DIAGEO PLC
Form 20-F
September 14, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: 30 June 2010

Commission file number 1-10691

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England

(Jurisdiction of incorporation or organisation)

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

(Address of principal executive offices)

Paul Tunnacliffe Company Secretary
Tel: +44 20 8978 6000
E-mail: the.cosec@diageo.com
Lakeside Drive, Park Royal, London NW10 7HQ, England

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

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

Title of each class	Name of each exchange on which registered
American Depositary Shares	New York Stock Exchange
Ordinary shares of $28^{101}/_{108}$ pence each	New York Stock Exchange*

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 2,753,946,805 ordinary shares of $28^{101}/_{108}$ pence each.

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

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

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

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

**This requirement does not apply to the Registrant until its fiscal year ending 30 June 2011.

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

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

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

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

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

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2010 of Diageo plc (the 2010 Form 20-F). Reference is made to the cross reference to Form 20-F table on pages 250 to 252 hereof (the Form 20-F Cross reference table). Only (i) the information in this document that is referenced in the Form 20-F Cross reference table, (ii) the cautionary statement concerning forward-looking statements on pages 31 and 32 and (iii) the Exhibits, shall be deemed to be filed with the Securities and Exchange Commission for any purpose, including incorporation by reference into the Registration Statements on Form F-3 File Nos. 333-110804, 333-132732 and 333-153488 and Registration Statements on Form S-8 File Nos. 333-153481, 333-154338 and 333-162490, and any other documents, including documents filed by Diageo plc pursuant to the Securities Act of 1933, as amended, which purport to incorporate by reference the 2009 Form 20-F. Any information herein which is not referenced in the Form 20-F Cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference.

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This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2010. The information set out in this Form 20-F does not constitute Diageo plc's statutory accounts under the UK Companies Acts for the years ended 30 June 2010, 2009 or 2008. KPMG Audit Plc has reported on those accounts; their audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 237 (2) or (3) of the Companies Act 1985 in respect of the accounts for the years ended 30 June 2009 or 2008 nor a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the year ended 30 June 2010. The accounts for 2009 and 2008 have been delivered to the registrar of companies and those for 2010 will be delivered in due course.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo's control. For more details, please refer to the cautionary statement concerning forward-looking statements on pages 31 and 32.

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

Diageo's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed and adopted for use in the European Union (EU) and IFRS as issued by the International Accounting Standards Board (IASB). References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB. Unless otherwise indicated, all financial information contained in this document has been prepared in accordance with IFRS. The brand ranking information presented in this report, when comparing volume information with competitors, has been sourced from data published during 2010 by Impact Databank. Market data information and competitive set classifications are taken from independent industry sources in the markets in which Diageo operates.

Information presented Unless otherwise stated in this document, percentage movements are organic movements. These movements and operating margins are before exceptional items. Commentary, unless otherwise stated, refers to organic movements. Share, unless otherwise stated, refers to value share. See the 'Business review' for an explanation of organic movement calculations. The market data and competitive set classifications contained in this document are taken from independent industry sources in the markets in which Diageo operates.

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Historical information

The following table presents selected consolidated financial data for Diageo prepared under International Financial Reporting Standards (IFRS) as endorsed and adopted for use in the European Union (EU) and IFRS as issued by the International Accounting Standards Board (IASB) for the five years ended 30 June 2010 and as at the respective year ends. References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB, unless otherwise indicated. The data presented below has been derived from Diageo's audited consolidated financial statements.

						Year ended 30 June
	Notes	2010	2009 (restated)	2008 (restated)	2007 (restated)	2006 (restated)
		£ million	£ million	£ million	£ million	£ million
Income statement data						
Sales		**12,958**	12,283	10,643	9,917	9,704
Operating profit	1,2	**2,574**	2,418	2,212	2,160	2,031
Profit for the year						
Continuing operations	1,2	**1,762**	1,704	1,560	1,417	1,956
Discontinued operations	3	**(19)**	2	26	139	
Total profit for the year	1,2	**1,743**	1,706	1,586	1,556	1,956
		pence	pence	pence	pence	pence
Per share data						
Dividend per share	4	**38.10**	36.10	34.35	32.70	31.10
Earnings per share						
Basic						
Continuing operations	1	**66.3**	64.5	58.0	50.2	66.9
Discontinued operations		**(0.8)**	0.1	1.0	5.2	
Basic earnings per share	1	**65.5**	64.6	59.0	55.4	66.9
Diluted						
Continuing operations	1	**66.2**	64.3	57.6	49.9	66.6
Discontinued operations		**(0.8)**	0.1	1.0	5.1	
Diluted earnings per share	1	**65.4**	64.4	58.6	55.0	66.6
		million	million	million	million	million
Average shares		**2,486**	2,485	2,566	2,688	2,841

