products

Holistic lifestyle is a growing trend across markets and we are moving to participate in this space. With Baileys Almande we are redefining the liqueur category with a gluten free, dairy free, vegan almond milk liqueur. We have also launched Smirnoff Seltzer in the United States and Smirnoff Pure in Australia. Both are low calorie and low sugar ready to drink products.

Mainstream spirits

The mainstream spirits opportunity is critical to accessing emerging middle class consumers. The emerging middle class consumer is worth £11 billion[iv] and accounts for 1.1 billion equivalent units globally.[iv] Our acquisition of United Spirits (USL) in India gave us not only the footprint to compete and win in India, but also the know-how to expand and apply how we develop and sell mainstream spirits in Africa.

(iv) Euromonitor 2015, internal analysis.

Our strategy in action

Here we share a selection of case studies that demonstrate how we are putting our strategy into action at a market and global level. The case studies also show how our approach to sustainability and responsibility supports everything we do.

Keep premium core vibrant: Mexico

Making Johnnie Walker the most iconic spirits brand in Mexico

Our vision for Johnnie Walker in Mexico is to become the most iconic spirits brand. To help achieve this, in 2017 we launched 'Keep Walking Mexico', a vibrant campaign aimed at recruiting a new generation of millennial legal purchase age consumers.

'Keep Walking Mexico' taps into an increasing wave of national pride, reaching the consumers, through digital, TV, out of home advertising and social media. We have also launched the 'Johnnie Walker Red Hour' to support the campaign on-trade, and off-trade we are reaching those millennial consumers through music festivals and Formula 1. Across the scotch portfolio in Mexico net sales were up 17% , driven by strong performance across price tiers and brands.

Our scotch growth in Mexico comes alongside one of our most impactful programmes to support responsible drinking. Actuando Mejor (Model Cities) aims to improve the ways in which alcohol is sold and consumed in Mexico. It has reached more than 118 million people through campaigns, training and law enforcement to reduce underage drinking, binge drinking and drink driving. Recently, Actuando Mejor has focused on reducing underage drinking by training people who sell alcohol and partnering with the Education Ministry of Queretaro to provide information to students about the dangers of underage drinking, and how to make healthy lifestyle choices. Police officers in 113 cities have received training through the programme to prevent alcohol-related car accidents.

Keep Walking Mexico advertisement at Antara Fashion Hall, Mexico.

Increase participation in mainstream spirits: Africa Regional Markets – Cameroon

The Cube – bringing mainstream spirits to consumers in Cameroon

In February, we launched the Cube, our stand alone bottling facility in Douala, Cameroon. This has enabled us to bring accessible and affordable mainstream spirits to consumers in Cameroon for the first time. Local production is key to achieving our strategy to grow mainstream spirits and shape the beverage alcohol market in Cameroon and Africa. Through the Cube, Cameroon is the first country in Africa to bottle Black & White Scotch whisky, a brand that has strong local appeal.

To support the launch of Black & White in Cameroon, the team leveraged our existing beer platform and route to consumer to bring the product to market quickly, covering about 60% of the country through 37 local distributors.

Diageo has a proud history in Cameroon. Our Guinness brewery in Douala has been part of the community since 1969, and our presence extends beyond our brands and production. Our Water of Life programme has connected 900,000 people across the country to clean water since 2008. We aim to source 70% of raw materials locally by 2020 and have reached 15,000 people with our responsible alcohol use programmes.


Cameroon is the first country in Africa to bottle Black & White Scotch whisky.

Continue to win in reserve: Europe – Great Britain (GB)

Cîroc's success has been built on a deep understanding of how and when consumers want to celebrate.

Cîroc – Great Britain's leading luxury vodka proves influence is key

Winning in reserve is essential to deliver our strategy. Cîroc is one of the exceptional spirits brands that sits within our reserve portfolio, and while performance in the United States, its core market, has been challenging, we have continued to focus on the opportunity for expansion across the rest of the world, and a great example of this is in Great Britain (GB).

Cîroc became the number one ultra premium vodka in GB by volume in 2016, and has continued to gain share in 2017. Its success has been built on a deep understanding of how and where consumers want to enjoy luxury celebrations. Through partnering with an influential selection of nightclubs and venues in cities across GB, Cîroc has captured the celebration occasions with consumers and created a halo effect that has filtered into growth in the on and off-trade.

More broadly, ambassadors in the form of our Learning for Life graduates also play a key role in our responsible drinking strategy and 2017 saw another successful cohort of graduates. The programme helps prepare young adults to find and succeed in jobs in hospitality and bartending through practical training and coaching. Learning for Life training always includes our DRINKiQ.com alcohol awareness module, which helps graduates play their part in reducing harmful drinking. More than 900 people have graduated from 80 courses, and Learning for Life helped Diageo win the British Institute of Innkeeping's Training Company of the Year award in 2016.

Drive innovation at scale: US Spirits

Innovations driving success of North American whisk(e)y

In the autumn of 2014, we launched Crown Royal Regal Apple, which became the fastest spirits variant to reach one million cases ever, in the United States (US). Two years later, on the back of this success we launched Crown Royal Vanilla. Vanilla is one of the most recognisable flavours in the world and we expect it to bring even more interest to the Crown Royal brand. These innovations have resulted in increased awareness and trial as well as bringing new millennial, female and multicultural consumers to the brand.

Crown Royal is not the only success story among our North American whiskies. Bulleit is the hottest bourbon in the US, growing faster than the category. To support this growth, in March 2017 we opened a new Bulleit distillery in Shelbyville, Kentucky that will produce 1.8 million proof gallons a year. The new state of the art distillery features the first industrial solar array in Shelby County, which will collect enough energy to run all on-site mobile equipment and a bio pond that will act as a natural filtration system for rainwater.

Crown Royal Vanilla launched in the autumn of 2016.

Build an advantaged route to consumer: India

Perfect Stores account for a third of outlets across India.

Perfect Stores – transforming the consumer experience in India

We want consumers to enjoy every aspect of our great brands – starting with their purchasing experience. We do this by improving the ways we reach consumers, ensuring our brands are available and presenting our products at their best – what we call 'route to consumer'. This is a key element to achieving our ambition in India, where we are treating every store and every bar as an opportunity to showcase our brands.

This year, we faced a number of headwinds in India including demonetisation and the introduction of a new regulation prohibiting the sale of alcohol near highways. Despite these challenges, we have remained focused on capturing the consumer opportunity. Our Perfect Stores programme is aimed at winning at the point of purchase. So far we have transformed about 20,000 stores to Perfect Stores across India. To achieve this, we set a clear set of executional standards and worked with retailers to focus on the right visibility, share of shelf and merchandising.

As always, Diageo is committed to reducing harmful drinking. This year, we continued to build on our Road to Safety programme, which has been running for the past three years and has covered 15 states and 50 cities in India. The programme has trained 4,000 police officials on traffic regulations, enforcement of drink driving offences and the correct usage of breath alcohol analysers and educated 6,000 drivers of commercial vehicles on the dangers of drink driving. In March 2017, we held the first ever Diageo Young India Summit on Road Safety at Delhi University in partnership with ENACTUS, a global network of students, academics and business leaders.

Embed productivity to drive out costs and invest in growth: Global

The relaunched Johnnie Walker Aged 18 Years.

International Supply – Driving out cost to reinvest in growth

In July 2015, we announced our productivity programme across Diageo focusing on every day efficiency to drive out cost across our business and invest in future growth. We have made great progress against this and in July 2017 announced that we raised our productivity goal to £700 million in savings and 175bps in operating margin over the three years ending 30 June 2019. Our productivity programme has five key focus areas, one of which is global supply. We have been focused on developing and rolling out best practice manufacturing processes across our supply footprint, improving sourcing strategies, optimising our logistics footprint and breaking down and assessing the cost of goods.

To assess the cost of goods, we have developed a codified analytical framework that ensures product cost and formats are competitive and that we are aware of the cost and value trade-offs we are making in every aspect of our product and packaging design.

In 2016, the Johnnie Walker Platinum bottle and packaging were among the first to go through our new 'tramlining' process. We discovered that a lot of the cost drivers were coming from the packaging and that by addressing these we would be able to deliver multi-million pound savings, while not compromising on the premium design of the bottle and packaging. In March 2017, we relaunched Johnnie Walker Platinum, with a new name, Johnnie Walker Aged 18 Years, and sophisticated new packaging.

Our productivity programme provides the fuel to grow our business. In 2017, we started to reinvest our savings in the United States, increasing our marketing spend in the second half and in F18 we will continue to reinvest in the US and in scotch.

Creating a positive role for alcohol in society: global

Preventing drink driving, promoting good decisions

Drink driving is never the right decision – and, as a business committed to helping people make good decisions, we're taking action to prevent it.

The fall in alcohol-related traffic deaths in developed countries over the past decade supports our conviction that improving awareness and consistent enforcement of legal blood alcohol limits are the most effective ways to stop drink driving.

We have been working with governments, police, NGOs and other community stakeholders for many years. In 2016, thanks to our track record in this field, UNITAR (United Nations Institute for Training and Research) chose Diageo as their partner for a two-year initiative to improve road safety globally.

But a single death anywhere caused by drink driving is one too many. There is much more to be done – to extend and build on effective programmes until drink driving fatalities are eliminated globally.

We are working on this in many ways. For example, we support training and enforcement initiatives for police officers through programmes such as Road to Safety in India, Twa Kwano Mmom in Ghana, and our partnership with traffic police in Thailand. We also support brand-led responsible drinking campaigns like Johnnie Walker's Join The Pact. The programme

Johnnie Walker's Join The Pact campaign encouraging consumers never to drink and drive.

has reached more than 40 countries, with 3.1 million people making the commitment to never drink and drive.

As part of an industry group, we helped the Dominican Republic formulate its first ever laws on blood alcohol limits in 2017 – and we have even taken our commitment into virtual reality. This year we launched a hard-hitting virtual reality simulation that puts the viewer in the middle of a drink driving tragedy as part of our DRINKiQ campaign.

Building thriving communities: Africa Regional Markets – Ethiopia

Transforming farming communities in Ethiopia

Since 2013, we have been improving the income and wellbeing of Ethiopian farming communities through our Sourcing for Growth (S4G) programme. With more than 6,000 farmers now growing and selling barley for our brewery, we are building a reliable local barley supply for the good of everyone.

This gives communities a more robust economy and better food security. It is making a real difference in people's everyday lives – with many families feeling more financially stable and enjoying better relationships and welfare (2016 impact study). And S4G is giving our brewery a reliable, sustainable ingredient supply that helps minimise its environmental impact.

Programmes like this also help us to understand the intricacies and challenges of local communities and stakeholders. This helps Diageo to work intelligently and responsibly to empower farmers and their families all over the world.

We are supporting Ethiopian farming communities through our Sourcing for Growth programme.

Reducing our environmental impact: India

Using renewable energy to drive climate change action

Solar power and the use of agricultural by-products as biomass fuel are transforming the carbon footprint of USL in India – and helping us meet our global commitment to reduce our greenhouse gas emissions.

New solar panels at our Baramati and Nasik sites in Maharashtra, installed and operational within three months of initial planning, are now producing 1.2 megawatts of energy – enough to supply around 20% of the sites' electricity needs. At the same time, we have adapted boilers at our Aurangabad Distillery that previously burnt coal so that we can use some of the biomass materials left over by farmers and our processes, including bagasse, rice husks and ground nutshell.

Through these initiatives, we have reduced carbon emissions overall at USL by 20,000 tonnes, or around 30%, compared with last year. We have also reduced waste to landfill by 50%, by eliminating ash from burning coal, and reduced the cost of producing steam by £3 per tonne or 20%.

Highest standards of governance and ethics: Africa Regional Markets – Cameroon

Addressing human rights and security challenges in our complex environments

We use private security personnel at our Guinness operation in Cameroon. Although they had been trained to operate in line with our Code of Business Conduct and human rights policy, a confidential SpeakUp report identified that staff were unable to take annual leave and were working unacceptably long hours. This is in direct breach of our Code.

We expect our suppliers to promote the principles of our Code within their own organisations and throughout their own supply chain, and to be able to verify this. Disciplinary action was taken against the security firm for breach of contract, while supplementary training provided for line managers and senior leaders at the location now ensures security personnel operate within the global policies and procedures they are expected to follow.

How we protect our business

Risk management and principal risks

Our Performance Ambition calls on us to be bold and to act like owners. Well managed risk taking lies at the heart of this. Great risk management drives better commercial decisions, creating a growing, resilient and sustainable business.

Our approach

Our risk management framework is simple. We believe that great risk management starts with the right conversations, to drive better business decisions. We assign clear accountability for managing our risks. It is the responsibility of each market and function to manage its risks directly, and then to report on the risks and their management to the relevant Executive member. The Diageo Executive reviews the effectiveness of risk management through the Audit & Risk Committee, and the Board exercises independent review through the Audit Committee, supported by Global Audit & Risk. The Diageo Executive updates the group's risk assessment annually, which is reviewed by the Board. Similarly, all markets and functions perform annual risk assessments and, at all levels in the business, risks are reviewed throughout the year, with updates to risks and/or mitigation plans made as necessary.

Further details about the group's risk management approach are described in the Report of the Audit Committee on page 65.

Focus in the year

The Diageo Executive and Board considered the risks described here as the group's principal risks for this financial year. Our principal risks reflect a turbulent external environment with significant change across many fronts. Macroeconomic volatility sits alongside deep political change and a continued threat from terrorism. Cyber security threats continue to evolve. Shifting social and consumer trends, driven in part by profound technological developments, provide a huge opportunity for innovation. Protectionism and local trade and regulatory policies have led to excise tax increases and restrictive regulations. Meanwhile the international tax environment continues to evolve. Alongside all of this, we remain deeply committed to operating in the right way in everything we do, and our risks on non-compliance with laws and regulations, including on data privacy, and our long-term commitments to sustainability, demonstrate our continued commitments here. Our Risk Management global standard emphasises leadership behaviours and on ensuring risk management is a basic part of doing business every day.

We continue to develop our risk planning work around Brexit and continue to work closely with our industry bodies to seek clarity on the transition process.

The Audit Committee and Board also receive periodic updates on emerging or topical risks. During the year, the Audit Committee received an update on terrorism and political violence, and the Board received training on crisis management.

Viability statement

In accordance with provision C.2.2 of the 2014 revision of the UK Corporate Governance Code, the Directors have assessed the prospects of the group over a longer period than the 12 months required by the 'Going Concern' statement. The Directors confirm that they have a reasonable expectation that the company will continue to operate and meet its liabilities, as they fall due, over the next three years from 30 June 2017. The Directors' assessment has been made by considering our current position and prospects, our strategy, the Board's risk appetite and our principal risks and how these are managed, as set out on pages 20 and 21 in the Strategic report.

Although the prospects of the company are considered over a longer period the Directors believe that a three-year assessment is most appropriate as it aligns with our normal and well established three-year strategic business planning processes and presents readers of the annual report with a reasonable degree of assurance while still providing a longer-term perspective.

The three-year business plan is based on our current strategy. This plan has been stress tested by modelling severe but plausible downside scenarios linked to principal risks. In order to reflect the most likely combination of principal risks affecting the business at one time a combination of the following scenarios was also modelled:

- severe marketing and/or route to market or fiscal changes are introduced by local governments,
- the potential impact of material negative changes in the macro economic environment that could impact the emerging markets, that generated 28% of our operating profit before exceptional items for the year ended 30 June 2017,
- underperformance from acquisitions made in recent years,
- unfavourable exchange movements in foreign currencies, mainly the euro and US dollar against sterling,
- potential failure to adapt to or participate in critical industry developments, and also
- increased potential tax rate due to changes in the international tax environment.

The principal risks considered in the most likely combination of downside scenarios are identified with the symbol 'V' on pages 20 and 21.

We have considered the risks presented by Brexit and at this early stage do not perceive any material risk to the company's viability. We will keep this under review as exit negotiations progress.

Testing also considers the effectiveness of mitigation actions and internal control systems, makes certain assumptions about temporary reduction in discretionary cash flows including capital expenditures and dividend payments and considers whether additional financing facilities will be required.

Based on the results of this analysis the Directors confirm they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period to 30 June 2020.

Relevance to strategy

1. Efficient growth
2. Consistent value creation
3. Credibility and trust
4. Motivated people

Risk	Impact	How we mitigate	Developments in 2017
1. Market restrictions and indirect tax Fiscal pressures and/or failure to address perceived growth in anti-alcohol sentiment. ◈ 1 2 3	• Regulators in major markets impose indirect tax increases and/or restrictions on marketing and availability. • Damage to our corporate reputation.	• Comprehensive tax and regulatory risk tracking and scenario planning. • Economic modelling to sharpen focus on tax and trade issues, and strengthened in-house resources and structure. • Proactive, evidence based engagement to build trust and deepen our relationship and reputation with governments, industry and other stakeholders.	• Political volatility and economic instability have increased public policy uncertainty and risk, particularly in tax, trade and regulatory policies. • Despite this, we have successfully mitigated threats and built momentum in our engagement with governments around the world to shape more balanced regulatory outcomes. • Strengthened delivery of programmes and policies to reduce harmful drinking.
2. Economic change Significant local volatility or upheaval, uncertainty or failure to react quickly enough to increasing volatility, including the UK's exit from the EU. ◈ 1 2	• Social unrest, liquidity issues, generalised downturn, currency instability, inflationary pressures, possible changes to customs duties and tariffs and/or eroded consumer confidence, impacting business forecasting and/or performance.	• On-the-ground market and country intelligence to build local preparedness for rapid change in external environment. • Market visits by Chief Executive and other senior executives to review local strategy. • Market-sensitive multi-country investment and capacity expansion strategy, and local sourcing strategy (e.g. to minimise currency risk). • Cross-functional steering group keeping risks of UK exit from the EU under review.	• Further scenario planning exercises across our higher volatility markets to strengthen response to uncertain conditions. • Corporate scenario planning undertaken at group level in response to higher global risk factors. • Ongoing identification and development of mitigation planning around risks of UK exit from EU.
3. Critical industry developments Failure to shape or participate in critical industry developments. ◈ 1 2 3	• Consumers move away from our brands. • Less efficient business model compared to key competitors.	• Highly diversified portfolio of brands to ensure coverage of consumer trends. • Rigorous processes of strategy development at corporate and market level. • Systematic review of emerging consumer and route-to-consumer trends including potential disruptive technologies. • Continuous assessment and optimisation of business efficiencies.	• Our mitigation approaches remain unchanged, and we have continued to deploy them in response to industry changes. • For example, we are building new capabilities in digital commerce and marketing, testing potential disruptive technologies through our Tech Ventures team and investing in potential new global brands through Distill Ventures.
4. Non-compliance with laws and regulations Non-compliance with local laws or regulations, or breach of our internal global policies and standards and/or significant internal control breakdown. 1 2 3 4	• Severe damage to our corporate reputation and/or significant financial penalty.	• Code of Business Conduct (Code) and supporting framework of policies set out compliance requirements. • Periodic training, communications and engagement activities to refresh employee understanding. • Internal risk-based control assurance programme, with local management accountability. • Strong tone from the top, anchored by our Performance Ambition of 'most trusted and respected'.	• Retrained all employees on Code through eLearning module and face-to-face events with integrated compliance certification. • Scenario planning undertaken in high risk and volatile markets to identify key risk indicators and triggers. • Continued focus on embedding control and compliance in new businesses and business change.
5. Sustainability and responsibility Failure to manage key sustainability risks or meet key sustainability goals. 2 3 4	• Harm to future growth either directly; or • Indirectly via reputational impact reducing trust amongst consumers and other stakeholders.	• Sustainable Development Strategy credible with stakeholders and set up to deliver against 2020 targets. • Partnerships with NGOs (i.e. CARE, WaterAid) in place. • Resource scarcity issues identified and mitigated, especially within agriculture. • Manufacturing standards programme including environmental performance in India, with future activity on community water around production sites.	• Human rights assessment programme undertaken in six countries. • Stronger impact metrics with new data collection system. • Development of 'Brands with Purpose' activity for key global brands aligned with sustainable development and alcohol in society strategies (e.g. Smirnoff, Johnnie Walker, Captain Morgan). • Stronger communications programmes (e.g. Guardian Sustainable Business campaign), with increased positive visibility. • Increased investor and external scrutiny of climate change impacts and human rights.