						As at 30 June
		2010	2009 (restated)	2008 (restated)	2007 (restated)	2006 (restated)
		£ million	£ million	£ million	£ million	£ million
Balance sheet data						
Total assets	1	**19,454**	18,018	15,992	13,934	13,909
Net borrowings	5	**6,954**	7,419	6,447	4,845	4,082
Equity attributable to the parent company's equity shareholders	1	**4,007**	3,169	3,463	3,947	4,477
Called up share capital	6	**797**	797	816	848	883

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Historical information (continued)

Notes to the historical information

1 Accounting policies All comparative financial data has been restated following the adoption of the *Amendment to IAS 38 Intangible assets* for advertising expenditure and a change in the accounting policy in respect of returnable bottles and crates.

The amendment to IAS 38 clarifies the accounting for advertising expenditure. The group charges advertising expenditure to the income statement when it has a right of access to the goods or services acquired, as opposed to charging such costs to the income statement when the advertisement is first shown to the public. Advertisements, non-depreciable point of sale materials, costs in respect of events and some sponsorship payments previously recorded in the income statement when delivered to the final customer are now expensed when delivered to the company. In addition, the group has changed its accounting policy in respect of returnable bottles and crates as the change more appropriately reflects the usage of these assets. These are now held within property, plant and equipment and depreciated on a straight-line basis to estimated residual values over their expected useful lives. Formerly a number of returnable bottles and crates were held within inventories and written down on purchase to their net realisable value.

The impacts of the adoption of these changes in accounting policies have reduced operating profit for the year ended 30 June 2009 by £25 million (2008 £14 million; 2007 increase of £1 million; 2006 £13 million), reduced profit from continuing operations for the year ended 30 June 2009 by £19 million (2008 £11 million; 2007 £nil; 2006 £9 million) and reduced basic and diluted earnings per share for the year ended 30 June 2009 by 0.6 pence (2008 0.3 pence; 2007 nil; 2006 0.3 pence). The charge of £3 million for year ended 30 June 2009 is in respect of non-controlling interests (2008 £3 million; 2007 £nil; 2006 £1 million). On the consolidated balance sheet at 30 June 2009 total assets decreased by £78 million (2008 £35 million; 2007 £22 million; 2006 £18 million) and total equity reduced by £62 million (2008 £42 million; 2007 £29 million; 2006 £29 million) of which non-controlling interests reduced by £10 million (2008 £7 million; 2007 £4 million; 2006 £4 million).

2 Exceptional items Exceptional items are charges or credits which, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper

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Historical information (continued)

understanding of the financial information. Such items are included within the income statement caption to which they relate. An analysis of exceptional items for continuing operations is as follows:

					Year ended 30 June
	2010	2009	2008	2007	2006
	£ million	£ million	£ million	£ million	£ million
Items included in operating profit					
Restructuring programmes	**(142)**	(170)	(78)		
Brand impairment	**(35)**				
Disposal of Park Royal property				40	
	(177)	(170)	(78)	40	
Sale of businesses					
(Losses)/gains on disposal and termination of businesses	**(15)**		9	(1)	6
Gain on disposal of General Mills shares					151
	(15)		9	(1)	157
Items included in taxation					
Tax credit on exceptional operating items	**39**	37	8		
Tax credit on other exceptional items	**10**				2
Settlements agreed with tax authorities		155			313
	49	192	8		315
Exceptional items in continuing operations	**(143)**	22	(61)	39	472
Discontinued operations net of taxation	**(19)**	2	26	139	
Exceptional items	**(162)**	24	(35)	178	472

3 Discontinued operations In the year ended 30 June 2010 discontinued operations comprise a charge of £19 million in respect of the discounted value of anticipated future payments to new thalidomide claimants. In the years ended 30 June 2009, 30 June 2008 and 30 June 2007 discontinued operations are in respect of the quick service restaurants business (Burger King, sold 13 December 2002) and the packaged food business (Pillsbury sold 31 October 2001).

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

The table below sets out the amounts of interim, final and total cash dividends paid by the company on each ordinary share. The dividends are translated into US dollars per ADS (each ADS

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Historical information (continued)

representing four ordinary shares) at the noon buying rate on each of the respective dividend payment dates.