Risk	Impact	How we mitigate	Developments in 2017
6. Business acquisitions Failure to deliver value from acquisitions and/or integrate them into Diageo effectively, including failure to embed Diageo's standards of compliance with laws, internal policies and controls. ❶❷❸	• Business case for an acquisition is not delivered leading to impairment charges and failure to meet targets. • Market confidence in Diageo's ability to deliver its strategy is weakened. • Prospects for securing regulatory approval in future are harmed. • Diageo may inherit liability for compliance failures in acquired businesses.	• Board and Executive Committee regularly track actual performance against the business case. • Global minimum standards for control and compliance for post-acquisition entities, subject to internal audit review. • Rigorous focus on timely roll-out of control and compliance standards for acquired entities.	• Our focus has been on embedding recent acquisitions (e.g. USL and Don Julio), making sure we have the right governance and integration platforms in place. • We have continued to monitor the M&A environment and transact where appropriate.
7. Cyber threat Theft, loss and misappropriation of our most important digital assets. ❶❷❸❹	• Financial loss, operational disruption and reputational damage. • Non-compliance with statutory data protection legislation.	• Embedding policies and standards on all data-sensitive applications. • Mandatory eLearning and regular phishing exercises to global workforce. • External monitoring of key security logs and events to proactively identify and respond to suspicious activities. • Advanced malware detection and blocking. • Two-factor authentication for cloud-based applications.	• IT service continuity plans integrated with cyber crisis response. • Threat intelligence used to prioritise vulnerability remediation. • Improved email encryption. • Strengthened privileged access management processes. • SAP system user role review to eliminate excessive access. • Stepped up external expert penetration testing of our network and systems to test IT security defences. • Network segmentation to protect important mission-critical networks from general access networks.
8. Political instability and terrorism Impacts from political instability and security threats including terrorism. ❶❸❹	• Diageo employees, sites or supply chain threatened and/or harmed. • Our ability to operate in key markets is disrupted.	• Monitoring of local security situation. • In-country security managers oversee people security, physical security and business continuity programmes. • Global travel security programme for all Diageo travellers. • Global and market liaison with government, academia, and industry on evolving threats and responding to incidents.	• Refreshed business continuity manual and global programme of market business continuity exercises underway. • Quarterly threat reviews established. • Detailed briefings to Audit & Risk Committee and Audit Committee.
9. Data privacy Breach of laws or regulations. ❶❷❸❹	• Harm to trust and/or reputation of Diageo, our brands or people. • Fines of up to 2-4% of global turnover. • Significant restriction in ability to deliver our digital productivity and growth plans.	• Data Privacy global risk assessment to understand full range of specific risks and putting actions in place. • Briefings to Board, Executive and other senior leadership on impact and implications of new EU Data Protection Regulation. • Use of Privacy Impact Assessments in key risk areas of business concerning the proper use of data.	• Publication of official Guidance under the General Data Protection Regulation (GDPR) by the Article 29 Working Party in several key areas and further guidance awaited including from EU regulators. • GDPR Toolkit for key business areas to identify their data processing operations, any gaps to GDPR compliance and remediation plans. • 'Know Your Data' global campaign ongoing with key actions steps for markets to identify and mitigate data risk.
10. International tax Significant changes to the international tax environment such as the OECD Base Erosion and Profit Shifting initiative and EU anti-tax abuse measures alter our operating position. ❶❷❸	• Increase in the cost of doing business arising from an increase in our Effective Tax Rate. • Changing tax laws lead to unexpected tax exposures and uncertainty.	• Ongoing review of business strategy and tax policy in light of changing rules and stakeholder expectations. • Monitoring and, where appropriate, expressing views on the formulation of tax laws either directly or through trade associations or similar bodies.	• Preliminary notices received from HM Revenue & Customs, the UK tax authority, in respect of Diverted Profits Tax. See note 18 to the Financial Statements. • Change of governments in a number of countries (notably the US) potentially increasing the likelihood of relevant tax law changes. • Continued development of processes to ensure we continue to comply with documentation requirements.

Group financial review

"We have delivered a strong sets of results that show progress on all our measures of efficient growth and value creation. Organic net sales growth was broad based and underpinned by volume growth. The everyday focus on efficiency through our productivity programme contributed to organic operating margin expansion across all regions. Our discipline in converting profit to cash and reducing working capital has enabled us to significantly improve free cash flow. I am confident that with the progress we have made and the high performance culture we are building in the business we can continue to drive strong growth."

Kathryn Mikells, Chief Financial Officer

Reported net sales were up
15%

as favourable exchange and organic growth more than offset the adverse impact from prior year disposals

Reported operating profit was up
25%

driven by favourable exchange, organic growth and lower exceptional operating charges

Organic results improved with volume growth of
1.1%

Organic net sales growth of
4.3%

Organic operating profit grew
5.6%

Free cash flow continued to be strong at
£2.7bn

up £566 million on last year

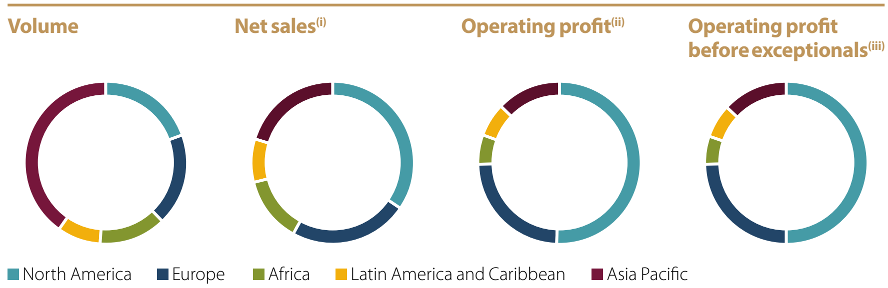
Net cash from operating activities was
£3.1bn

Basic eps of
106.0 pence

was up 18%

Eps before exceptional items increased
21%

to 108.5 pence



(i) Excluding corporate net sales of £46 million (2016 - £36 million).
(ii) Excluding net corporate operating costs of £189 million (2016 - £150 million).
(iii) Excluding exceptional operating charges of £42 million (2016 - £167 million) and net corporate operating costs of £189 million (2016 - £150 million).

Summary financial information		2017	2016
Volume	EUm	242.2	246.4
Net sales	£ million	12,050	10,485
Marketing	£ million	1,798	1,562
Operating profit before exceptional items	£ million	3,601	3,008
Exceptional operating items(i)	£ million	(42)	(167)
Operating profit	£ million	3,559	2,841
Share of associates and joint ventures profit after tax	£ million	309	221
Exceptional non-operating items(i)	£ million	20	123
Net finance charges	£ million	329	327
Tax rate	%	20.6	17.4
Tax rate before exceptional items	%	20.6	19.0
Discontinued operations (after tax)(i)	£ million	(55)	–
Profit attributable to parent company's shareholders	£ million	2,662	2,244
Basic earnings per share	pence	106.0	89.5
Earnings per share before exceptional items	pence	108.5	89.4
Recommended full year dividend	pence	62.2	59.2

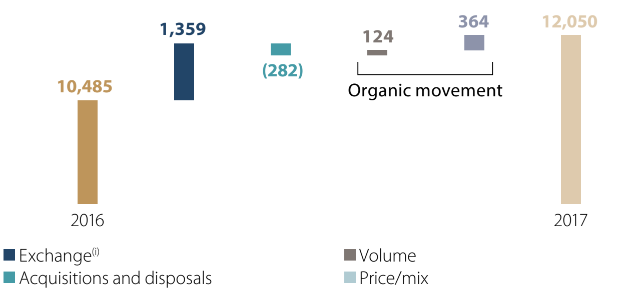
(i) For further details of exceptional items see pages 110 and 111, and discontinued operations see page 115.

	Volume %	Net sales %	Marketing %	Operating profit(i) %
North America	1	17	19	22
Europe, Russia and Turkey	1	11	10	17
Africa	3	11	16	3
Latin America and Caribbean	2	21	17	26
Asia Pacific	(6)	17	14	23
Diageo – reported growth by region(ii)	(2)	15	15	20
North America	2	3	4	4
Europe, Russia and Turkey	3	5	3	8
Africa	3	5	5	10
Latin America and Caribbean	2	9	4	15
Asia Pacific	(1)	3	–	4
Diageo – Organic growth by region(ii)	1	4	3	6

(i) Before exceptional items.
(ii) Includes Corporate. In the year ended 30 June 2017 corporate net sales were £46 million (2016 - £36 million). Net corporate operating costs were £189 million (2016 - £150 million).

Net sales (£ million)

14.9% increase in reported net sales aided by favourable exchange
Organic net sales growth of 4.3% with 1.1% volume growth and positive price/mix



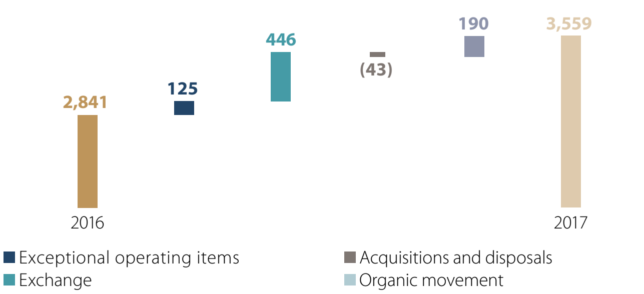
(i) Exchange rate movements reflect the translation of prior year reported results at current exchange rates.

Net sales grew 14.9%, driven by favourable exchange and organic net sales growth which more than offset the impact from the prior year disposal of non-core assets.

Organic volume growth of 1.1% and 3.2% positive price/mix drove 4.3% organic net sales growth across all regions.

Operating profit (£ million)

Reported operating profit growth of 25.3%
Organic operating profit growth of 5.6%



Reported operating profit was up 25.3% largely driven by favourable exchange, organic growth and lower exceptional operating charges. Organic operating profit was up 5.6%.

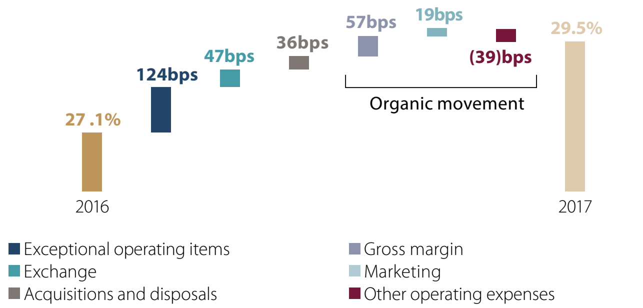
Acquisitions and disposals

The impact of acquisitions and disposals on the reported figures was primarily attributable to the prior period disposals of non-core assets, including the Desnoes & Geddes Limited beer business based in Jamaica and the group's wine businesses in the United States and United Kingdom. The year on year net impact from acquisitions and disposals on net sales was £(282) million and on operating profit was £(43) million.

Diageo announced the acquisition of super premium tequila Casamigos on 21 June 2017 for an initial consideration of $700 million (£538 million), with a further potential $300 million (£230 million) based on Casamigos performance linked targets being met over the next ten years. The transaction is expected to complete in the second half of calendar 2017, subject to regulatory approval.

Operating margin (%)

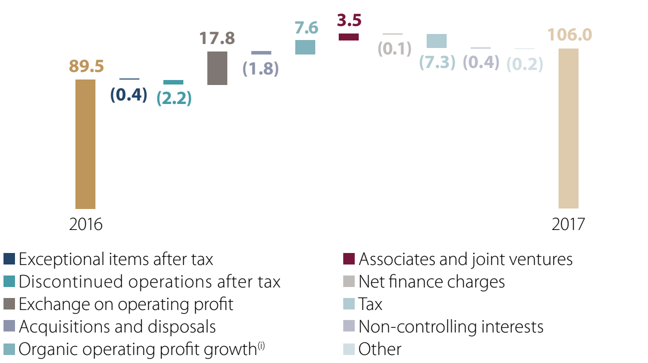
Reported operating margin growth of 244bps
Organic operating margin grew by 37bps



Reported operating margin improved by 244bps driven by the comparison against the prior period exceptional operating charge, favourable exchange, the disposal of lower margin non-core assets and organic operating margin improvement. Organic operating margin improved 37bps driven by our productivity programme which enabled gross margin expansion, marketing efficiencies and overhead savings. The negative impact of other operating expenses arose primarily from lapping the profit on the sale of United Breweries shares and the sale of surplus land, partially mitigated by productivity efficiencies in overheads.

Basic earnings per share (pence)

Basic eps increased 18% from 89.5 pence to 106.0 pence
Eps before exceptional items increased 21% from 89.4 pence to 108.5 pence



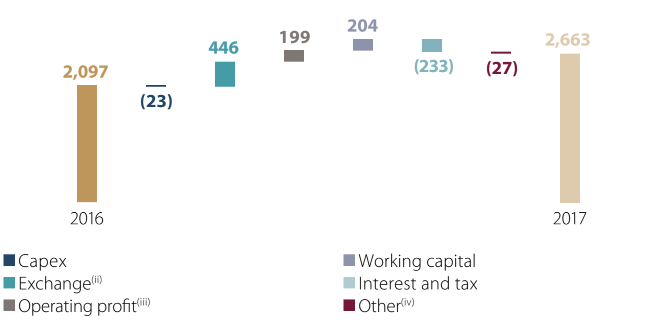
(i) Excluding exchange

Basic eps was impacted by net exceptional charges in the current year compared to exceptional income in the prior year and a charge in respect of an agreement with the UK Thalidomide Trust accounted for in discontinued operations.

Eps before exceptional items increased 19.1 pence as favourable exchange, organic operating profit growth and higher income from associates more than offset the negative impact from a higher tax charge and the exchange impact on reported tax.

Free cash flow (£ million)

Net cash from operating activities[(i)] was £3,132 million, an increase of £584 million compared to the same period last year. Free cash flow was £2,663 million, an increase of £566 million.

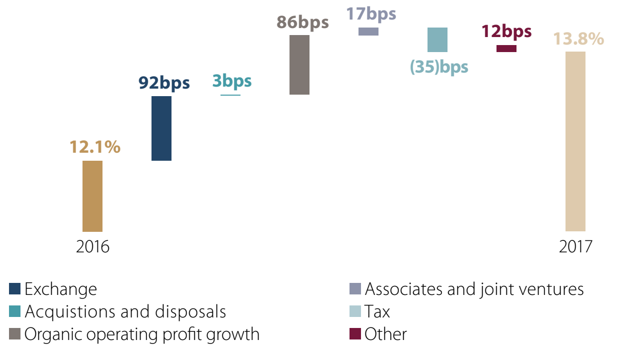


(i) Net cash from operating activities excludes net capex, loans and other investments ((£469) million in 2017 – (£451) million in 2016)
(ii) Exchange on operating profit before exceptional items.
(iii) Operating profit excluding exchange, depreciation and amortisation, post employment payments and non cash items but including operating exceptional items.
(iv) Other items include post employment payments, dividends received from associates and joint ventures, loans and other investments and discontinued operations.

Free cash flow improved £566 million in the year ended 30 June 2017 driven by favourable exchange, higher organic operating profit growth and favourable working capital movement, partially offset by higher tax payments. The improvement in working capital is primarily driven by lower debtors due to focus on efficient debtor management and reduction in overdue debt.

Return on average invested capital (%)[(i)]

ROIC increased 175bps



(i) ROIC calculation excludes exceptional items.

ROIC before exceptional items increased 175bps mainly driven by favourable exchange and organic operating profit growth, partially offset by higher tax charges.

Income statement

	2016 £ million	Exchange (a) £ million	Acquisitions and disposals (b) £ million	Organic movement[ii] £ million	2017 £ million
Sales	15,641	1,978	(332)	827	18,114
Excise duties	(5,156)	(619)	50	(339)	(6,064)
Net sales	10,485	1,359	(282)	488	12,050
Cost of sales	(4,251)	(525)	219	(123)	(4,680)
Gross profit	6,234	834	(63)	365	7,370
Marketing	(1,562)	(193)	8	(51)	(1,798)
Other operating expenses[i]	(1,664)	(195)	12	(124)	(1,971)
Operating profit before exceptional items	3,008	446	(43)	190	3,601
Exceptional operating items (c)	(167)				(42)
Operating profit	2,841				3,559
Non-operating items (c)	123				20
Net finance charges	(327)				(329)
Share of after tax results of associates and joint ventures	221				309
Profit before taxation	2,858				3,559
Taxation (d)	(496)				(732)
Profit from continuing operations	2,362				2,827
Discontinued operations (c)	–				(55)
Profit for the year	2,362				2,772

(i) Before exceptional operating items, see note (c) below.
(ii) For the definition of organic movement see page 52.

(a) Exchange

The impact of movements in exchange rates on reported figures is principally in respect of the weakening of sterling against the US dollar, the euro, the Kenyan schilling and the Indian rupee, partially offset by strengthening against the Nigerian naira.

The effect of movements in exchange rates and other movements on profit before exceptional items and taxation for the year ended 30 June 2017 is set out in the table below.

	Gains/ (losses) £ million
Translation impact	323
Transaction impact	123
Operating profit before exceptional items	**446**
Net finance charges – translation impact	(28)
Mark to market impact of IAS 39 on interest expense	12
Impact of IAS 21 and IAS 39 on net other finance charges	(6)
Net finance charges	(22)
Associates – translation impact	34
Profit before exceptional items and taxation	**458**

		Year ended 30 June 2017	Year ended 30 June 2016
Exchange rates			
Translation	£1 =	$1.27	$1.48
Transaction	£1 =	$1.45	$1.55
Translation	£1 =	€1.16	€1.34
Transaction	£1 =	€1.22	€1.28

(b) Acquisitions and disposals

The impact of acquisitions and disposals on the reported figures was primarily attributable to the disposals of Desnoes & Geddes Limited (D&G), the Red Stripe business in Jamaica, on 7 October 2015 and the group's wine businesses in the United States and the UK Percy Fox wine business on 1 January 2016.

(c) Exceptional items

Exceptional operating charges in the year ended 30 June 2017 were £42 million before tax, a decrease of £125 million against last year.

In the year ended 30 June 2017, £33 million was charged to exceptional items in respect of a Turkish Competition Authority investigation into certain of Mey İçki's trading practices in Turkey.

During the year ended 30 June 2017 United Spirits Limited received a claim, followed by a debit note, from a customer in India in respect of differential pricing charged over a number of years in respect of products sold to that customer primarily for the period prior to the acquisition of United Spirits Limited by Diageo. While challenging the amount of the claim and contesting it, the group has made a provision of £32 million in exceptional items against the current receivable from the customer.

On 25 February 2016, the group incurred an exceptional operating charge of £49 million including a £53 million payment to Dr Vijay Mallya (Dr Mallya) over a five year period. In the year ended 30 June 2016 a payment of £28 million was made to Dr Mallya. In the year ended 30 June 2017 owing to various reasons, including breaches of several provisions of the 25 February 2016 Agreement by Dr Mallya, Diageo believes that it was not liable to pay the $7 million (£5 million) instalment in February 2017 under that agreement and considers it very unlikely that it will become liable to pay future instalments in subsequent years and accordingly the outstanding provision of £23 million was credited back to the income statement.

In addition, in the year ended 30 June 2016 exceptional operating charges also included an exceptional impairment charge of £118 million in respect of the Ypióca brand and related tangible fixed assets and goodwill allocated to the Paraguay, Uruguay and Brazil (PUB) cash-generating unit.

Non-operating items in the year ended 30 June 2017 were a net gain of £20 million before tax compared to a gain of £123 million before tax in the comparative period, a decrease of £103 million.

Non-operating items in the year ended 30 June 2017 comprised a net gain of £20 million in respect of the sale of Diageo's wine interests in the United States arising from the release of Diageo from a guarantee in respect of the vineyards, net of the settlement of the net working capital balance with Treasury Wine Estates on the date of disposal.

Non-operating items of £123 million in the year ended 30 June 2016 comprised:

- a loss of £191 million in the period in respect of the sale of the majority of Diageo's wine interests in the United States and its UK based Percy Fox businesses.
- a loss of £38 million in respect of the sale of Diageo's interests in Argentina to Grupo Peñaflor.
- a loss of £27 million in respect of sale of Diageo's equity interests in Diageo's South African associate interests.
- a gain of £14 million in respect of sale of Diageo's equity interests in Central Glass Industries Limited (CGI), a Kenyan glass bottle manufacturer.
- a gain of £457 million in respect of the sale of Diageo's 57.87% shareholding in the group's Jamaican Red Stripe business and a 49.99% stake in Diageo's Singapore and Malaysian beer businesses.
- a provision for a guarantee provided by Diageo for a loan of £92 million given by Standard Chartered Bank (SCB) to Watson Limited. The underlying security package for the loan remains in place.

Following an agreement reached in December 2016 with the UK Thalidomide Trust, ***discontinued operations*** comprised £55 million (net of deferred tax of £9 million), of additional amounts payable to the Trust, updates to the discount and inflation rates applied to the existing thalidomide provision and legal costs. Cash payments in the year ended 30 June 2017 in respect of the agreement were £31 million.

(d) Taxation

The reported tax rate for the year ended 30 June 2017 was 20.6% compared with 17.4% for the year ended 30 June 2016. The tax rate before exceptional items for the year ended 30 June 2017 was 20.6% compared with 19.0% in the prior year. As for most multinationals the current tax environment is creating increased levels of uncertainty. Our current expectation is that the tax rate before exceptional items for the year ending 30 June 2018 will be approximately 21%.

(e) Dividend

The group aims to increase the dividend at each half-year and the decision as to the rate of the dividend increase is made with reference to dividend cover as well as the current performance trends including top and bottom line together with cash generation. Diageo targets dividend cover (the ratio of basic earnings per share before exceptional items to dividend per share) within the range of 1.8-2.2 times. For the year ended 30 June 2016 dividend cover was 1.5 times. The recommended final dividend for the year ended 30 June 2017 is 38.5 pence, an increase of 5% consistent with the interim dividend. This brings the full year dividend to 62.2 pence per share and dividend cover to 1.7 times. It is expected to maintain dividend increases at roughly a mid-single digit rate until cover is back in range.

Subject to approval by shareholders, the final dividend will be paid to holders of ordinary shares and ADRs on the register as of 11 August 2017. The ex-dividend date for the holders of the ordinary shares is 10 August 2017, and 9 August 2017 for US ADR holders. The final dividend will be paid to shareholders on 5 October 2017. Payment to US ADR holders will be made on 11 October 2017. A dividend reinvestment plan is available to holders of ordinary shares in respect of the final dividend and the plan notice date is 14 September 2017.

(f) Share buyback

The group aims to maintain a leverage ratio of between 2.5-3.0 times adjusted net debt (net borrowings aggregated with net post employment deficit) to EBITDA (excluding exceptional operating items). This enables the group to support the growth of the business while achieving an efficient cost of capital. Diageo closed the year with an adjusted net debt to EBITDA ratio of 2.0 times driven by strong cash flow performance. The group has now fallen below the target range and generated surplus capital. Consequently, on 26 July 2017 the board approved a share buyback programme to return up to £1.5 billion to shareholders during the year ending 30 June 2018.

Movement in net borrowings and equity

Movement in net borrowings	2017 £ million	2016 £ million
Net borrowings at the beginning of the year	**(8,635)**	(9,527)
Free cash flow (a)	**2,663**	2,097
Acquisition and sale of businesses (b)	**(83)**	1,047
Proceeds from issue of share capital	**1**	1
Net purchase of own shares for share schemes (c)	**(41)**	(1)
Dividends paid to non-controlling interests	**(83)**	(101)
Purchase of shares of non-controlling interests	**–**	(21)
Repayment of bonds (d)	**(1,234)**	(1,003)
Net movements in other borrowings (e)	**414**	(233)
Equity dividends paid	**(1,515)**	(1,443)
Net increase in cash and cash equivalents	**122**	343
Net decrease in bonds and other borrowings	**820**	1,236
Exchange differences (f)	**(205)**	(725)
Borrowings disposed through sale of businesses	**–**	14
Other non-cash items	**6**	24
Net borrowings at the end of the year	**(7,892)**	(8,635)

(a) See page 24 for the analysis of free cash flow.

(b) In the year ended 30 June 2017 acquisitions and sale of businesses included the settlement of the guarantee in respect of the US wines disposal partially offset by the working capital settlement received from Treasury Wine Estates.

In the year ended 30 June 2016 acquisitions and sale of businesses include the disposal of the group's shareholdings in its Jamaican Red Stripe business and Malaysian beer business, the disposal of the group's wine interests in the United States and its UK based Percy Fox wine business, the disposal of the group's equity stake in its South African associate interests and the proceeds from the sale of CGI, a Kenyan glass manufacturer.

(c) Net purchase of own shares comprised purchase of treasury shares for the future settlement of obligations under the employee share option schemes of £102 million (2016 – £47 million) less receipts from employees on the exercise of share options of £61 million (2016 – £46 million).

(d) In the year ended 30 June 2017, the group repaid bonds of $1,600 million (£1,234 million). In the comparable period the group repaid bonds of $1,500 million (£1,003 million).

(e) In the year ended 30 June 2017 the net movement in other borrowings principally arose from the settlement of cross currency interest rate swaps and cash movements on foreign currency swaps and forwards.

(f) Increase in net borrowings of £205 million is primarily driven by the adverse exchange differences on US dollar and euro denominated borrowings partially offset by a favourable movement on foreign exchange swaps and forwards.

Movement in equity	2017 £ million	2016 £ million
Equity at the beginning of the year	10,180	9,256
Profit for the year	2,772	2,362
Exchange adjustments (a)	36	875
Net remeasurement of post employment plans	644	(856)
Tax on post employment plans	(122)	166
Exchange recycled to the income statement (b)	–	51
Fair value movements on available-for-sale investments	–	(20)
Purchase of shares of non-controlling interests	–	(21)
Disposal of non-controlling interest	–	(24)
Dividends to non-controlling interests	(83)	(101)
Dividends paid	(1,515)	(1,443)
Other reserve movements	116	(65)
Equity at the end of the year	12,028	10,180

(a) Movement in the year ended 30 June 2017 primarily arose from exchange gains in respect of the Indian rupee, US dollar and the euro, partially offset by an exchange loss in respect of the Turkish lira.

(b) In the year ended 30 June 2016 exchange losses of £51 million were recycled to the income statement in respect of disposals.

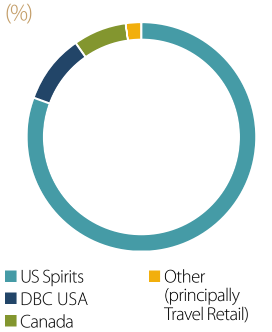
Post employment plans

The deficit in respect of post employment plans before taxation decreased by £702 million from £1,193 million at 30 June 2016 to £491 million at 30 June 2017. The decrease primarily arose due to an increase in the market value of the assets held by the post employment schemes partially offset by an increase in long term inflation rates (UK RPI from 2.8% to 3.2%, UK CPI from 1.8% to 2.2% and Ireland CPI from 1.4% to 1.6%). Total cash contributions by the group to all post employment plans in the year ending 30 June 2018 are estimated to be approximately £200 million.

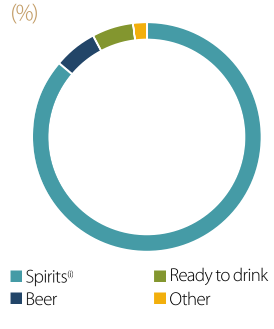
North America

North America, the largest market for premium drinks in the world, represents about a third of our net sales and around half of operating profit. The consumer is at the center of everything we do and we are focused on sustainable growth through our strategy of getting the right brands in the right occasions at the right price. The demographic and economic trends in North America are in our favour and the industry is projected to grow in line with performance seen over the past several years.

Net sales by markets
(%)

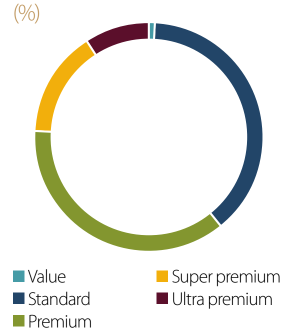


Net sales by categories
(%)



(i) excluding RTDs

Net sales by price points
(%)



Key financials	2016 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2017 £ million	Reported movement %
Net sales	3,565	588	19	(132)	121	4,161	17
Marketing	541	86	–	(9)	24	642	19
Operating profit	1,551	270	15	(13)	76	1,899	22

(i) Reclassification comprise changes to a reallocation of the results of the Travel Retail operations to the geographical regions.

Our markets

The North America business is headquartered in Norwalk, Connecticut, and comprises US Spirits, Diageo Beer Company USA (DBC USA) and Diageo Canada.

Supply operations

We have nine bottling, distilling, blending and maturation sites including operations in Plainfield, Illinois; Amherstburg, Ontario; Valleyfield, Quebec; Relay, Maryland; Gimli, Manitoba; Tullahoma, Tennessee and Shelbyville and Louisville, Kentucky. Over the last five years, we have made significant changes to our supply footprint in North America as we focus on continuously improving efficiency across our supply chain. In addition to opening a brand new distillery in Shelbyville, Kentucky – the home of Bulleit Frontier Whiskey – we have recently received approval to construct a Guinness brewery and brew pub at our existing site in Relay, Maryland.

Route to consumer

The route to consumer in the United States is through the three-tier system and we distribute our products through approximately 40 spirits distributors and brokers, and more than 400 beer distributors. We have a unique route to consumer for our spirits business in the United States, with approximately 3,000 dedicated distributor sales people focused only on Diageo and Moët Hennessy spirits brands. We have consolidated our US Spirits business into single distributors or brokers in 41 states and the District of Columbia, representing more than 80% of our US Spirits volume.

The US Spirits business operates through three divisions in open states where we sell to distributors who then sell to retailers, and through two divisions in control states where we sell to the state, which in turn sells to state or agency stores and on premise retailers. DBC USA sells and markets brands including Guinness and Smirnoff Ice. Beer distribution generally follows the three-tier open state regulations across the United States. Diageo Canada distributes our portfolio of spirits and beer brands across all Canadian provinces, which generally operate through a provincial control system. Diageo Canada operates through a single broker with a dedicated sales force handling our brands in the country. National brand strategy, strategic accounts marketing and corporate functions are managed at the North America level.

Sustainability and responsibility

Core to our success in North America, our largest market, is our reputation as a leading voice on responsible drinking. We have some industry firsts to our name, for example including nutritional information on our Crown Royal packaging, following our 12-year campaign for alcohol companies to be allowed to include alcohol content and nutritional information per serve on packaging (passed in 2015). In 2016 we launched an innovative virtual film designed to prevent drink driving and an online version of our DRINKiQ training course to encourage responsible choices.

As a producer in the region, we are looking at our impact across the whole supply chain. This includes how we work to support diversity amongst our supply base, tracking ownership as part of promoting greater diversity. We are also ensuring our environmental performance at our new Bulleit distillery in Kentucky matches the leading performance of our existing distilleries – in carbon and water management as well as waste and other environmental impacts. The distillery is using green electricity and has enough solar panels on site to power all electricity-powered forklifts and utility vehicles.

North America delivered net sales growth of 3% with full year performance improving in US Spirits and Diageo Beer Company USA (DBC USA), and Canada continuing to grow. Full year depletion and net sales growth in US Spirits was 3%. Share gains were achieved in all key categories, except vodka. North American whisk(e)y, scotch and tequila delivered the strongest category performance. North American whisk(e)y net sales grew 12% as momentum on Crown Royal and Bulleit continued. Scotch grew 8% driven by Johnnie Walker Black Label, Buchanan's and reserve variants. Captain Morgan and Baileys performance improved versus last year. Vodka net sales declined 8% primarily driven by Cîroc and Ketel One. Smirnoff depletion volume was flat but net sales were down as we continued to focus on inventory management and made price adjustments in the first half. DBC USA net sales grew 3% with ready to drink growing and beer flat. Net sales in Canada were up 3%. Marketing in North America increased 4%, growing ahead of net sales with increased activity on core brands in the second half. Operating margin increased 51bps as positive mix and productivity initiatives delivered gross margin expansion with zero based budgeting and organisational effectiveness changes driving lower overhead cost, partially offset by increased marketing.

Key highlights

- Net sales in **US Spirits** were up 3%. Diageo maintained its leadership position in the North American whisk(e)y category in the United States with Crown Royal and Bulleit delivering strong net sales growth and continued share gains. Crown Royal net sales increased 13% with the launch of Crown Royal Vanilla and the continued growth of Crown Royal Deluxe and Crown Royal Regal Apple. Johnnie Walker net sales grew 8% with growth in Johnnie Walker Black Label and reserve variants driven by the successful 'Keep Walking America' platform, scaled up liquid on lips and focus on gifting. Scotch malts grew 9% with the launch of The Singleton and Lagavulin benefiting from the award winning 'My Tales of Whisky' partnership with Nick Offerman. Vodka decline was driven primarily by Cîroc and Ketel One declining 15% and 6%, respectively. Cîroc performance was primarily impacted by the lapping of the successful Apple flavour innovation with a smaller Mango launch and a decline in legacy flavours. Smirnoff depletion volume was flat and brand equity scores improved as consumers were reminded that it is a quality vodka at a great price through a new campaign involving celebrity influencers and activation against millennials and multi-cultural consumers. Captain Morgan made strong share gains in a weak rum category as it encouraged consumers to 'Live like a Captain' through its new campaign, innovated with the launch of LocoNut and new signature serve 'Morgan Mule'. Don Julio net sales grew 20% building on the momentum of last year. Tanqueray gin and Baileys grew net sales and continued category share gains.
- **DBC USA** net sales increased 3% with ready to drink growing 5% and beer flat. Ready to drink growth was driven by strong growth of Smirnoff Ice which benefited from a packaging and liquid renovation, activation against the football consumption occasion and the launch of two new flavours of Smirnoff Ice Spiked, as well as the launch of Smirnoff Spiked Sparkling Seltzer. Guinness net sales grew 1% offsetting declines on Smithwick's ale and Harp lager.
- Net sales in **Canada** grew 3%, driven by growth in Smirnoff, Crown Royal, Johnnie Walker and ready to drink. Smirnoff grew 5% through its continued association with music through the Smirnoff Sound Collective and increased digital presence in search. Crown Royal continued to benefit from the 'We Make Whisky The Canadian Way' campaign, which highlights the brand's quality and craftmanship and from the launch of Crown Royal Vanilla. Ready to drink growth was driven by Smirnoff which benefited from packaging renovation and launch of new flavours.
- **Marketing** grew 4% with increased activity on core brands in the second half funded partially from productivity initiatives.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
North America	2	1	3	17
US Spirits	2	1	3	17
DBC USA	2	(4)	3	12
Canada	2	2	3	17
Spirits(i)	1	1	3	20
Beer	(1)	(9)	–	8
Ready to drink	4	4	4	21

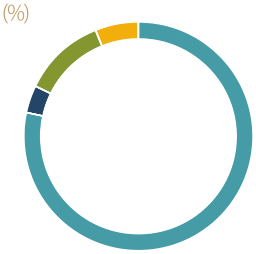
Global giants and local stars and reserve(i):	Organic volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Crown Royal	10	12	30
Smirnoff	(1)	(2)	15
Captain Morgan	4	4	21
Johnnie Walker	3	6	23
Ketel One vodka	(3)	(6)	9
Cîroc	(13)	(15)	(1)
Baileys	3	2	19
Guinness	–	1	18
Tanqueray	(1)	(1)	15
Don Julio	16	19	39
Bulleit	22	23	43
Buchanan's	12	7	25

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement.

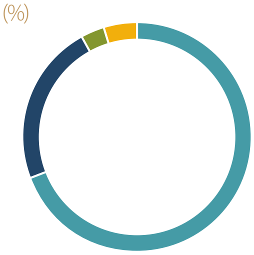
Europe, Russia and Turkey

Diageo is the largest premium drinks business in Europe. Within the geography of Europe there are three markets: Europe, Russia and Turkey. In Europe consumer marketing programmes are developed at a market level to drive consistency, efficiency and scale across all countries. In Russia we are driving our premium core, standard and value brands and reserve portfolio, whilst in Turkey, we use our local businesses' route to consumer to drive growth in international premium spirits. In Europe our reputation as a trusted and respected company and for groundbreaking innovation, is key to our ability to attract and retain the people we need to deliver our Performance Ambition.

Net sales by markets
(%)

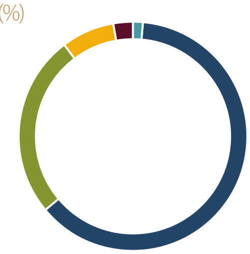


Net sales by categories
(%)



(i) excluding RTDs

Net sales by price points
(%)



Key financials	2016 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2017 £ million	Reported movement %
Net sales	2,544	211	37	(96)	128	2,824	11
Marketing	404	22	5	(2)	14	443	10
Operating profit before exceptional items	801	64	14	(10)	67	936	17
Exceptional operating items(ii)	–					(33)	
Operating profit	801					903	13

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions and the results of Lebanon, other Middle Eastern and North African countries which were formerly reported in Asia Pacific and Africa geographical regions now being included in Europe, Russia and Turkey.
(ii) For further details of exceptional operating items see pages 110 and 111.

Our markets
Europe comprises Great Britain, Ireland, France, Continental Europe (including Northern Europe, Germany, Austria and Switzerland, Poland, Iberia, the Mediterranean and the Europe Partner Markets distribution businesses), while Russia and Turkey are standalone markets. Europe is managed as a single market with country teams focusing on sales and customer marketing execution.

Supply operations
The International Supply Centre (ISC) comprises the supply operations in the United Kingdom, Ireland and Italy. The group owns 29 whisky distilleries in Scotland, a Dublin based brewery, maturation and packaging facilities in Scotland, England, Ireland and Italy. The ISC exports whisky, vodka, gin, rum, beer, wine, cream liqueurs, and other spirit-based drinks to over 180 countries. Through our planned £1 billion investment in Scotch whisky production and inventory, distilling capacity has increased by over 25% since 2012. Raki, vodka and wine are produced at a number of sites in Turkey and Smirnov vodka and other local brands are produced in Russia.

Route to consumer
In Great Britain we sell and market our products through Diageo GB (spirits, beer and ready to drink) and Justerini & Brooks Fine Wines (wines private clients). Products are distributed through independent wholesalers and directly to retailers. In the on-trade, products are sold through major brewers, multiple retail groups and smaller regional independent brewers and wholesalers. In the Republic of Ireland and Northern Ireland, Diageo sells and distributes directly to the on-trade and the off-trade as well as wholesalers. In France our products are sold through a joint venture arrangement with Moët Hennessy. In Continental Europe, we distribute our spirits brands primarily through our own distribution companies. Europe Partner Markets distributes our beer brands in mainland Europe, focusing on Germany, Russia and France, our largest mainland European beer markets.

In Russia we operate through wholly owned subsidiaries.

In Turkey, we sell our products via the distribution network of Mey İçki, our wholly owned subsidiary. Mey İçki distributes both local brands (raki, other spirits and wine) and Diageo's global spirits brands.

Sustainability and responsibility
Concern over harmful drinking is high on the public agenda in this region, so our work to promote responsible drinking is both a key issue and a key strength. Our responsible drinking programmes aim to tackle drink driving, underage drinking and heavy episodic drinking. For example, our Smashed programme in Great Britain brings theatre to schools to discourage underage drinking, and we work with retailers from Tesco in the UK to Auchan in Italy to provide consumer information about responsible drinking. This focus is at the heart of our Learning for Life programme, which is helping to train a new generation of people in the hospitality industry in Europe. Of those taking part, more than 70% secured lasting employment within 12 months of completing the programme.

Our manufacturing operations, notably our distilleries in Scotland and our Guinness brewery in Ireland, aim for leadership in safety standards and environmental sustainability. Our plans for a new distillery at St James's Gate in Dublin include the same high standards of environmental performance and management that we expect from any of our new facilities, and build on the leading performance of the new Brewhouse at St James's Gate.

The region delivered 5% net sales growth reflecting continued strong performance in Europe and good net sales growth in Russia and Turkey.
In Europe, net sales were up 4% with Continental Europe and Great Britain the main contributors. Europe continued to gain share in spirits, taking 20bps over the year. Strong performance on Johnnie Walker, Baileys and Captain Morgan continued. Tanqueray had double digit growth in most countries across Europe and Guinness net sales were up 2% supported by innovations from the 'The Brewers Project'. Strong performance in reserve brands continued with 9% growth. In Russia, whilst the prior year price increases continued to impact performance with volume down 4%, net sales grew 7% with share gains in Bell's and Johnnie Walker. In Turkey, volumes were down 2% but net sales grew 4%, also driven by price rises following excise increases. Gross margins were up across the three markets driven by positive mix in Europe and price in Russia and Turkey. Operating margin in the region increased 91bps driven mainly by positive price/mix and ongoing productivity initiatives partially offset by other one off operating costs.