		Year ended 30 June				
		2010	**2009**	**2008**	**2007**	**2006**
		pence	**pence**	**pence**	**pence**	**pence**
Per ordinary share	Interim	**14.60**	13.90	13.20	12.55	11.95
	Final	**23.50**	22.20	21.15	20.15	19.15
	Total	**38.10**	36.10	34.35	32.70	31.10
		$	**$**	**$**	**$**	**$**
Per ADS	Interim	**0.90**	0.82	1.05	0.99	0.84
	Final	**1.41**	1.46	1.46	1.64	1.43
	Total	**2.31**	2.28	2.51	2.63	2.27

Note: Subject to shareholders' approval the final dividend for the year ended 30 June 2010 will be paid on 19 October 2010, and payment to US ADR holders will be made on 25 October 2010. In the table above, an exchange rate of £1 = $1.50 has been assumed for this dividend, but the exact amount of the payment to US ADR holders will be determined by the rate of exchange on 19 October 2010.

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

6 Share capital During the year ended 30 June 2010 the company did not repurchase any ordinary shares for cancellation or to be held as treasury shares. During the year ended 30 June 2009, the company repurchased 38 million ordinary shares as part of its share buyback program at a cost including fees and stamp duty of £354 million (2008 97 million ordinary shares, cost of £1,008 million; 2007 141 million ordinary shares, cost of £1,405 million; 2006 164 million ordinary shares, cost of £1,407 million).

7 Exchange rates A substantial portion of the group's assets, liabilities, revenues and expenses are denominated in currencies other than pounds sterling. For a discussion of the impact of exchange rate fluctuations on the company's financial condition and results of operations, see 'Business review Risk management'.

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

	Year ended 30 June				
	2010	**2009**	**2008**	**2007**	**2006**
	$	**$**	**$**	**$**	**$**
Year end	**1.50**	1.65	1.99	2.01	1.85
Average rate(a)	**1.57**	1.60	2.01	1.93	1.78

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Historical information (continued)

The following table shows period end, high, low and average US dollar/pound sterling noon buying exchange rates by month, for the six-month period to 31 August 2010, expressed in US dollars per £1.

						2010
	August	July	June	May	April	March
	$	$	$	$	$	$
Month end	**1.53**	**1.57**	**1.50**	**1.45**	**1.53**	**1.52**
Month high	**1.60**	**1.57**	**1.51**	**1.53**	**1.55**	**1.54**
Month low	**1.53**	**1.50**	**1.40**	**1.43**	**1.52**	**1.48**
Average rate(b)	**1.57**	**1.53**	**1.48**	**1.47**	**1.53**	**1.51**

Average exchange rate for the period 1 to 8 September 2010 was £1 = $1.54 and the noon buying rate on 8 September was £1 = $1.55.

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

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

(c) These rates have been provided for information only. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the consolidated financial statements. See note 2(e) to the consolidated financial statements for the actual rates used in the preparation of the consolidated financial statements.

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Business description

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

Diageo plc is incorporated as a public limited company in England and Wales. 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.

Diageo is a major participant in the global beverage alcohol industry. It brings together world class brands and a management team that seeks to maximise shareholder value over the long term. The management team expects to continue the strategy of investing behind Diageo's global brands, launching innovative new products, and seeking to expand selectively either through partnerships or acquisition that add long term value for shareholders.

Diageo produces and distributes a leading collection of branded premium spirits, beer and wine. These brands include Johnnie Walker, Smirnoff, Baileys, Captain Morgan, J&B, Tanqueray and Guinness. In addition it also has the distribution rights for the Jose Cuervo tequila brands in North America and many other markets.

Strategy

Diageo is one of a small number of premium drinks companies that operate globally across spirits, beer and wine. Diageo is the leading premium spirits business in the world by volume, by net sales and by operating profit. It manages eight of the world's top 20 spirits brands as defined by Impact Databank. Diageo's beer brands include the only global stout brand, Guinness, and beer in total accounts for approximately 22% of Diageo's net sales. Diageo's wine brands are sold predominantly in North America and Europe and they comprise approximately 6% of Diageo's net sales.

Diageo's size provides for scale efficiencies in production, distribution, selling and marketing. In addition to these cost efficiencies, Diageo is committed to the dissemination of best practice in business operations across markets and brands, allowing Diageo to serve its customers and consumers better.

All of the above factors enable Diageo to attract and retain talented individuals with the capabilities necessary to deliver Diageo's strategy of growing its premium drinks business organically while looking to selectively acquire premium drinks brands that add long term value for shareholders.

Diageo's brands have broad consumer appeal across geographies. The company and its employees are proud of the responsible manner in which the brands are marketed and the positive role that moderate consumption of these brands plays in the lives of many people.

Diageo acknowledges that when misused, alcohol like many other products may lead to health or social problems for the individual or society as a whole. Diageo seeks to be at the forefront of industry efforts to promote responsible drinking and works with other stakeholders to combat alcohol misuse. Diageo's approach is based on three strategic approaches: setting high company and industry standards in responsible marketing, implementing initiatives to minimise alcohol misuse and promoting effective and targeted alcohol policies through stakeholder dialogue.