Key highlights

- In **Europe** net sales were up 4%:
  - In **Great Britain**, net sales grew 3%. Tanqueray grew strong double digit due to expanded distribution, gaining share of 80bps in the gin category. Captain Morgan grew 6%, taking 300bps of share and gained category leading status. Innovation success with Hop House 13 Lager and Smirnoff Cider also contributed to growth this year. Reserve brands were up 15% driven by Tanqueray and the launch of Haig Club Clubman. Smirnoff gained share due to momentum of the 'We're Open' platform but net sales fell 7%, due to changes in the commercial footprint leading to efficiencies including inventory reduction.
  - Net sales in **Ireland** were flat. Guinness net sales were up 2% driven by continued success of Hop House 13 Lager, offset by other beer brands where net sales declined 4%. Net sales growth in spirits of 10% was driven by Gordon's and Smirnoff.
  - In **France**, net sales were flat. Continued strong performance in Captain Morgan and Zacapa, was offset by weakness in J&B and Smirnoff including ready to drink.
  - In **Continental Europe**, net sales were up 7%:
    Net sales in **Iberia** were up 7% due to changes in the commercial footprint in the prior year and Scotch share gain in a growing scotch category, with Johnnie Walker net sales growth of 7% and J&B returning to growth of 3%. Tanqueray net sales were up 9% in a growing gin category.
    In **Germany, Austria and Switzerland**, net sales grew 10% driven by double digit growth in Baileys, Johnnie Walker and Tanqueray, all achieving share gains in their respective categories.
    Benelux net sales were down 2% within a declining spirits category. Performance continued to be impacted by a significant tax increase implemented in the prior year in Belgium.
    In **Italy**, net sales were up 5%, mainly due to strong net sales growth in Tanqueray in a growing gin category.
    Poland net sales grew 9% due to performance improvement in scotch and reserve brands.
    Europe Partner Markets grew net sales 12% due to an expanded distribution footprint and performance improvement in Johnnie Walker, Captain Morgan and Guinness.
- **Russia** net sales grew 7%. While performance continues to be impacted by the economy and recent history of price increases, Russia achieved double digit growth in Bell's and Johnnie Walker, with share gains across both brands. Performance improved due to broader distribution in the off-trade, increased activations and consistent execution of growth drivers as well as innovation success with Bell's Spiced.
- In **Turkey**, net sales grew 4% reflecting the impact of price rises taken in response to increases in excise duties. This performance was delivered in a challenging market, driven by 5% growth in raki. Johnnie Walker continued to deliver double digit growth.
- **Marketing** increased 3% and benefited from productivity initiatives which improved efficiency and effectiveness of the brand investment. The region continues to be focused on the key growth opportunities including reserve brands, gin, scotch, beer and innovation with up-weighted spend in the second half.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Europe, Russia and Turkey	3	1	5	11
Europe	3	–	4	9
Russia	(4)	(4)	7	41
Turkey	(2)	(2)	4	6
Spirits(i)	3	4	5	15
Beer	2	(1)	2	10
Ready to drink	(2)	(2)	(3)	5

Global giants and local stars(i):	Organic volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Guinness	2	2	10
Johnnie Walker	10	10	34
Smirnoff	(2)	(4)	2
Baileys	8	6	16
Yenì Raki	(2)	4	5
Captain Morgan	14	12	23
J&B	2	–	14
Tanqueray	33	29	43

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except Johnnie Walker 19% and J&B 3% which were impacted by the reclassification of Middle Eastern and North African countries to the region.

Africa

In Africa our strategy is to grow Diageo's leadership across beer and spirits by providing brand choice across a broad range of consumer motivations, profiles, price points and occasions. We are focused on growing beer faster than the market and accelerating the growth of spirits through continued investment in infrastructure and brands with mainstream spirits being critical to realising the potential of the region. Local sourcing is a key element of our strategy in Africa as it directly supports our commercial operations, while indirectly supporting our position by bringing wider benefits to society as a whole.

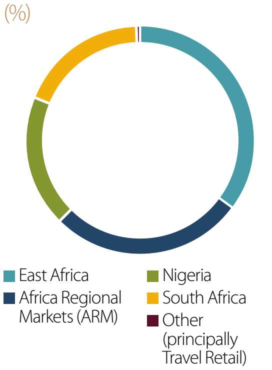
Our markets

The region comprises East Africa (Kenya, Tanzania, Uganda, Burundi, Rwanda and South Sudan), Africa Regional Markets (including Ghana, Cameroon, Ethiopia, Angola and a sorghum beer business in South Africa), Nigeria and South Africa (including the Republic of South Africa and Mozambique).

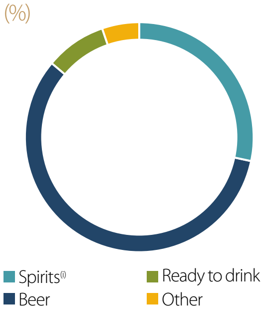
Supply operations

We operate 12 breweries in Africa, three sites that produce sorghum beer in South Africa, one cider plant and five facilities which provide blending and malting services. In addition, our beer and spirits brands are produced under licence by third-parties in 16 African countries.

Net sales by markets
(%)

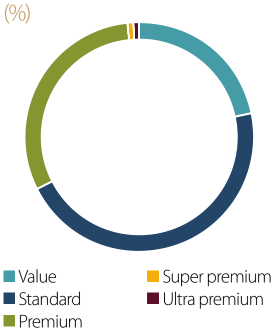


Net sales by categories
(%)



(i) excluding RTDs

Net sales by price points
(%)



Key financials	2016 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2017 £ million	Reported movement %
Net sales	1,401	78	(13)	15	75	1,556	11
Marketing	143	13	(2)	5	7	166	16
Operating profit	212	7	(7)	(14)	20	218	3

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions and the results of North African countries which were formerly reported in the Africa geographical regions now being included in Europe, Russia and Turkey.

Route to consumer

In Africa our largest businesses are in Nigeria, where we own 54.32% of a listed company whose principal brands are Guinness, Orijin, Harp and Malta, and in East Africa, where we own 50.03% of East African Breweries Limited (EABL). EABL produces and distributes beer and spirits brands to a range of consumers in Kenya and Uganda, and owns 51% of Serengeti Breweries Limited located in Tanzania. Within Africa Regional Markets, we have wholly owned subsidiaries in Cameroon, Ethiopia and Reunion and majority owned subsidiaries in Ghana and the Seychelles. Angola is supplied via a third party distributor. In South Africa and Mozambique we sell spirits, beer, cider and ready to drink products through wholly owned subsidiaries. Diageo has agreements with the Castel Group who license, brew and distribute Guinness in several countries across Africa Regional Markets. Diageo sells spirits through distributors in the majority of other sub-Saharan countries.

Sustainability and responsibility

We have a large production footprint, and our overall approach is to consider the broader context of our contribution as a local taxpayer, employer and member of the community. Our sourcing strategy is particularly important, and we aim to source 80% of agricultural raw materials locally by 2020, from some 50,000 farmers. In 2017 we had reached 76%. Through our Sustainable Agriculture Strategy, we are supporting farmers in our supply chain to develop economically, environmentally and socially sustainable farming practices. For example, we are carrying out a pilot in Northern Tanzania to help barley farmers improve their livelihoods through better resilience to drought and broader sustainable agriculture practices.

Fifteen of our production sites in Africa are in water-stressed areas, so we focus closely on managing water efficiently and enhancing access to clean water to surrounding communities through our pan-African Water of Life programme. This provided more than 173,000 additional people with safe water in 2017, securing a basic resource that underpins their community.

A major focus of our work in Africa centres on preventing drink driving. This year our partnership with the United Nations Training and Research Institute (UNITAR) brought together regional and local stakeholders to promote road safety in Nigeria and South Africa. We also support awareness and education campaigns in all our major markets and work with transportation authorities on training and enforcement initiatives. And we work with partners, such as community health care workers in Ethiopia, to reduce underage drinking.

Africa delivered net sales growth of 5% with all markets contributing to growth except East Africa, which remained flat. East Africa performance was driven by mainstream spirits up 24%, with strong growth of Kenya Cane offset by beer, down 4%, due to a significant increase in duty in Kenya in December 2015. Africa Regional Markets were up 5% driven by the relaunch of Meta in Ethiopia and in Ghana, good growth of Guinness and Malta Guinness, partially offset by a decline in Orijin due to increased competition in the bitters category. Nigeria was up 16% as the beer market continues to shift towards the value segment with Satzenbrau, up 61%, capitalising on the trend. South Africa was up 7%, due to growth of Smirnoff 1818. Beer performance in the region with net sales up 3%, was driven by Senator and Satzenbrau, partially offset by Guinness down 5% and Tusker down 10%. Mainstream spirits showed strong growth, up 21%. Scotch was up 5% and in growth across all markets except South Africa, driven by Johnnie Walker supported by the 'Keep Walking' campaign. Operating margin increased 60bps supported by productivity savings in supply, zero based budgeting on indirect spend and organisation effectiveness benefits, partially offset by an increase in marketing spend and route to consumer investments.

Key highlights

- In **East Africa**, net sales were flat. Beer was down 4%, driven by the impact of the duty increase on bottled beer affecting Guinness and Tusker, partially offset by growth in Senator of 14%. Growth in value beers was supplemented by Ngule, a new value price point innovation in Uganda. Spirits grew 17% driven by mainstream spirits, up 24%. Reserve brands grew double digit following enhanced outlet partnerships and activation supported by brand ambassadors.
- In **Africa Regional Markets**, net sales grew 5% reflecting strong growth in Ethiopia, and a solid contribution by Ghana and Cameroon. These markets continued to benefit from the enhanced route to consumer delivering improved distribution, availability and execution.
  – In Ethiopia, net sales increased 28% driven by Meta, up 23%, following the relaunch last year. Spirits growth was fuelled by Johnnie Walker strong double digit growth driven by the new distributor model.
  – Ghana net sales increased 4%. Growth in beer offset a decline in spirits driven by Orijin Bitters which lapped its launch. Guinness net sales were up 15% and Malta Guinness, up 14% both benefiting from the 'First Beer On Us' campaign, offsetting declines in other beer brands, predominantly Star.
  – In Cameroon, net sales growth of 3% was driven largely by ready to drink, up 42%. This was led by Orijin ready to drink following the launch last year. Spirits also contributed to the good performance driven predominately by Johnnie Walker Black Label, up 17%. Malta Guinness declined due to rising competition in the category.
- In **Nigeria**, net sales increased 16% driven by beer growth up 11%. The beer value category continues to grow and now represents more than 50% of the market volume. Satzenbrau with net sales up 61% and the Dubic Malt launch, more than offset the decline in Guinness, Malta Guinness and Harp. Strong mainstream spirits growth was driven by increased support and the successful launch of brands including McDowell's in the first half of the year, which is now produced locally at Benin. Scotch net sales were up strong double digit, driven by Johnnie Walker increased investment. Ready to drink was down 15%, driven by the highly competitive category affecting Orijin, partly offset by strong performance in Smirnoff Double Black and Guarana and Smirnoff Ice. The recent launch of Orijin Zero is extending reach into the non-alcoholic drinks market.
- **South Africa** net sales grew 7% driven by growth in mainstream spirits, up 15%, led by strong growth of Smirnoff 1818 which was partially offset by Guinness decline and scotch down 1% with volume down 6% following the negative category trend and impacted by price increases across the portfolio.
- **Marketing** was up 5% in the region. In Africa Regional Markets investment was focused behind the activation of Guinness campaigns and Johnnie Walker 'Step up' across all markets, and in Ethiopia on the Meta relaunch. South Africa investment was behind Johnnie Walker and Bell´s to revitalize the scotch category with activations at scale through liquid on lips. In Nigeria investment remained flat, with special focus on Satzenbrau and mainstream spirits launches. East Africa investment was focused on Johnnie Walker, while efficiencies on Tusker were reinvested in mainstream spirits.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Africa	3	3	5	11
East Africa	5	5	–	16
Africa Regional Markets	–	–	5	18
Nigeria	10	10	16	(16)
South Africa	(1)	2	7	40
Spirits[i]	9	7	13	24
Beer	1	1	3	4
Ready to drink	(10)	3	(3)	14

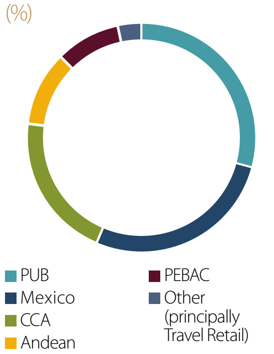
Global giants and local stars[i]:	Organic volume movement[ii] %	Organic net sales movement %	Reported net sales movement %
Guinness	(5)	(5)	(7)
Johnnie Walker	(1)	3	5
Smirnoff	4	22	47
Other beer:			
Malta Guinness	(12)	2	(11)
Tusker	(7)	(10)	5
Senator	10	14	32
Satzenbrau	22	61	18

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except for Johnnie Walker (10)% which was impacted by the reclassification of Algeria and Morocco to the Europe, Russia and Turkey region.

Latin America and Caribbean

In Latin America and Caribbean the strategic priority is continued leadership in scotch, while broadening our category range through vodka, rum, liqueurs and local spirits. We continue to invest in routes to market and in the breadth and depth of our portfolio of leading brands. We are also enhancing our supply structure to enable the business to provide both the emerging middle class and an increasing number of wealthy consumers with the premium brands they aspire to. In this region's changing regulatory landscape, our presence is supported by our reputation as a trusted and respected business, based on our stance on responsible drinking, and community development programmes.

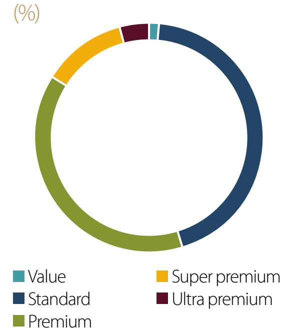
Net sales by markets
(%)



Net sales by categories
(%)

(i) excluding RTDs

Net sales by price points
(%)



Key financials	2016 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2017 £ million	Reported movement %
Net sales	863	131	(13)	(26)	89	1,044	21
Marketing	167	22	1	(2)	7	195	17
Operating profit before exceptional items	199	35	(11)	(5)	32	250	26
Exceptional operating items(ii)	(118)					–	
Operating profit	81					250	209

(i) Reclassification comprise changes to a reallocation of the results of the Travel Retail operations to the geographical regions.
(ii) Ypióca impairment.

Our markets
Our Latin America and Caribbean (LAC) business comprises five markets: PUB (Paraguay, Uruguay and Brazil), Mexico, CCA (Central America and Caribbean), Andean (Colombia and Venezuela) and PEBAC (Peru, Ecuador, Bolivia, Argentina and Chile).

Supply operations
The majority of brands sold in the region are manufactured by our International Supply Centre in Europe. In recent years, we have acquired a number of supply operations and expanded our co-packer network across the region. In 2015 we acquired the remaining 50% equity interest in Tequila Don Julio in Mexico, which resulted in full ownership of the brand and its production facilities. In 2012 we acquired Ypióca in Brazil, including its cachaça production site, and in 2011 we acquired a controlling interest in Anejos de Altura (Guatemala) which produces Zacapa. We also have partnerships with 14 brewers and 10 co-packing partners.

Route to consumer
We drive an efficient route to consumer through differentiated models tailored to each markets' size and needs. In Mexico and Peru our in-market companies sell directly to retailers and wholesalers. In Brazil, we distribute the majority of Ypióca through a reseller network in Ceará state, and serve the rest of the country and brands via distributors, wholesalers, and multiple retail groups. In Andean we partner with geographically exclusive distributors, but in Colombia a subsidiary sells to the key accounts directly. In Chile we also serve retailers directly, while the rest of the channels are covered by a single distributor.

In most of CCA and Argentina we partner with distributors in each country who are responsible for the execution of the sales and marketing programmes.

Sustainability and responsibility
Diageo has long been known in the region for our flagship community re-investment programme, Learning for Life, and our overall approach to developing an industry that brings economic and social value to society. Our commercial and brand teams have been working to increase the scale and impact of Learning for Life, to deliver more for our communities, partners, customers and our business. In Mexico, for example, Project Entrepreneur creates new businesses, and has resulted in around 12,000 new jobs in Mexico City.

Key issues we address in the region are underage drinking and drink driving. For example, we support schemes with retailers in Brazil, Mexico and Colombia to ensure they check for identification to prevent underage sales. In the Dominican Republic, we worked with industry partners to support legislation to establish a maximum blood alcohol level for driving.

Latin America and Caribbean delivered 2% growth in volume and 9% growth in net sales, with strong performance from Mexico, Andean and PEBAC. Mexico net sales were up 20% driven by scotch and strong double digit growth from Don Julio. Andean performance was driven by Colombia with net sales growth of 20%. Both Andean and PEBAC growth was mainly driven by scotch. PUB grew net sales 4% as the rate of decline in Brazil slowed due to lapping the impact of prior year tax increases, and performance improvement in Uruguay and Paraguay. Across the region, scotch net sales grew 12% and a decline in vodka was offset by growth in tequila, Baileys and rum. Operating margin for the region increased 111bps benefiting from product mix in Mexico and Colombia, productivity led marketing efficiencies and overhead savings through both indirect spend and organisational effectiveness programmes.

Key highlights

- In **PUB (Paraguay, Uruguay and Brazil)**, net sales grew 4%. In Brazil, the decline in net sales slowed as performance lapped the impact from the tax increase in December 2015. Net sales declined in vodka and ready to drink, which offset the 4% growth in scotch, where Black & White grew 28% gaining 11 percentage points share of primary scotch. In cachaça, Ypióca net sales grew 5% with Ypióca Ouro (Gold variant) growing double digit driven by strong in store execution and commercial incentives. Paraguay and Uruguay continued to grow due to improved performance in the export channels. Net sales for reserve brands in PUB continued their strong performance with 18% growth driven by Ketel One vodka and Johnnie Walker Gold Label Reserve.
- In **Mexico**, net sales increased 20% driven by strong performance across all categories except ready to drink and vodka. Scotch continues to be a key category driver with net sales growth for Johnnie Walker at 16% and Buchanan's at 14%. In primary scotch, Black & White net sales grew double digit. Reserve grew net sales 33% driven by Don Julio which grew 42% taking 2pps of share. Net sales also grew in rum, Baileys and gin.
- In **CCA (Central America and Caribbean)**, net sales declined 1%. The domestic markets grew net sales 3% driven by scotch, Smirnoff ready to drink and Guinness. Export channels net sales declined 9% as market conditions remained challenging given the continued currency weakness against the US dollar.
- **Andean (Colombia and Venezuela)** continued strong growth with net sales up 21%. Colombia net sales increased 20% driven by route to consumer expansion and implementation of commercial standards. Growth in Colombia was across all categories except vodka with scotch up 23% driven by Buchanan's and Johnnie Walker continuing to grow our leadership position in the category. In Venezuela volume decreased 27% as volatility in the market continued. Although net sales grew significantly faster, with price increases in the high inflation environment, the business remains small with net sales of approximately £10m.
- **PEBAC (Peru, Ecuador, Bolivia, Argentina and Chile)** delivered net sales growth of 13%, mainly driven by Chile and Argentina. Growth in Chile was driven by scotch. Argentina's growth was driven by a route to market change, implemented in F16.
- **Marketing** increased by 4%, and benefited from procurement savings resulting in an underlying investment increase of 9%. Investment on scotch was spread across price points with support focused behind Johnnie Walker, Buchanan's and Black & White.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Latin America and Caribbean	2	2	9	21
PUB	(3)	(3)	4	38
Mexico	16	16	20	27
CCA	(4)	(10)	(1)	1
Andean	(11)	(11)	21	39
PEBAC	43	46	13	18
Spirits(i)	3	4	12	27
Beer	1	(29)	17	(36)
Ready to drink	(16)	(17)	(3)	20

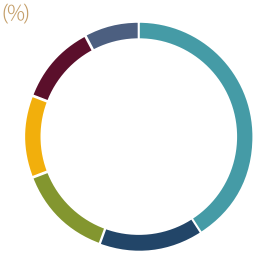
Global giants and local stars(i):	Organic volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Johnnie Walker	2	11	23
Buchanan's	19	23	32
Smirnoff	(2)	(10)	10
Old Parr	(1)	3	20
Baileys	8	15	28
Ypióca	1	5	41
Black & White	46	21	40

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except for Smirnoff 4% and Baileys 9% due to acquisitions and disposals.

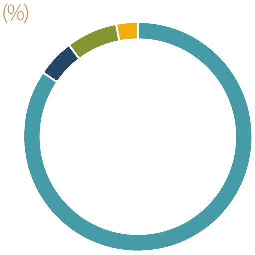
Asia Pacific

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

Net sales by markets
(%)

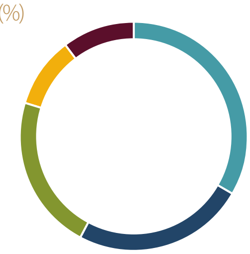


Net sales by categories
(%)



(i) excluding RTDs

Net sales by price points
(%)



Key financials

	2016 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2017 £ million	Reported movement %
Net sales	2,076	346	(30)	(43)	70	2,419	17
Marketing	301	47	(4)	–	(1)	343	14
Operating profit before exceptional items	395	85	(11)	(1)	19	487	23
Exceptional operating items(ii)	(49)					(9)	
Operating profit	346					478	38

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions and the results of Lebanon, other Middle Eastern countries which were formerly reported in the Asia Pacific geographical region now being included in Europe, Russia and Turkey.
(ii) For further details of exceptional operating items see pages 110 and 111.

Our markets

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

Supply operations

We have distilleries at Chengdu, in China that produce Chinese white spirit and in Bundaberg, Australia that produce rum. United Spirits Limited (USL) operates 23 owned manufacturing units in India and Nepal and leases one manufacturing facility in India. USL and Diageo brands are also produced under licence by third-parties in 36 manufacturing units in India. In addition, we have bottling plants in Korea, Thailand, Indonesia and Australia with ready to drink manufacturing capabilities.

Route to consumer

In South East Asia, spirits and beer are sold through a combination of Diageo companies, joint venture arrangements, and third party distributors. In Thailand, Malaysia and Singapore, we have joint venture arrangements with Moët Hennessy, sharing administrative and distribution costs. Diageo operates wholly owned subsidiaries in the Philippines and Vietnam. In Vietnam we own a 45.56% equity stake in Hanoi Liquor Joint Stock Company. In Indonesia, Guinness is brewed by, and distributed through, third party arrangements.

In Greater China the majority of our brands are now sold through our wholly owned subsidiary. Some brands are distributed through a joint venture arrangement with Moët Hennessy. In addition, we are the sole distributor of Shui Jing Fang, a super premium Chinese white spirit, through our controlling 39.71% equity stake in a listed company. Diageo operates a wholly owned subsidiary in Taiwan.

In India, we manufacture, market and sell Indian whisky, rum, brandy and other spirits through our 54.78% shareholding in USL. Diageo also sells its own brands through USL.

In Australia, we manufacture, market and sell the Diageo products and in New Zealand we operate through third party distributors.

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

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

Sustainability and responsibility

We have spent time re-aligning our programmes based on material issues to our business and our stakeholders, such that they better support our commercial agenda and our relationships in the many and varied markets that make up this region. We are moving our efforts towards programmes focused where we source, make and sell.

For example, we have developed community water programmes in India around our production sites, reducing the amount we use while ensuring safe drinking water for around 40,000 people. Our Model Villages programme is also tackling illicit alcohol and heavy episodic drinking. We are working with local NGOs and communities to support more balanced lifestyles and with women's groups to support their empowerment.

To address local concerns we focus on preventing underage drinking, and this year launched Smashed, our theatre education programme, in many countries including China, Taiwan and Indonesia. We are also continuing to focus on preventing heavy drinking among university students in Korea and Australia.

Asia Pacific net sales grew 3% with strong growth in Greater China and solid performance in Australia and South East Asia. This was partly offset by the continued contraction of the scotch category in Korea which led to a further decline in net sales and there was also weakness in travel retail in the region. In Greater China, net sales grew 25% as a result of strong momentum in Chinese white spirits and scotch performance, up 5%. The business in India grew net sales by 2%, largely driven by IMFL whisky and scotch, despite the impact of demonetisation and the Supreme Court ruling banning sales in certain outlets near highways. South East Asia net sales grew 3% and Australia net sales also grew 3% driven by scotch and ready to drink innovation. Operating margin improved 20bps benefiting from mix, driven by strong growth from reserve brands, overhead efficiency benefits from the productivity programme across all markets, and in India, margin improvement was supported in particular by significant supply efficiencies. These benefits were partially offset by lapping the profit on the sale of United Breweries shares in the prior year.

Key highlights

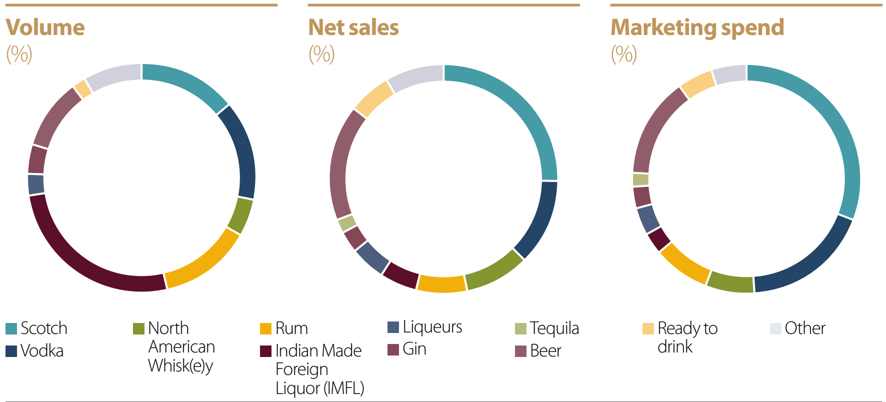
- **India** net sales were up 2% despite the impact of demonetisation and the recent Supreme Court ruling prohibiting the sale of alcohol in certain outlets near highways. Prestige and above grew 7% as McDowell's No. 1 and Signature continued to benefit from their renovation, with net sales growth of 9% and 31%, respectively. Scotch grew net sales 6% driven by Johnnie Walker and Black & White. Popular brands declined 5% particularly within the rum category. The focus on route to consumer continues with perfect stores now representing over a third of total business. Distribution and share of shelf have grown, driving net sales growth and share on key scotch brands.
- **Greater China** net sales were up 25%. Chinese white spirits grew 69%, driven by route to consumer initiatives and brand equity investment. Scotch net sales growth was up 5% driven by Johnnie Walker, The Singleton and other malts.
- **Australia** net sales increased 3% driven by growth in scotch. The relaunch of the Johnnie Walker 'Keep Walking' campaign and innovations including blender's batch select cask and red rye finish contributed to Johnnie Walker net sales growth of 4%. Reserve was up 9%. Whilst the ready to drink category remains challenging, innovation launches including Bundaberg Lazy Bear, Smirnoff Pure and Pimm's Premixes, delivered significant net sales for the business through addressing consumer demand for low tempo refreshing drinks.
- **South East Asia** net sales grew 3% with growth in the Philippines and Key Accounts offsetting the declines in Thailand and Indonesia. In the Philippines the focus on route to consumer is driving significant increases in distribution in the modern trade and secondary outlets, while also improving execution standards and activation. The 'Keep Walking Philippines' campaign launch during the first half supported by occasion-driven activation during the second half led to double digit growth for Johnnie Walker. Scotch grew net sales 7% driven by Key Accounts, which continues to lap a period of planned inventory reduction, and the Philippines. The mourning period in Thailand, following the death of the king, impacted performance with net sales down 10% following the closure of on-trade outlets for varying periods over the one year formal mourning period. In Indonesia, total beer net sales declined 5% impacted by structural trade changes. Guinness decline was mitigated by the launch of Ginseng under the Guinness Zero brand.
- In **North Asia**, net sales declined 3%. In Korea net sales declined 7% as Windsor continued to be impacted by the contraction of the traditional on-trade, increased competition and shifts to lower alcohol by volume local whisky segments. This was partially offset by net sales growth of 41% for W Ice by Windsor, a low alcohol variant and by Guinness as the international beer category grows. Japan grew net sales 6% driven by scotch with net sales growth of 21% offsetting the decline in ready to drink.
- **Travel Retail Asia and Middle East** continued to decline net sales at 13% with lower spend by travellers and currency volatility impacting performance.
- **Marketing** investment remained broadly flat with marketing efficiencies across the region offset by up-weighted investment behind Chinese white spirits.

Markets:	Organic volume movement[(i)] %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Asia Pacific	(1)	(6)	3	17
India	(2)	(7)	2	14
Greater China	25	25	25	45
Australia	–	–	3	25
South East Asia	7	13	3	15
North Asia	11	11	(3)	18
Travel Retail Asia and Middle East	(14)	(17)	(13)	(15)
Spirits[(ii)]	(1)	(7)	4	16
Beer[(iii)]	1	46	–	17
Ready to drink	–	–	–	20

Global giants and local stars[(ii)]:	Organic volume movement[(iv)] %	Organic net sales movement %	Reported net sales movement %
Johnnie Walker	3	1	7
McDowell's	(1)	1	13
Windsor	(11)	(12)	5
Smirnoff	(1)	1	17
Guinness	–	(1)	18
Bundaberg	(4)	–	21
Shui Jing Fang[(v)]	66	65	81

(i) Difference between organic and reported volume for Asia Pacific is driven by the move to the franchise model for some popular segment brands in India.
(ii) Spirits brands excluding ready to drink.
(iii) Following a review of group's reporting of volume an adjustment was made to include Malaysia and Singapore contract brew volume in the reported beer figures which increased the reported volume in Asia Pacific by 0.3 million equivalent cases (2016 – 0.4 million equivalent cases).
(iv) Organic equals reported volume movement except for Johnnie Walker (2)%, Smirnoff (2)% and McDowell's (7)% which were impacted by the reclassification of Lebanon and other Middle East countries to the Europe, Russia and Turkey region and the move from an owned to a franchise model in India.
(v) Organic growth figures represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

Category review



- **Scotch** represents 25% of Diageo's net sales and was up 5% with broad based growth across all regions except Asia Pacific which was impacted by Windsor decline in line with the scotch category contraction in Korea. This was more than offset by growth driven by Johnnie Walker up 6% and Buchanan's up 16%. Performance was consistently strong across all price segments, growing net sales in standard and primary from brands such as Johnnie Walker Red Label up 6% and Black & White up 16%. Premium segments grew 5% with Buchanan's continuing to perform strongly in Latin America and Caribbean and North America. Scotch reserve brands grew net sales 4%, driven by Johnnie Walker Gold Label Reserve and The Singleton up 8%.
- **Vodka** represents 12% of Diageo's net sales and declined 4%, driven by soft performance in all the regions except for Africa where net sales grew 22%. Net sales decline was driven predominantly by Cîroc and Ketel One vodka in North America. Smirnoff declined 1%. This was driven by Great Britain, where despite gaining share, it was impacted by changes to the commercial footprint that led to efficiencies, including an inventory reduction, and declined 7%. Smirnoff was also down 2% in US Spirits, partially offset by a strong growth of Smirnoff 1818 in South Africa.
- **North American whisk(e)y** represents 9% of Diageo's net sales and grew 11%. Performance continued to be driven by strong growth and share gains in Crown Royal and Bulleit in US Spirits.

Key categories	Reported volume movement[iii] %	Organic net sales movement %	Reported net sales movement %
Spirits[i]	1	5	19
Scotch	4	5	18
Vodka[ii]	(2)	(4)	10
North American whisk(e)y	8	11	29
Rum[ii]	(2)	4	19
Indian-Made Foreign Liquor (IMFL) whisky	1	6	21
Liqueurs	4	3	12
Gin[ii]	8	8	20
Tequila	27	26	43
Beer	1	2	7
Ready to drink	(4)	–	17

(i) Spirits brands excluding ready to drink.
(ii) Vodka, rum, gin including IMFL brands.
(iii) Organic equals reported volume movement except for Spirits (2)%, Rum (6)%, IMFL whisky (2)%, Liqueurs 1%, Gin 3% and Ready to drink 0% which were impacted by disposals and the move from an owned to a franchise model in India.

Global giants, local stars and reserve[i]:	Organic volume movement[ii] %	Organic net sales movement %	Reported net sales movement %
Global giants			
Johnnie Walker	4	6	18
Smirnoff	(1)	(1)	13
Baileys	6	5	18
Captain Morgan	7	6	22
Tanqueray	12	9	24
Guinness	(1)	–	8
Local stars			
Crown Royal	10	12	30
Yenì Raki	(3)	4	5
Buchanan's	16	16	29
J&B	3	–	13
Windsor	(11)	(12)	5
Old Parr	–	5	22
Bundaberg	(4)	–	21
Black & White	24	16	37
Ypióca	1	5	41
McDowell's	(1)	2	15
Shui Jing Fang[iii]	66	65	81
Reserve			
Scotch malts	3	2	17
Cîroc	(10)	(12)	1
Ketel One vodka	–	(5)	11
Don Julio	25	25	43
Bulleit	23	24	44

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except for McDowell's No.1 (6)%, which was impacted by the move from an owned to a franchise model in India.
(iii) Organic growth figures represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

- **Rum** represents 7% of Diageo's net sales and grew 4%. In Europe, Africa and Latin America and Caribbean net sales grew double digit while North America was up 3%, driven by the turnaround of Captain Morgan. In India net sales declined 8% driven by McDowell's No.1 Rum.
- **IMFL whisky** represents 5% of Diageo's net sales and grew 6%. The relaunches of two of the biggest brands McDowell's No.1 and Signature have contributed to this growth with both brands growing double digit.
- **Liqueurs** represents 5% of Diageo's net sales and grew 3% driven by growth in all regions except Africa. Baileys was up 5%, led by Europe, following an exceptional on-trade execution and positive results of the 'Don't mind if I Baileys' advertising campaign.
- **Gin** represents 3% of Diageo's net sales and grew 8%. Strong double digit growth in Europe, Africa and Latin America and Caribbean fuelled growth in the category. Tanqueray was the largest contributor, followed by Gordon´s.
- **Tequila** represents 2% of Diageo's net sales and grew 26%. The performance was driven by continued double digit growth of Don Julio in US Spirits and Mexico.
- **Beer** represents 16% of Diageo's net sales and grew 2%. Strong performance in the value beer portfolio in Africa was driven by Satzenbrau in Nigeria and Senator in Kenya. Guinness growth in Europe was led by innovation from the 'The Brewers Project' including Guinness Hop House 13 Lager. This was offset by declines in Tusker and Guinness Extra Stout as a result of the increase of duty on bottled beer in Kenya as well as a decline in Guinness in Nigeria.
- **Ready to drink** represents 6% of Diageo's net sales and remained flat. North America delivered strong performance in Smirnoff launches offset predominantly by declines in Orijin in Nigeria.
- **Global giants** represent 41% of Diageo net sales and grew 3%, driven by Europe up 6% and Latin America and Caribbean up 9%. All Global Giants grew with the exception of Guinness which remained flat and Smirnoff which was down 1%.
  - **Johnnie Walker** net sales were up 6% with growth in all regions. Latin America and Caribbean and Europe were the largest contributors with 11% and 9% growth, respectively. North America was up 6%, accelerating growth in the second half. In Asia Pacific, net sales grew 1%, with growth driven by South East Asia, China and India partially offset by Travel Retail Asia and Middle East. Reserve variants grew 6% driven by Johnnie Walker Gold Label Reserve and Johnnie Walker Green Label.
  - **Smirnoff** net sales were down 1%. Declines in US Spirits, Europe and Latin America and Caribbean were partly offset by Asia Pacific up 1%, and Africa growth up 22% driven by the strong performance of Smirnoff 1818 in South Africa. The decline in Europe was driven by Great Britain, Benelux and France performance, partly offset by Iberia up 16% and Ireland up 9%.
  - **Baileys** net sales grew 5% across all regions driven by 6% growth in its biggest market, Europe, following an exceptional on-trade execution. Latin America and Caribbean contributed with double digit growth behind Mexico Mother´s Day shopper platform and North America contributed with brand innovations.
  - **Captain Morgan** net sales grew 6% across all regions, with a strong performance in Europe driven by Europe Partner Markets, France and Great Britain. In US Spirits net sales grew 4% and gained share, supported by innovation.
  - **Tanqueray** net sales grew 9% across all regions except for North America. Europe led the growth with strong double digit growth driven by Great Britain, Italy and Germany, Austria and Switzerland.
  - **Guinness** net sales were flat. Africa declined 5% largely driven by the shift to value beer in Kenya and Nigeria partially offset by growth in Europe and Africa Regional Markets. Guinness in Europe grew 2% driven by expansion of distribution in Europe Partner Markets supported by media investment and the success of Hop House 13 Lager in Great Britain and Ireland.
- **Local stars** represent 20% of net sales and grew 9%. This was driven by Crown Royal in North America growing 12%, Buchanan's up 16% and double digit growth in Chinese white spirits. Solid growth in Yenì Raki in Turkey and McDowell's more than offset the declines in Windsor in Korea. Black & White growth of 16% was driven by Latin America and Caribbean and Asia Pacific.
- **Reserve brands** represent 16% of net sales and grew 7%, across all regions. Chinese white spirits and strong performance in Don Julio growth in US Spirits and Mexico were partly offset by Cîroc and Ketel One vodka declines in US Spirits. Scotch reserve brands grew 4% with Johnnie Walker driving the growth. Bulleit continued its strong growth with net sales up 24%. Tanqueray No. TEN grew strong double digit, up 25%. Malts up 2%, was driven by Lagavulin in North America and The Singleton in Asia Pacific and North America.

Our role in society

Sustainability & Responsibility review

Our vision is to create a positive role for alcohol in society, and an inclusive business that can play its part in a low-carbon and water-resilient economy. Our 2020 sustainability and responsibility targets are designed to help us on that journey, by addressing the issues most material to our stakeholders, and to us as a business. They are core to our growth, now and in the future.

Our sustainability and responsibility strategy is designed to support Diageo's overall growth and performance. It aims to make a positive contribution to society while building our business by growing our brands' relationships with consumers, strengthening our supply chain, supporting our productivity, and mitigating risk.

Key to our strategy is our assessment of our most material issues – those which are important to our stakeholders, the environment, and the future success of our business. These are reflected in our risk register and our growth plans too. That means looking at what will matter to the world, and our business, in 2020, 2030, and even 2050. As a result, we prioritise addressing climate change, water, non-communicable diseases, and empowering women – issues central to the UN's Global Goals for Sustainable Development.

Our 2020 targets help drive this strategy, which is underpinned by a commitment to acting as a good corporate citizen, with exemplary governance and ethics, respect for human rights and a focus on creating shared value. We measure and drive our performance in three interdependent areas:

- **Creating a positive role for alcohol in society**
- **Building thriving communities**
- **Reducing our environmental impact**

Proud of our contribution

Our brands give enjoyment to millions of people, and we are proud of them – not just of their heritage, quality and craftsmanship, but of the value they create.

We directly employ 30,400 people, and in 2017, we paid over £7.4 billion in taxes and other duties to governments. Our brands can use their connection to people's lives to build positive social impacts such as challenging prejudice, inspiring personal progress, and fostering inclusivity. And our value chain as a whole is built on interdependent relationships, from the farmers who grow our ingredients, to our employees and contractors, to the retailers and premises who sell our products.

Maximising our contribution

Our 2020 targets each include metrics to evaluate the impacts of our work and help us coordinate our efforts. We aim to create value and contribute to the UN Global Goals at scale, bringing the maximum benefit for our stakeholders, and for us.

A key way we achieve greater impact and create value is to work with partners who bring expertise and scale to our programmes as discussed in this review.

Throughout our business, an important focus this year has been on delivering productivity and efficiency, maximising impact at reduced cost. We made structural changes that enabled our strategy to be better implemented in each market, strengthening synergies between our programmes. Our focus on improving our performance management systems is helping us drive performance in our programmes and increasing the value we create.

Reporting our contribution

In this review, we report at a high level against our 2020 targets. Please see our Sustainability & Responsibility Performance Addendum for disclosures against GRI and the UN Global Compact (UNGC).

Creating a positive role for alcohol in society

Ensuring that alcohol plays a positive role in society is at the heart of our licence to operate, and essential to our performance now and in the future. It is a material issue to everyone who works at Diageo as well as to our stakeholders more broadly: we're proud of what we do, and we maintain that pride by working to ensure that our business has a positive impact on the people around us.

Our contribution includes working to reduce harmful drinking, promoting rigorous company and industry standards for responsible marketing, and providing consumers with information to help them make responsible choices. We aim to make an impact at scale – whether through global partnerships, through industry collaboration, or by harnessing innovation and technology to reach and inform more people than ever before.

Reducing harmful drinking

We share the WHO goal of reducing harmful drinking by 10% across the world by 2025, and we work on a wide range of initiatives and programmes aimed at preventing drink driving, underage drinking and heavy episodic drinking among other issues.

We aim to achieve impact by raising awareness and shifting attitudes and behaviour to encourage informed choices around drinking – or not drinking – and we work with others to maximise the contribution we can make. Our partnerships with international organisations, governments, law enforcement agents, educators, parents and civil society allow us to gain important insights and to reach more people.

Increasingly, we are focusing our efforts on partnerships that can deliver measurable impact, at scale and where it is most needed. In 2016, for example, we began a two-year partnership with the UN Institute for Training and Research (UNITAR) aimed at reducing death and injuries from traffic accidents in more than 60 countries, with a focus on those with the highest road traffic death rates. In its first year, the partnership began advocacy and programme work in countries including Mexico, Nigeria, South Korea and South Africa, where national and local government officials, representatives from academia, the private sector and civil society gathered to build capacity and exchange best practices and approaches that improve road safety. We have also been working in India with government agencies, leading national news channel NDTV and a leading nationwide chain of petrol stations on a campaign to encourage responsible drinking and reduce drink driving particularly in young adults. Since the campaign began in 2013, we have reached 50 cities in 15 states, and gathered more than three million pledges never to drink and drive. As part of the programme, we have trained police officials to better enforce drink driving laws, and educated thousands of commercial and student drivers on the dangers of drinking and driving.

We have also significantly scaled up our partnerships to bring 'Smashed', a theatre-based education programme that aims to teach teenagers the dangers of underage drinking, to eight countries. Since it began 10 years ago, the programme has reached 1,400 schools and more than 300,000 young people. This year, as a result of expanding the programme, we reached 135,000. 'Smashed' is really helping to tackle perceptions of underage drinking, as seen by the change in awareness of those reached by the programme before and after they took part. There was a 30% increase in awareness of where to get help, a 19% increase in awareness of the influence of peer pressure on behaviour, and a 38% increase in awareness of alcohol misuse. And, 98% of teachers say they would welcome 'Smashed' back in the following school year. Overall in 2017, we supported 264 programmes to reduce harmful drinking in 57 countries.

Informing consumers

We want to provide our consumers with the information, tools and resources to make informed, personal choices. Harnessing innovation and technology to reach more people is an essential part of this.

In response to the growing demand for our DRINKiQ training on the effects of drinking, in 2016 we developed a new, mobile-friendly e-learning version of the training in order to reach more individuals and organisations. The new online tool uses interactive learning and tests to allow people to gain insights on how drinking affects the body, and gives them the tips they need to make the right choices. The e-learning was launched in March 2017 in the UK, US and Australia, with plans to launch in 20 more countries.

Our labels and packaging give us another key way to help consumers make smart choices about drinking, or choosing not to drink. Through our Diageo Consumer Information Standards, we deliver consistent, mandatory minimum standards for the information that must be included on labels and packaging on all our brands in all geographies (where legally permitted). Labels and packaging must include alcohol content and nutrition information per serve, alcohol content by volume (ABV), at least one and up to three responsible drinking symbols, a reference to DRINKiQ.com, a list of allergens, and recycling and sustainability symbols. Alcohol content and nutrition information about all of our brands is also available on DRINKiQ.com.

We have also taken an important step towards meeting consumers' increasing interest in the environmental footprint of their brands. This year we published illustrative environmental footprints for five of our global brands, drawing on a series of assessments to understand and estimate their greenhouse gas (carbon) and water impact across their life cycles. An approximation of these brands' carbon and water impact is available at www.diageo.com, alongside comparisons with a number of generic beverages and information on how we are working to address our impacts.

Responsible marketing

The Diageo Marketing Code and Digital Code are our mandatory minimum standards for responsible marketing and we review them every 12-18 months to ensure they represent best practice.

Five industry bodies publicly report breaches of their self-regulatory codes. This year, we were found in breach on one occasion: the ASA in the UK found that a TV advertisement for Captain Morgan was in breach of their code on the grounds that it implied drinking alcohol could contribute to an individual's popularity or confidence. While disagreeing with this judgement, Diageo withdrew the advert from all media channels immediately.

Advocating effective public policy

We comply with all laws and regulations, wherever we operate, as a minimum requirement – but we go beyond this to advocate for alcohol policies and regulations where they do not exist, such as mandating a minimum legal purchasing age of not less than 18; a maximum blood alcohol concentration (BAC) level for drivers of no more than 0.08mg; and lower BACs for novice and commercial drivers. For example, we worked with industry partners to encourage the passage of a new transportation law in the Dominican Republic, including a maximum blood alcohol content law for drivers for the first time.

Our 2020 target

Industry collaboration

To support greater impact, we work with our peers to implement the global Beer, Wine and Spirits Producers' Commitments to Reduce Harmful Drinking, including:

- Reducing underage drinking
- Strengthening and expanding marketing codes of practice
- Providing consumer information and responsible product innovation
- Reducing drink driving
- Enlisting the support of retailers to reduce harmful drinking.

KPI:

The Global Producers' Commitments are set to expire in December 2017 and we are pleased that, working together with our industry colleagues, we have continued to make good progress against all focus areas. For example, our collective efforts resulted in 236 education programmes operating in 73 countries and 10,744,296 underage individuals reached, up from 9,750,367 in 2015, a 10% increase. We also continued to work with retailers and others to ensure the legal purchase age laws in countries are enforced. For example, in Brazil, Diageo works in partnership with Walmart and small retailers to reinforce the law through age verification programmes. The 2016 (latest available) annual report on progress against these Commitments can be found at www.producerscommitments.org.

Complaints about advertising upheld by industry bodies that report publicly

Country	Body	Industry complaints upheld	Complaints upheld about Diageo brands
Australia	Alcohol Beverage Code	7	0
Ireland	Advertising Standards Authority for Ireland (ASAI)	3	0
United Kingdom	The Portman Group	1	0
	Advertising Standards Authority (ASA)	9	1
United States	Distilled Spirits Council of the United States (DISCUS)	2	0

Our 2020 target

Impactful programmes

- Going beyond industry commitments, we will work in partnership to support programmes to address harmful drinking in our top 19 countries. We will evaluate these initiatives for efficacy and impact and report on the results.

KPI:

Number of countries that evaluate responsible drinking programmes.

This year, 95% of our top 19 countries assessed the effectiveness of their programmes, measuring increases in awareness or shifts in attitudes or behaviour. For example, since 2012, Guinness Ghana has worked to reduce drink driving by commercial drivers through the Twa Kwano Mmom Don't Drink and Drive campaign. This year, working with the police force, we ran 17,600 random breathalyser tests at transport terminals and on roads. Since the start of the programme, we have conducted close to 76,000 breathalyser tests, and educated more than 7,000 drivers all over the country on road safety and the effects of alcohol.

This campaign, which is increasing in reach and impact year on year, has been endorsed by the Ministry of Health, Ministry of Transport, National Road Safety Commission and the Motor Traffic and Transport Department of the Ghana Police Service.

For more examples of our evaluation in action, please see the 'Our role in society' section of www.diageo.com.

Our 2020 target

Training

- Reach 1 million adults with training materials that will enable them to become responsible drinking (RD) ambassadors.

KPI:

Number of adults, above legal drinking age, who have completed interactive training (face-to-face or online) on responsible drinking, which can also include training on responsible serving, selling and marketing.

We are reaching more people than ever before, linking our programmes to increase our scale. Our new e-learning DRINKiQ tool, launched in March 2017, helped us surpass our 1 million target. We have reached and enabled more than 1,150,000 RD ambassadors since 2015. This year alone we reached 397,843 people through training programmes such as DRINKiQ, Learning for Life, Diageo Bar Academy, Plan W and others. These programmes reach a broad audience including consumers, retail and hospitality industry workers, police and government agency personnel, and members of the medical profession.

Building thriving communities

We want to strengthen the value we create by helping the communities we live and work in to thrive. That means making Diageo a great, safe, and diverse place to work; building sustainable and inclusive supply chains; and delivering programmes that empower communities and individuals and enable them to grow.

Human rights

Our business is built on long-term relationships based on trust and shared value, and respect for human rights is fundamental to who we are and how we do business.

We have a well-developed and embedded policy framework that addresses human rights, and details our commitment to acting ethically and with integrity in all our business dealings. We do not tolerate discrimination, harassment, bullying or abuse; we comply with wage and working time laws; we respect our employees' decisions to join or not join a trade union; and we do not tolerate forced or compulsory labour. In 2016 we published our Modern Slavery Statement, describing the activities we are undertaking to prevent slavery and human trafficking in our business operations and supply chain in line with the UK Modern Slavery Act 2015 and the California Transparency in Supply Chains Act 2010.

Our human rights commitments apply throughout our value chain: we will not work with anyone, including any supplier, who we discover does not adopt these values. Further details of our policies are available at www.diageo.com.

Our 2020 target

- Act in accordance with the UN Guiding Principles on Business and Human Rights.

KPI:
Number of markets in which we have carried out HRIAs

We have been signatories to the UN Guiding Principles on Business and Human Rights (UNGP) since 2014. This year, we continued to embed human rights throughout our value chain, using our robust and comprehensive Human Rights Impact Assessment (HRIA) in our markets, prioritised by risk and based on a global mapping process. The HRIA considers our entire value chain from sourcing to selling. It is based on international and local risk assessments, and leads to mitigation plans where we need to address specific human rights issues or strengthen our processes to prevent them arising. The HRIA was initially piloted in Kenya in 2015, and in 2017, we carried out HRIAs in Uganda, Mexico, Brazil, Turkey, Thailand and Ghana. We aim to conduct HRIAs in all markets by 2020.

In line with the UNGP, we have identified three issues as particularly salient to our business: labour rights, including the risk of child labour, especially in agricultural supply networks; treatment of contract workers; and sexual harassment in the hospitality sector in some countries.

These issues were identified as external risk factors in the places where we operate, rather than through reported incidents in our value chain. Nonetheless, we are focusing resources on awareness programmes around child protection, and measures to protect workers, including seasonal contract workers and sales teams working in bars. Because human rights issues such as these are often systemic, we will also work with others to address them at scale.

Empowering and enabling communities through our programmes

We are proud of our long record of direct investment in programmes that address the developmental challenges facing communities where we source, make and sell our products. Our programmes support the three main strands of our strategy, which align with a number of the UN Global Goals:

- Enabling entrepreneurship, employability and skills (Goal 4)
- Improving health and wellbeing (Goal 3), including through access to clean water, sanitation and hygiene (Goal 6)
- Helping to empower women (Goal 5).

Working in partnership to deliver holistic impact

This year, Diageo invested £9 million or 0.3% of operating profit (2016 – £14.3 million[i]) in projects that matter most to our stakeholders. Our Social Impact Framework (SIF) guides the implementation of programmes, using key performance indicators to quantify their impacts. This allows us to measure potential benefits and make a stronger case for investment.

Through our online global performance management system, developed this year, our SIF is also helping us better quantify the value of existing programmes. This work is in its early stages, and we are just beginning to see results for some of our programmes. For example, we have learnt that Learning for Life is leading to greater awareness of the benefits of more balanced consumption. Data from the tool is also indicating where we might have greater impact through partnerships: this year, we worked with the UNDP and the NGOs CARE and WaterAid, among others, to improve livelihoods in our value chain.

(i) Restated: 2016 investment was £14.3 million rather than the £16.3 million reported in 2016.

Our partnership work around our distillery and bottling plant in Alwar, Rajasthan, in India, is an example of how working with the community, government and an NGO has brought together WASH (water, sanitation and hygiene), water replenishment, and women's empowerment initiatives in a single, impactful programme.

Our 2020 target

- Our community programmes enable those who live and work in our communities, particularly women, to have the skills and resources to build a better future for themselves. We will evaluate and report on the tangible impacts of our programmes.

KPI:

Each programme has its own KPI.

- **Water of Life** has reached more than 10 million people in 21 countries in Africa since 2006, including 173,044 this year. It is focused on access to water, sanitation and hygiene in line with UN Global Goal 6. We are developing projects in rural areas that supply our raw materials, to ensure the programme is aligned with our business.
- **Plan W**, which contributes to UN Global Goal 5, aims to empower women in our business and wider value chain to play a greater role in the economy. Our programmes support women's economic empowerment by working closely with the hospitality sector, and by enabling women to build their own businesses. We also work with whole households, including men, to support broader women's empowerment. To date, Plan W has empowered more than 300,000 women and reached more than 1.7 million people.
- **Learning for Life** supports vocational and life-skills training, and strengthens our value chain through its emphasis on hospitality, retail, and entrepreneurship, while delivering long-term opportunities for the young people involved. More than 123,000 young people have taken part since we launched the programme in 2008, with more than 70% gaining permanent jobs.

Community investment by focus area

Community aspects of responsible drinking projects[i]	46%
Learning for Life	23%
Brand-led and local community spend[ii]	16%
Plan W	9%
Water of Life	6%

(i) This is a sub section of the total responsible drinking budget.
(ii) Category includes cause-related brand campaigns, local market giving and disaster relief.

Community investment by region

North America	33%
Europe and global functions	24%
Asia Pacific	20%
Latin America and Caribbean	15%
Africa	8%

Our people

We aim to create a diverse, inclusive and welcoming culture, where people are proud of their work, empowered to succeed, and know that their safety and other human rights are respected.

Health and safety

Our global Zero Harm programme is designed to ensure that all our people go home safe, every day. It has brought significant improvements in safety, with a 21% reduction in lost-time accidents (LTAs) this year compared with 2016, and an LTA rate of 1.14, approaching our 2020 target of less than one LTA per 1,000 employees and no fatalities. We are evolving our approach to focus on employee wellbeing as a key leading indicator of safety. Our new Health, Safety and Wellbeing Policy reflects this more integrated approach.

Our 2020 target

- Keep our people safe by achieving less than one lost-time accident (LTA) per 1,000 employees and no fatalities.

KPI:

Number of LTAs; number of fatalities.

We regret that our good progress in safety in many locations was overshadowed by the death of a contractor cleaner at our Rosa site in India, who fell from the packing hall roof. Our investigation showed that our protocols and procedures are the right ones, and we are working to ensure consistent compliance in all markets.

Turning to our LTAs, we saw a 21% improvement in both these and medical treatment cases across the business, and 16 of our 21 markets achieved or bettered our 2020 target of one LTA per 1,000 employees. We are pleased to have achieved this progress.

Further improvements in our USL business in India and continued excellence in high-performing sites, along with continued sustained performance in our more developed markets, underpin several years of progress.

Our overall aim remains zero accidents, and the health, safety and wellbeing of our employees remains top priority. We are renewing our focus on compliance to our primary standards, and are moving to enhance our ability to predict and prevent incidents through greater integration of wellbeing into our health and safety policy and programmes.

Diversity and inclusion

We strive to create an inclusive culture, from recruitment onwards, that gives everyone the freedom to succeed, irrespective of their gender, race, religion, disability, age or sexual orientation. Our training and education programme includes retraining, if needed, for people who have become disabled.

We are proud of the fact that 40% of our Executive and 40% of our Board are women, and more than 30% of leadership positions are now held by women. We are now focusing on delivering our target of 35% of leadership positions held by women by 2020.

Throughout the company, we set ambitious plans to achieve our gender diversity targets and each of our markets has a multi-year talent plan with stretching goals. We are also reviewing our policies to further support our diversity and inclusion agenda.

Our wider ambition is to ensure that our workforce reflects the consumer demographics of our markets, especially our three priority markets of India, UK and US.

Our 2020 target

- Build diversity, with 35% of leadership positions held by women and measures implemented to help female employees attain and develop in leadership roles.

KPI:

% of leadership positions held by women.

This year, 30% of leadership roles were held by women. At the most senior level, 40% of our Board members and 40% of our Executive Committee members are women.

Engaged and empowered employees

We want our people to be engaged – passionate about our strategy, connected to our values and purpose, and motivated to perform at their best as advocates of our brands. We measure employee engagement as one of our overarching KPIs, as set out on page 9, using our annual employee Values Survey. This year we simplified and improved our survey. While our engagement metrics are unchanged, we have changed the way we measure other aspects of performance (see footnote to KPI on page 46).

We support employees through clear policies, competitive reward programmes, coaching and development opportunities, alongside health and wellbeing initiatives. We aim to engage them through collaborative campaigns and to give them the freedom to succeed by fostering a culture of open communication. A two-way channel of communication between employees and leadership is particularly important, and our Chief Executive's weekly blog and regular global leadership broadcasts play a significant role.

Employees are inspired by local and brand community projects, and by business-wide initiatives such as International Women's Day and Learning for Life. Each March, our #proudofwhatwedo campaign invites employees to celebrate locally and share globally the achievements that make them proud, and this year, our Proud to Work for Diageo Values Survey metric increased to 89%. We also measured whether employees believe that Diageo makes the most of our people's diversity to improve business performance, with 72% responding favourably.

Lost-time accident frequency rate per 1,000 full-time employees(i)	2013	2014	2015	2016	2017
North America	1.64	0.84	1.83	0.37	**0.70**
Europe, Russia and Turkey	2.12	2.08	2.51	1.28	**1.46**
Africa	2.55	0.56	1.20	0.77	**1.26**
Latin America and Caribbean	10.88	4.7	0.66	2.27	**1.79**
Asia Pacific	1.26	1.62	1.21	2.01	**0.81**
Diageo (total)	2.97	1.66	1.66	1.44	**1.14**Δ

(i) Number of accidents per 1,000 employees and directly supervised contractors resulting in time lost from work of one calendar day or more.
Δ Within PwC's independent limited assurance scope. Please see page 158 for further details.

Number of days lost to accidents per 1,000 full-time employees	2013	2014	2015	2016	2017
Diageo (total)	66.0	49.7	89.4	57	**36**

Fatalities	2013	2014	2015	2016	2017
Diageo (total)	4	1	1	1	**1**

Average number of employees by region by gender(i)	Men	%	Women	%	Total
North America	1,661	60	1,124	40	2,785
Europe, Russia and Turkey	6,758	61	4,364	39	11,122
Africa	3,769	76	1,196	24	4,965
Latin America and Caribbean	1,758	63	1,023	37	2,781
Asia Pacific	6,920	79	1,860	21	8,780
Diageo (total)	20,866	69	9,567	31	30,433

Average number of employees by role by gender	Men	%	Women	%	Total
Senior manager(ii)	449	70	192	30	641
Line manager(iii)	3,560	68	1,656	32	5,216
Supervised employee(iv)	16,857	69	7,719	31	24,576
Diageo (total)	20,866	69	9,567	31	30,433

New hires by region by gender(i)	Men	Women	Total	% of regional headcount
North America	267	169	436	15.7
Europe, Russia and Turkey	866	686	1,552	14.0
Africa	383	177	560	11.3
Latin America and Caribbean	307	175	482	17.3
Asia Pacific	882	545	1,427	16.3
Diageo (total)	2,705	1,752	4,457	14.6
Percentage of total new hires	60.7	39.3		

Leavers by region by gender(i)	Men	Women	Total	% of regional headcount
North America	206	177	383	13.8
Europe, Russia and Turkey	877	826	1,703	15.3
Africa	797	255	1,052	21.2
Latin America and Caribbean	509	290	799	28.7
Asia Pacific	874	398	1,272	14.5
Diageo (total)	3,263	1,946	5,209	17.1
Percentage of total leavers	62.6	37.4		

(i) Employees have been allocated to the region in which they reside.
(ii) Top leadership positions in Diageo, excluding Executive Committee.
(iii) All Diageo employees (non-senior managers), with one or more direct reports.
(iv) All Diageo employees (non-senior managers), who have no direct reports.

Our 2020 target(i)

- Increase employee engagement to 80%, becoming a top quartile performer on measures such as employee satisfaction, pride and loyalty.

KPI:

Employee satisfaction, loyalty, advocacy and pride, measured through our Values Survey.

93% of our people participated in the annual Values Survey (23,043 of the 24,733 invited), a best-in-class response rate. 75% identified themselves as being engaged, down from 77% in 2016. This small shift, in a year of significant organisational change, shows that, overall, we have continued to bring our people with us as we focus on productivity improvements to enable investment in growth.

(i) In 2017, we improved our annual Values Survey to simplify the process and ensure the results were relevant to the business, reducing the survey from 40 questions to 15. As a result, we no longer measure our previous performance enablement metric and we have ceased reporting on what was formerly the second 2020 target in this area, 'Raise our performance enablement score, which measures a link between engagement and performance commitment, to 83%.'

Sustainable supply chains

Our business has always depended on, and created value for, the communities from whom we buy our raw materials. In recent years we have deepened this essential relationship, focusing on building capability among our supplier communities and strengthening environmental practices in our supply chain.

As a responsible business, we comply with legal and regulatory requirements, including those related to human rights and working conditions – but we aim to go further. We want our supply chain to be a resilient foundation for our business success, while enabling us to contribute to reducing poverty and inequality, addressing environmental challenges, increasing wellbeing, and improving livelihoods in line with the UN Global Goals.

Sustainable agriculture strategy

In July 2016 we launched 'Building Sustainable Supply Chains', our strategy for sustainable agriculture. It sets out our aims for making our agricultural supply chains environmentally, socially and economically sustainable. While we will tailor our approach for different raw materials and markets, the strategy is built on three core principles:

- Securing a supply for our business, while contributing to economic and wider growth
- Respecting human rights, building capacity and creating shared value with farming communities
- Using resources efficiently, minimising environmental impact, and safeguarding future crops and ecosystems.

We aim to expand our strategy for sustainable agriculture to cover all raw materials used in our products, but we are initially focusing on six priority raw materials – barley, maize, sugar, sorghum, agave and aniseed.

Identifying risks and opportunities

We have been working to understand the risks and opportunities in our supply chain, and this year we completed our work to map our agricultural supply chain to tier 1, which includes around 200 suppliers. This analysis also supports our work on human rights (see page 43, and our Modern Slavery Statement, published on our website).

Our 2020 targets

- Establish partnerships with farmers to develop sustainable agricultural supplies of key raw materials.

KPI:

Number of smallholders in our farming development programmes.

We support more than 45,000 farmers in Africa, creating resilient and viable farms through a variety of programmes, including: training; better access to seeds and fertilisers to improve yields; providing access to capital through micro-loans; supporting farmers' groups; and encouraging sustainable practices that protect natural resources.

We are aligned to industry standards through the Farm Sustainability Assessment (FSA) developed by the Sustainable Agriculture Initiative (SAI) Platform, and other standards where appropriate, working with large-scale farmers. We have begun to measure sustainability practices in our supply chains through a system of benchmarking while avoiding duplication or increasing burdens on farmers. For small-scale farmers, we have tested a smallholder FSA in Tanzania and will continue to work with the SAI and others on the development of this tool.

- Source 80% of our agricultural raw materials locally in Africa by 2020.

KPI:

% of agricultural raw materials sourced locally in Africa.

We sourced 76% this year compared to 73% last year. Our continuing progress is closely related to our capacity-building among farmers. Our research demonstrates the positive impact this has on farmers and their families but we need to continue to build their resilience. Our Sourcing for Growth report on Ethiopian barley farming, available on www.diageo.com, examines this in more detail.

- Deliver our responsible sourcing commitments with suppliers to improve labour standards and human rights in our supply chains.

KPI:

% of potential high-risk supplier sites audited.

We continued to work through SEDEX, a not-for-profit organisation enabling suppliers to share assessments and audits of ethical and responsible practices with customers, and AIM-PROGRESS, a forum of consumer goods companies which promotes responsible sourcing practices. We also have a Know Your Business Partner (KYBP) programme to assess suppliers against the risk of bribery and corruption, as well as money laundering.

To date, 1,224 of Diageo's supplier sites assessed as a potential risk have completed a SEDEX self-assessment. Of these, 424 were assessed as a potential high risk, with 65% independently audited over the past three years. Of these audits, we commissioned 157 and 117 came through SEDEX or AIM-PROGRESS. 147 were conducted in the past year. Our audit programme helps embed human rights further across our business, as described on page 43.

Global raw materials[i] by volume
(Total – 1.5 million tonnes)

Barley[ii]	37%	Sugar	6%
Maize	12%	Agave	4%
Wheat	12%	Rice	4%
Molasses	9%	Dairy	1%
Grapes	7%	Raisins	1%
Sorghum	6%	Other (including rye, cassava, hops, and aniseed)	1%

(i) Figures represent raw materials we buy directly, and excludes raw materials used to make the neutral spirit we purchase.
(ii) Includes malted barley.

Global packaging materials[i] by volume
(Total – 1.4 million tonnes)

Glass	83%	Closures and crowns	2%
Corrugate	7%	Cans	1%
Cartons	3%	Labels and sleeves	1%
PET	2%	Beverage cartons	1%

(i) Excludes promotional materials.

Reducing our environmental impact

Our business success is inextricably linked with the natural environment. Not only do we rely on a supply of high-quality raw materials and water to make our brands, but our business shares with others the social and financial risks associated with climate change, water scarcity, soil degradation or the loss of biodiversity. We therefore aim to be a business which uses natural resources efficiently across the whole value chain, and where possible, improves the environment we operate in. Our strategy aligns with and supports the UN Global Goals, particularly on water and climate change.

We are absolutely committed to minimising our environmental impact, in particular reducing carbon emissions to address climate change. We aim to reduce harm to habitats or biodiversity, making improvements where we can, and to be a responsible steward of water. While we have most control over our own operations, where we have achieved the fastest results, we are also working to reduce our impacts throughout our value chain.

Continuing to improve our environmental performance is the right thing to do, both in itself and because of the interdependency between the environment and the communities around us. It also makes business sense. We welcome recent trends in the disclosure of climate change risk and the work in the UK of the Financial Stability Board's Task Force on Climate-related Financial Disclosure (TCFD), which aims to improve how companies report on climate change risk. Mitigating climate change through appropriate water stewardship is particularly critical for our business, and is an important element in our Water Blueprint, described below. Leadership in these issues will strengthen our business, reduce costs and mitigate risks. The measures we take will improve our efficiency and make our operations and supply chains more robust.

Climate change action
As members of the We Mean Business Coalition, we are committed to carbon emissions reduction targets, eliminating commodity-driven deforestation, and providing climate change information in corporate filings. We are also committed to procuring 100% of our electricity from renewable sources by 2030, and reducing emissions from short-lived climate pollutants.

This year, alongside improvements in greenhouse gas performance in our own operations, we continued our work on assessing, quantifying and identifying opportunity areas in our upstream and downstream supply chain emissions. Increasing our understanding of our indirect (Scope 3) emissions is an important step towards our target to reducing total supply chain emissions by 30%. We have also increased our understanding of the environmental footprint of our brands: this year, we published indicative carbon and water footprints of five global brands, which included comparisons with other beverages to contextualise our impact for consumers and other stakeholders.

Performance against key 2020 targets

2020 target	KPI	2017 performance	Cumulative performance vs baseline[(i)]
Reduce water use through a 50% improvement in water use efficiency	% improvement in litres of water used per litre of packaged product	3.3%	40.0%
Return 100% of wastewater from our operations to the environment safely	% reduction in wastewater polluting power, measured in BOD ('000 tonnes)	10.6%	44.5%
Replenish the amount of water used in our final product in water-stressed areas	% of water replenished in water-stressed areas (m^3)	24.8%	45.5%
Reduce absolute greenhouse gas (GHG) emissions from direct operations by 50%	% reduction in absolute GHG (kt CO_2e)	5.6%	40.5%
Achieve a 30% reduction in absolute greenhouse gas emissions along the total supply chain	% reduction in absolute GHG (kt CO_2e)	7.7%	22.1%
Reduce total packaging by 15%, while increasing recycled content to 45% and making 100% of packaging recyclable	% of total packaging by weight	0.8%	8.8%
	% of recycled content by weight	1.0%	41.0%
	% of recyclable packaging by weight	0.0%	98.7%
Achieve zero waste to landfill	% reduction in total waste to landfill (tonnes)	37.9%	93.8%

(i) Baseline year is 2007, except for packaging which is 2009 and water replenishment which is 2015.

Water: our continuing strategic focus
Water is an essential resource to our business, and its careful management is a commercial priority as well as a responsibility to the communities and habitats with which we share it. Good water stewardship is a vital part of our strategy for mitigating and adapting to climate change, since climate change and water scarcity are inextricably linked.

Our strategic aim is to reduce our overall impact, especially in water-stressed regions in Africa, India and Brazil, which requires a deep commitment to collaboration with multiple stakeholders. The map on page 15 shows where our sites are located in water-stressed areas: these sites account for approximately a third of our total production by volume.

We continue to deliver our Water Blueprint, launched in 2015, which outlines our strategic approach to protecting and managing our water resources globally, particularly in relation to markets where there is significant water stress. It includes our approach to reducing water use in our own operations and agricultural supply chains; replenishing water in water-stressed areas; and supporting community water programmes which combined create greater collaboration and impact in water management. This strategy incorporates our global supply chain, so that we can better understand and manage our total impact on water, and also includes a commitment to global water advocacy, working in partnership with key NGOs such as WaterAid.

Our 2020 targets

Water stewardship
- Reduce water use through a 50% improvement in water use efficiency.

KPI:
% improvement in litres of water used per litre of packaged product.

This year our water efficiency improved by 3.3% compared to 2016 and 40% against our 2007 baseline. The steady improvement reflects the continuous application of efficiency measures across our operations, with particular gains coming from our distilleries and packaging plants in India, where water efficiency improved by 17%. 539,933 cubic metres of water were used for agricultural purposes on land under Diageo's operational control. This is reported separately from water used in our direct operations.

- Return 100% of wastewater from our operations to the environment safely.

KPI:
% reduction in wastewater polluting power, measured in BOD ('000 tonnes).

Wastewater polluting power has improved by 10.6% versus prior year. This is mainly attributable to improvements in the treatment of wastewater across sites in India, Africa and progress in commissioning the bioenergy facility at Cameronbridge Distillery in Scotland. When fully operational, the bioenergy plant and auxiliary wastewater treatment plant at Cameronbridge will reduce BOD significantly, converting the organic materials to biogas for subsequent use as energy, and displacing fossil fuels.

- Replenish the amount of water used in our final product in water-stressed areas.

KPI:

% of water replenished in water-stressed areas (m^3).

Cumulatively 45.5% of total water used in final product in water-stressed areas was replenished. Of this, 53.6% has been replenished in India, where we run holistic programmes that bring together WASH, community empowerment and water replenishment initiatives. In Kenya, Ghana, Uganda and Tanzania, there was an increased emphasis on water replenishment during this reporting year through our continued investment in WASH programmes in the communities where we source raw materials. We ensure that we replenish in catchments impacted by our sites and their supply chain that are water-stressed.

In addition, the volume of water recycled or reused in our own production was 1,169,696m^3, representing 5.6% of total water withdrawals.

- Equip our suppliers with tools to protect water resources in our most water-stressed locations.

KPI:

% of key suppliers engaged in water management practices.

We engage suppliers through CDP's Supply Chain Water Programme, which we joined in 2015. This year, we engaged 107 of our largest suppliers to disclose their water management practices through this programme, with a 77% response rate. Of these suppliers, 54% reported having water reduction targets in place. Our next step is to complete water risk mapping of the sites of all our key suppliers, building on our risk assessment of our third-party operations in India. This will help us better understand the water impact of our supply chain and then directly support suppliers with a comprehensive water stewardship guide.

Water efficiency by region, by year (l/l)[(i), (ii)]

	2007	2015	2016	2017
North America	6.67	5.35	5.20	**5.72**
Europe, Russia and Turkey	7.89	6.73	5.79	**5.76**
Africa	8.48	5.14	4.55	**4.32**
Latin America and Caribbean	34.66	6.26	4.58	**3.84**
Asia Pacific	7.02	5.68	5.00	**4.25**
Diageo (total)	8.21	5.84	5.13	**4.96**Δ

Wastewater polluting power by region, by year (BOD/t)[(i)]

	2007	2015	2016	2017
North America	242	13	101	**276**
Europe, Russia and Turkey	22,927	31,543	19,494	**17,613**
Africa	9,970	670	436	**181**
Latin America and Caribbean	11	50	48	**38**
Asia Pacific	95	489	299	**64**
Corporate	–	–	–	**–**
Diageo (total)	33,245	32,765	20,378	**18,172**
Total under direct control	32,415	32,535	20,999	**17,969**Δ

(i) 2007 baseline data and data for each of the intervening years in the period ended 30 June 2016 have been restated in accordance with Diageo's environmental reporting methodologies.
(ii) In accordance with Diageo's environmental reporting methodologies, total water used excludes irrigation water for agricultural purposes on land under the operational control of the company.
Δ Within PwC's independent limited assurance scope. Please see page 158 for further details.

Carbon

- Reduce absolute greenhouse gas emissions from direct operations by 50%.

KPI:

% reduction in absolute GHG (kt CO_2e).

We use the World Resources Institute/ World Business Council for Sustainable Development Greenhouse Gas Protocol as a basis for reporting our emissions, and we include all facilities over which we have operational control for the full year. We reduced greenhouse gas emissions in our direct operations this year by 5.6% through a range of measures and initiatives, including further reduction in coal use in India.

Diageo's total direct and indirect carbon emissions (location/gross) this year were 809,077 tonnes, comprising direct emissions (Scope 1) of 618,104 tonnes and indirect (Scope 2) emissions of 190,973 tonnes. In 2016, total direct and indirect carbon emissions, (location basis/gross), were 841,866 tonnes; (direct emissions 656,524 and indirect emissions 185,342 tonnes). The intensity ratio for this year was 191Δ grams per litre packaged, compared to 202 grams per litre in 2016.

This year, 53.6% of electricity at our production sites came from low-carbon sources such as wind, hydro and nuclear, compared to 52.7% in 2016, and 23.2% of our electricity was from renewable sources only. In the United Kingdom, 100% of our electricity came from low-carbon sources.

- Achieve a 30% reduction in absolute greenhouse gas emissions along the total supply chain.

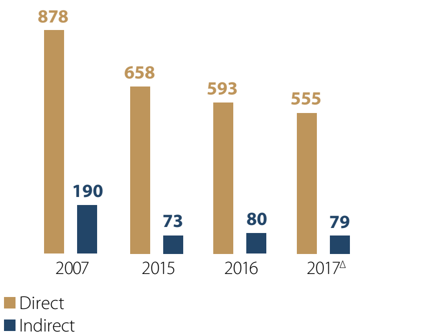
KPI:

% reduction in absolute GHG (kt CO_2e).

In 2017, our total supply chain carbon footprint was 3.2 million tonnes, a reduction of 22.1% versus the baseline and 7.7% versus 2016, driven predominantly by emissions reductions in distribution and logistics and direct operations. We will continue to improve the methodology to aggregate total supply chain carbon and are partnering with our suppliers and customers to reduce our footprint.

We achieved an excellent response rate, 93%, from the 155 key suppliers we engaged on measuring and managing their carbon emissions through the CDP. Of these suppliers, 48% reported having an emissions reduction target in place. At the same time, we have introduced a new performance review system for suppliers, alongside our own background data assurance method, which enables us to analyse and assess the Scope 3 emissions our suppliers report to CDP, and drive further reductions.

Direct and indirect carbon emissions by weight (1,000 tonnes CO_2e)(i),(ii) (market-/net-based)



(i) CO_2e figures are calculated using the WRI/WBCSD GHG Protocol guidance available at the beginning of our financial year, the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation, or the International Energy Agency, as applicable.
(ii) 2007 baseline data, and data for each of the intervening years in the period ended 30 June 2016, have been restated in accordance with the WRI/WBCSD GHG Protocol and Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 158 for further details.

Carbon emissions by weight by region (1,000 tonnes CO_2e)(i), (ii)

	2007	2015	2016	2017
North America	213	53	45	**49**
Europe, Russia and Turkey	405	330	283	**264**
Africa	271	243	244	**235**
Latin America and Caribbean	8	15	15	**16**
Asia Pacific	151	80	72	**59**
Corporate	20	10	10	**11**
Diageo (total)	1,068	731	672	**634**Δ

(i) CO_2e figures (market/net) are calculated using the WRI/WBCSD GHG Protocol guidance available at the beginning of our financial year, the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation, or the International Energy Agency, as applicable.
(ii) 2007 baseline data, and data for each of the intervening years in the period ended 30 June 2016, have been restated in accordance with the WRI/WBCSD GHG Protocol and Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 158 for further details.

Total waste to landfill by region (tonnes)(i)

	2007	2015	2016	2017
North America	40,142	123	148	**146**
Europe, Russia and Turkey	22,442	7,208	2,974	**1,241**
Africa	37,062	7,507	6,081	**3,937**
Latin America and Caribbean	246	218	155	**390**
Asia Pacific	8,583	2,984	922	**346**
Corporate	604	690	648	**718**
Diageo (total)	109,079	18,730	10,928	**6,778**Δ

(i) 2007 baseline data and data for each of the intervening years in the period ended 30 June 2016 have been restated in accordance with Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 158 for further details.

- Ensure all our new refrigeration equipment in trade is HFC-free, with a reduction in associated greenhouse gas emissions from 2015.

KPI:
% of new equipment sourced HFC-free from 1 July 2015.

Eliminating HFCs plays a role in reducing our overall carbon footprint. 100% of the 25,000 new fridges we purchased since July 2015 were HFC-free. In 2016 we reported that 99% of new fridges purchased were HFC-free; we have replaced the 200 units purchased in error that were not HFC-free, to bring our total back to 100% this year.

Packaging

- Reduce total packaging by 15%, while increasing recycled content to 45% and making 100% of packaging recyclable.

KPI:
% of total packaging by weight.
KPI:
% of recycled content by weight.
KPI:
% of recyclable packaging by weight.

We achieved a 0.8% reduction in packaging weight versus 2016 (8.8% versus our 2009 baseline); and a 1.0% increase in recycled content versus 2016. The overall recycled content in our packaging now stands at 41%, and packaging recyclability remains at 98.7%.

Glass makes up a significant proportion of our packaging weight, and we work with our suppliers and other partners to improve recycled content. Partnership work with a number of suppliers has increased the proportion of recycled content in glass in, for example, flint glass for Smirnoff and Johnnie Walker. Our Sustainable Packaging Commitments, refreshed in 2016, are used by brands and technical teams as well as suppliers and support our ongoing programme to produce packaging with lower environmental impact. This year we published a supplementary guideline on plastics to support our sustainable packaging strategy and in recognition of the increasing concern about the impact of plastics on the environment.

- Sustainably source all of our paper and board packaging to ensure zero net deforestation.

KPI:
% sustainably sourced paper and board packaging.

We define sustainably sourced as Forest Stewardship Council (FSC) or Programme for the Endorsement of Forest Certification (PEFC) certified, or recycled fibre. This year we continued embedding our sustainable sourcing requirements with our suppliers. To date we have engaged over 250 suppliers with 70% responding. Collectively these suppliers have self-reported that 78% of the paper and board packaging they supply meets our sustainable sourcing criteria. Over the next year we will continue our programme of engagement with suppliers to increase this percentage and drive improvements.

Waste

- Achieve zero waste to landfill.

KPI:
% reduction in total waste to landfill (tonnes).

We achieved a 37.9% reduction in waste to landfill compared to last year. This performance was driven by a new initiative to recover and reuse carton materials in South Africa. Meanwhile, in Turkey, the re-use of by-products from wastewater treatment facilities in a number of applications was used as a source of energy in brick manufacture and in land application as fertiliser.

Governance and ethics

Trust in business has never been more important, and we know that doing business with integrity is key to our performance ambition. Our global risk and compliance framework is designed to support our business through focus on the right behaviours and to provide rigorous oversight of our risk management, controls and compliance environment. We expect good governance and ethics to contribute to our performance and safeguard our reputation, and we continue to invest to make our programme more engaging and efficient.

Leadership and ethical business

There is no room for complacency when it comes to doing business with integrity, and the importance of ethical business conduct has been repeatedly emphasised by our senior leadership to all employees this year: each one of us holds the hard-earned reputation of Diageo and our brands in our hands. While our employees have received renewed compliance training this year, described below, we believe that our culture must encourage levels of integrity that are beyond compliance, and this is encouraged through a range of creative engagement activities.

Communications and compliance training

In July 2016 we retrained all our people on our refreshed Code of Business Conduct (our Code) through eLearning, which for the first time integrated our Annual Certification of Compliance (ACC). All employees at manager level and above certified that they fully understood what was expected of them. In July 2016, the ACC was completed by all eligible employees, a total of 9,403 people. In USL, which runs its own ACC training, 2,176 (100%) of eligible employees completed the ACC. Next year, USL will be integrated into Diageo's global eLearning programme.

The Code eLearning training was delivered within a year of the launch of our refreshed Code to every employee in every market. It covered all areas of our Code, with specific emphasis on key topics reinforced by scenario-based animated films. Employees were able to complete it in one of 19 languages on their desktop, laptop, tablet or smartphone, with a face-to-face classroom training option delivered at sites where employees do not use computers. All new joiners are required to complete the training within 30 days.

KPI:

Number of eligible employees completing the Annual Certification of Compliance (ACC).

100% of manager level and above employees completed the ACC as part of our combined Master the Code eLearning and ACC.

Managing third parties

We continue to improve our third-party due diligence programme. As part of this we have implemented a global tool which supports a more streamlined and automated way to assess third parties against the risk of bribery, corruption and money laundering, and to mitigate those risks across the business.

Monitoring and auditing

This year we further rationalised and simplified both our assurance delivery methodology and our controls assurance framework to focus on key risk areas. Deep dives into key operating areas, and expansion of our continuous monitoring tool, created opportunities to leverage our shared service centres, allowing us to deliver assurance in a more efficient and effective way.

Reporting and investigation

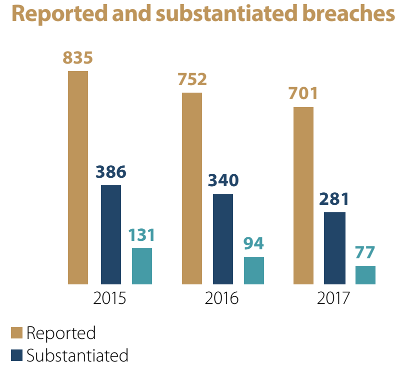
We want employees to feel comfortable raising concerns about potential breaches of our Code or policies. We expect anyone who comes across a breach to report it immediately, either through our confidential whistleblowing helpline SpeakUp, to their manager, or to a member of the global risk and compliance, human resources or legal teams. Alongside the independent phone lines, our www.diageospeakup.com website was refreshed in 2017 to make it simpler to report. It is now available in all our Code languages, and is also available to our business partners.

There were 701 suspected breaches reported this year, of which 281 (40%) were subsequently substantiated. Of the suspected breaches, 282 were reported through SpeakUp, compared with 311 in 2016. Of the total number reported, seven related to human rights issues. All human rights issues identified through this process feed into our wider human rights programme and inform our work in this area. Each issue is investigated with appropriate actions put in place.

All reports are taken seriously, and we follow up and investigate those that require action. We monitor breaches to identify trends or common areas and use any findings to inform the development of our compliance and ethics programme. This year, 77 people exited the business as a result of breaches of our Code or policies.

Overall case volumes fell by 7% with the number of employees exiting the business as a result of breaches falling by 18%. We believe this continues to be a positive indication of the maturity of our compliance programme and the impact of our training and communication with employees and third parties.

Reported and substantiated breaches



Definitions and reconciliations of non-GAAP measures to GAAP measures

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

Volume

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

Organic movements

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

Calculation of organic movements

The organic movement percentage is the amount in the row titled 'Organic movement' in the tables below, expressed as a percentage of the amount in the row titled '2016 adjusted'. Organic operating margin is calculated by dividing operating profit before exceptional items by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.

(a) Exchange rates

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

Exchange impacts in respect of the external hedging of intergroup sales of products and the intergroup recharging of third party services are allocated to the geographical segment to which they relate. Residual exchange impacts are reported in Corporate.

(b) Acquisitions and disposals

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

Where a business, brand, brand distribution right or agency agreement was disposed of, or terminated, in the period up to the date of the external results announcement, the group, in the organic movement calculations, excludes the results for that business from the current and prior year. In the calculation of operating profit, the overheads included in disposals are only those directly attributable to the businesses disposed of, and do not result from subjective judgements of management. In addition, disposals include the elimination of the results (for volume, sales and net sales only) of operations in India where United Spirits Limited (USL) previously fully consolidated the results but which are now operated on a royalty or franchise model where USL now only receives royalties for sales made by that operation.

(c) Exceptional items

Exceptional items are those which, in management's judgement, need to be disclosed by virtue of their size or nature. Such items are included within the income statement caption to which they relate, and are separately disclosed in the notes to the consolidated financial statements, and are excluded from the organic movement calculations.

Exceptional operating items are those that are considered to be material and are part of the operating activities of the group such as impairments of fixed assets, duty settlements, property disposals and changes in post employment plans. Charges in respect of material global restructuring programs were disclosed as exceptional operating items until and including the year ended 30 June 2015.

Gains and losses on the sale of businesses, brands or distribution rights, step up gains and losses that arise when an investment becomes an associate or an associate becomes a subsidiary and other material, unusual non-recurring items, that are not in respect of the production, marketing and distribution of premium drinks, are disclosed as non-operating exceptional items below operating profit in the consolidated income statement.

It is believed that separate disclosure of exceptional items and the classification between operating and non-operating further helps investors to understand the performance of the group.

Organic movement calculations for the year ended 30 June 2017 were as follows:

	North America million	Europe, Russia and Turkey million	Africa million	Latin America and Caribbean million	Asia Pacific million	Corporate million	Total million
Volume (equivalent units)							
2016 reported	47.0	43.9	31.3	20.6	103.6	–	246.4
Reclassification(ii)	0.1	0.5	(0.2)	–	–	–	0.4
Disposals(iii)	(0.5)	(1.2)	(0.1)	(0.4)	(13.3)	–	(15.5)
2016 adjusted	46.6	43.2	31.0	20.2	90.3	–	231.3
Acquisitions and disposals(iii)	**–**	**–**	**0.3**	**0.5**	**7.6**	**–**	**8.4**
Organic movement	**0.8**	**1.2**	**0.9**	**0.4**	**(0.8)**	**–**	**2.5**
2017 reported	**47.4**	**44.4**	**32.2**	**21.1**	**97.1**	**–**	**242.2**
Organic movement %	**2**	**3**	**3**	**2**	**(1)**	**n/a**	**1**
Sales							
2016 reported	4,037	4,593	1,875	1,078	4,022	36	15,641
Exchange(i)	667	312	153	158	683	5	1,978
Reclassification(ii)	19	37	(12)	(13)	(31)	–	–
Disposals(iii)	(137)	(128)	(9)	(41)	(255)	–	(570)
2016 adjusted	4,586	4,814	2,007	1,182	4,419	41	17,049
Acquisitions and disposals(iii)	**–**	**3**	**32**	**7**	**196**	**–**	**238**
Organic movement	**139**	**168**	**93**	**114**	**308**	**5**	**827**
2017 reported	**4,725**	**4,985**	**2,132**	**1,303**	**4,923**	**46**	**18,114**
Organic movement %	**3**	**3**	**5**	**10**	**7**	**12**	**5**
Net sales							
2016 reported	3,565	2,544	1,401	863	2,076	36	10,485
Exchange(i)	588	211	78	131	346	5	1,359
Reclassification(ii)	19	37	(13)	(13)	(30)	–	–
Disposals(iii)	(132)	(99)	(6)	(34)	(91)	–	(362)
2016 adjusted	4,040	2,693	1,460	947	2,301	41	11,482
Acquisitions and disposals(iii)	**–**	**3**	**21**	**8**	**48**	**–**	**80**
Organic movement	**121**	**128**	**75**	**89**	**70**	**5**	**488**
2017 reported	**4,161**	**2,824**	**1,556**	**1,044**	**2,419**	**46**	**12,050**
Organic movement %	**3**	**5**	**5**	**9**	**3**	**12**	**4**
Marketing							
2016 reported	541	404	143	167	301	6	1,562
Exchange(i)	86	22	13	22	47	3	193
Reclassification(ii)	–	5	(2)	1	(4)	–	–
Disposals(iii)	(9)	(2)	–	(4)	–	–	(15)
2016 adjusted	618	429	154	186	344	9	1,740
Acquisitions and disposals(iii)	**–**	**–**	**5**	**2**	**–**	**–**	**7**
Organic movement	**24**	**14**	**7**	**7**	**(1)**	**–**	**51**
2017 reported	**642**	**443**	**166**	**195**	**343**	**9**	**1,798**
Organic movement %	**4**	**3**	**5**	**4**	**–**	**–**	**3**
Operating profit before exceptional items							
2016 reported	1,551	801	212	199	395	(150)	3,008
Exchange(i)	270	64	7	35	85	(15)	446
Reclassification(ii)	15	14	(7)	(11)	(11)	–	–
Acquisitions and disposals(iii)	(13)	(10)	(3)	(5)	(1)	1	(31)
2016 adjusted	1,823	869	209	218	468	(164)	3,423
Acquisitions and disposals(iii)	**–**	**–**	**(11)**	**–**	**–**	**(1)**	**(12)**
Organic movement	**76**	**67**	**20**	**32**	**19**	**(24)**	**190**
2017 reported	**1,899**	**936**	**218**	**250**	**487**	**(189)**	**3,601**
Organic movement %	**4**	**8**	**10**	**15**	**4**	**(15)**	**6**
Organic operating margin %							
2017	**45.6%**	**33.2%**	**14.9%**	**24.1%**	**20.5%**	**n/a**	**30.2%**
2016	45.1%	32.3%	14.3%	23.0%	20.3%	n/a	29.8%
Margin improvement (bps)	**51**	**91**	**60**	**111**	**20**	**n/a**	**37**

(1) For the reconciliation of sales to net sales and operating profit before exceptional items to operating profit see page 25 and page 106.
(2) Percentages and margin improvement are calculated on rounded figures.

Notes: Information in respect of the organic movement calculations

(i) The exchange adjustments for sales, net sales, marketing and operating profit are principally in respect of the US dollar, the euro, the Kenyan schilling and the Indian rupee, partially offset by the Nigerian naira.

(ii) Reclassification comprises (a) the results of Lebanon, other Middle Eastern and North African countries which were formerly reported in Asia Pacific and Africa geographical regions now being included in Europe, Russia and Turkey and (b) the results of the Travel Retail operations have been reallocated to the geographical regions to better reflect the region in which the sale to the customer is made. In addition following a review of the group's reporting of volume an adjustment was made to include Malaysia and Singapore contract brew volume in the reported beer figures which increased volume in Asia Pacific by 0.3 million equivalent cases (2016 – 0.4 million equivalent cases).

(iii) In the year ended 30 June 2017 the acquisitions and disposals that affected volume, sales, net sales, marketing and operating profit were as follows:

	Volume equ. units million	Sales £ million	Net sales £ million	Marketing £ million	Operating profit £ million
Year ended 30 June 2016					
Acquisitions					
Integration costs	–	–	–	–	1
	–	–	–	–	1
Disposals					
North America Wines	(0.3)	(112)	(110)	(8)	(8)
Percy Fox	(0.8)	(84)	(67)	(1)	(5)
Grand Marnier	(0.2)	(31)	(24)	–	(4)
Bouvet	–	(8)	(8)	–	(1)
Argentina	(0.3)	(18)	(15)	(2)	(2)
South Africa – ready to drink and beer	(0.1)	(7)	(5)	–	(2)
Jamaica and Red Stripe	(0.5)	(59)	(47)	(4)	(8)
Bushmills	–	(3)	(2)	–	(1)
USL franchise	(13.3)	(246)	(82)	–	–
CGI (Kenya)	–	(2)	(2)	–	(1)
	(15.5)	(570)	(362)	(15)	(32)
Acquisitions and disposals	(15.5)	(570)	(362)	(15)	(31)
Year ended 30 June 2017					
Acquisitions					
South Africa – ready to drink and beer	0.3	32	21	5	(11)
Argentina	0.3	4	5	–	–
Transaction costs	–	–	–	–	(1)
	0.6	36	26	5	(12)
Disposals					
Argentina	0.2	3	3	2	–
USL franchise	7.6	196	48	–	–
Yellow tail	–	3	3	–	–
	7.8	202	54	2	–
Acquisitions and disposals	8.4	238	80	7	(12)

Earnings per share before exceptional items

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

Earnings per share before exceptional items for the year ended 30 June 2017 and 30 June 2016 are set out in the table below.

	2017 £ million	2016 £ million
Profit attributable to equity shareholders of the parent company – continuing operations	2,717	2,244
Exceptional operating items attributable to equity shareholders of the parent company	28	171
Non-operating items attributable to equity shareholders of the parent company	(20)	(115)
Tax in respect of exceptional operating and non-operating items attributable to equity shareholders of the parent company	1	(58)
	2,726	2,242

Weighted average number of shares	million	million
Shares in issue excluding own shares	2,512	2,508
Dilutive potential ordinary shares	11	10
	2,523	2,518
	pence	pence
Basic earnings per share before exceptional items	108.5	89.4
Diluted earnings per share before exceptional items	108.0	89.0

Free cash flow

Free cash flow comprises the net cash flow from operating activities aggregated with the net cash received/paid for loans receivable and other investments and the net cash cost paid for property, plant and equipment and computer software that are included in net cash flow from investing activities.

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

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

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

Free cash flow reconciliations for the years ended 30 June 2017 and 30 June 2016 are set out in the table below.

	2017 £ million	2016 £ million
Net cash from operating activities	3,132	2,548
Disposal of property, plant and equipment and computer software	46	57
Purchase of property, plant and equipment and computer software	(518)	(506)
Movements in loans and other investments	3	(2)
Free cash flow	2,663	2,097

Operating cash conversion

Operating cash conversion is calculated by dividing cash generated from operations excluding cash inflows and outflows in respect of exceptional items, dividends received from associates, maturing inventories, other items and post-employment payments in excess of the amount charged to operating profit by operating profit before depreciation, amortisation, impairment and exceptional operating items.

The ratio is stated at the budgeted exchange rates for the respective year in line with management reporting and is expressed as a percentage.

Operating cash conversion for the years ended 30 June 2017 and 30 June 2016 were as follows:

	2017 £ million	2016 £ million
Operating profit	3,559	2,841
Exceptional operating items	42	167
Depreciation and amortisation(i)	361	355
Retranslation to budgeted exchange rates	(582)	18
	3,380	3,381
Cash generated from operations	4,177	3,360
Cash payments in respect of exceptional items(ii)	45	80
Post employment payments less amounts included in operating profit(i)	111	58
Net movement in maturing inventories(iii)	138	144
Dividends received from associates	(223)	(173)
Other items(i), (iv)	(25)	15
Retranslation to budgeted exchange rates	(614)	75
	3,609	3,559
Operating cash conversion	106.8%	105.3%

(i) Excluding exceptional items.
(ii) Exceptional cash payments for exceptional restructuring and for discontinued operations were £14 million (2016 – £52 million) and £31 million (2016 – £nil), respectively. In addition, the year ended 30 June 2016 included £28 million of payments in respect of disengagement agreements relating to United Spirits Limited.
(iii) Excluding non-cash movements such as exchange and impact of acquisitions and disposals of £35 million (2016 – £(83) million).
(iv) Excluding payment of £31 million in respect of discontinued operations in the year ended 30 June 2017 (2016 – £nil).

Return on average total invested capital

Return on average total invested capital is used by management to assess the return obtained from the group's asset base and is calculated to aid evaluation of the performance of the business.

The profit used in assessing the return on average total invested capital reflects operating profit before exceptional items attributable to the equity shareholders of the parent company plus share of after tax results of associates and joint ventures after applying the tax rate before exceptional items for the year. Average total invested capital is calculated using the average derived from the consolidated balance sheets at the beginning, middle and end of the year. Average capital employed comprises average net assets attributable to equity shareholders of the parent company 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 calculate average total invested capital.

Calculations for the return on average total invested capital for the years ended 30 June 2017 and 30 June 2016 are set out in the table below.

	2017 £ million	2016 £ million
Operating profit	3,559	2,841
Exceptional operating items	42	167
Profit before exceptional operating items attributable to non-controlling interests	(119)	(108)
Share of after tax results of associates and joint ventures	309	221
Tax at the tax rate before exceptional items of 20.6% (2016 – 19.0%)	(781)	(593)
	3,010	2,528
Average net assets (excluding net post employment liabilities)	11,828	10,202
Average non-controlling interests	(1,715)	(1,558)
Average net borrowings	8,488	9,130
Average integration and restructuring costs (net of tax)	1,639	1,639
Goodwill at 1 July 2004	1,562	1,562
Average total invested capital	21,802	20,975
Return on average total invested capital	13.8%	12.1%

Tax rate before exceptional items

Tax rate before exceptional items is calculated by dividing the total tax charge on continuing operations before tax charges and credits in respect of exceptional items, by profit before taxation adjusted to exclude the impact of exceptional operating and non-operating items, expressed as a percentage. The measure is used by management to assess the rate of tax applied to the group's continuing operations before tax on exceptional items.

The tax rates from operations before exceptional and after exceptional items for the years ended 30 June 2017 and 30 June 2016 are set out in the table below.

	2017 £ million	2016 £ million
Tax before exceptional items (a)	736	552
Tax in respect of exceptional items	(4)	(56)
Taxation on profit from continuing operations (b)	732	496
Profit from continuing operations before taxation and exceptional items (c)	3,581	2,902
Non-operating items	20	123
Exceptional operating items	(42)	(167)
Profit before taxation (d)	3,559	2,858
Tax rate before exceptional items (a/c)	20.6%	19.0%
Tax rate from continuing operations after exceptional items (b/d)	20.6%	17.4%

Other definitions

Volume share is a brand's retail volume expressed as a percentage of the retail volume of all brands in its segment. Value share is a brand's retail sales value expressed as a percentage of the retail sales value of all brands in its segment. Unless otherwise stated, share refers to value share.

Price/mix is the number of percentage points by which the organic movement in net sales differs to the organic movement in volume. The difference arises because of changes in the composition of sales between higher and lower priced variants/markets or as price changes are implemented.

Shipments comprise the volume of products made to Diageo's immediate (first tier) customers. Depletions are the estimated volume of the first onward sales made by our immediate customers. Both shipments and depletions are measured on an equivalent units basis.

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

References to reserve brands include, but not limited to, Johnnie Walker Blue Label, Johnnie Walker Green Label, Johnnie Walker Gold Label Reserve, Johnnie Walker Platinum Label 18 year old, John Walker & Sons Collection, Johnnie Walker The Gold Route, Johnnie Walker The Royal Route and other Johnnie Walker super premium brands; Roe & Co; The Singleton, Cardhu, Talisker, Lagavulin and other malt brands; Buchanan's Special Reserve, Buchanan's Red Seal; Bulleit Bourbon, Bulleit Rye; Tanqueray No. TEN, Tanqueray Malacca Gin; Cîroc, Ketel One vodka; Don Julio, Zacapa, Bundaberg SDlx, Shui Jing Fang, Jinzu gin, Haig Club whisky, Orphan Barrel whiskey and DeLeón Tequila.

References to global giants include the following brand families: Johnnie Walker, Smirnoff, Captain Morgan, Baileys, Tanqueray and Guinness. Local stars spirits include Buchanan's, Bundaberg, Crown Royal, JεB, McDowell's, Old Parr, Yenì Raki, Black & White, Shui Jing Fang, Windsor and Ypióca. Global giants and local stars exclude ready to drink and beer except Guinness. References to Shui Jing Fang represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

References to ready to drink also include ready to serve products, such as pre-mix cans in some markets, and progressive adult beverages in the United States and certain markets supplied by the United States.

References to beer include cider and some non-alcoholic products such as Malta Guinness.

References to the group include Diageo plc and its consolidated subsidiaries.

This Strategic Report was approved by a duly appointed and authorised committee of the Board of Directors on 26 July 2017 and signed on its behalf by David Harlock, Company Secretary.