Market participation Diageo manages its business through four regions: North America, Europe, International and Asia Pacific. The North American region, comprising the United States and Canada, accounts for the largest proportion of Diageo's net sales and operating profit. The second largest, Europe, is comprised of Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe. The International region is made up of three distinct business units: Latin America and the Caribbean (including Mexico), Africa and Global Travel and Middle East (GTME). The Asia Pacific region comprises South Korea, Japan, the People's Republic of China, India and other

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Business description (continued)

Asian markets, Australia and New Zealand. In the past financial year roughly two-thirds of net sales were derived from developed markets (mainly North America and Western Europe) and one-third from developing markets (mainly Latin America and the Caribbean, Africa and Asia Pacific). In 2005 approximately four-fifths of net sales arose in developed markets and one-fifth in developing markets.

Product offering Diageo classifies eight brands as global priority brands: Smirnoff, Johnnie Walker, Baileys, Captain Morgan, J&B, Jose Cuervo, Tanqueray and Guinness. These brands are the main focus for the business and receive the majority of the marketing spend. In aggregate, they comprise 54% of Diageo's net sales.

Several other brands also have leading positions in the markets in which they are distributed. They drive growth on a significant scale but with a narrower geographical reach than the global priority brands. Examples of brands with regional strength are Crown Royal Canadian whisky and Ketel One vodka in North America, Buchanan's scotch whisky in Latin America and the Caribbean, and Windsor Premier scotch whisky in Asia Pacific.

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

Incorporation Diageo was incorporated as Arthur Guinness Son & Company Limited on 21 October 1886. The group was formed by the merger of Grand Metropolitan Public Limited Company (GrandMet) and Guinness PLC (the Guinness Group) in December 1997.

Premium drinks

Diageo is engaged in a broad range of activities within the beverage alcohol industry, with products sold in approximately 180 markets around the world. Its operations include producing, distilling, brewing, bottling, packaging, distributing, developing and marketing a range of brands. Diageo markets a wide range of recognised beverage alcohol brands including a number of the world's leading spirits and beer brands. In calendar year 2009, the Diageo brand range included 17 of the top 100 premium distilled spirits brands worldwide.

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

In the year ended 30 June 2010, Diageo sold 114.9 million equivalent units of spirits (including ready to drink), 25 million equivalent units of beer and 3.5 million equivalent units of wine. In the year ended 30 June 2010, ready to drink products contributed 5.9 million equivalent units of total volume, of which Smirnoff ready to drink variants accounted for 3.9 million equivalent units. Volume has been measured on an equivalent units basis to nine-litre cases of spirits. An equivalent unit represents one nine-litre case of spirits, which is approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer. Therefore, to convert volume of products other than spirits to equivalent units, the following guide has been used: beer in hectolitres divide by 0.9, wine in nine-litre cases divide by 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.

Diageo's portfolio of premium drinks comprises brands owned by the company as a principal and brands held by the company under agency or distribution agreements. Diageo's agency agreements vary depending on the particular brand, but tend to be for a fixed number of years. Diageo's principal agency brand is Jose Cuervo in North America and many other markets (with distribution rights extending to 2013). Diageo also brews and sells other companies' beer brands under licence, including

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Business description (continued)

Budweiser and Carlsberg lagers in Ireland, Heineken lager in Jamaica and Tiger beer in Malaysia. There can be no assurance that Diageo will be able to prevent termination of distribution, manufacturing or licence agreements or to renegotiate distribution, manufacturing or licence agreements on favourable terms when they expire.

Diageo classifies its brands as global priority brands and other brands. The classification of brands as 'local priority brands' and 'category brands' has been discontinued for reporting purposes.

Global priority brands:
Johnnie Walker scotch whiskies
Smirnoff vodka and Smirnoff ready to drink products
Baileys Original Irish Cream liqueur
Captain Morgan rum and rum based products
Jose Cuervo tequila (agency brand in North America and many other markets)
JεB scotch whisky
Tanqueray gin
Guinness stout

Diageo has eight global priority brands that it markets worldwide. Diageo considers these brands to have the greatest current and future earnings potential. Each global priority brand is marketed consistently around the world, and therefore can achieve scale benefits. The group manages and invests in these brands on a global basis. Figures for global priority brands include related ready to drink products, unless otherwise indicated.

In the year ended 30 June 2010, global priority brands accounted for 57% of total volume (81.9 million equivalent units) and contributed net sales of £5,267 million.

Johnnie Walker scotch whiskies comprise Johnnie Walker Red Label, Johnnie Walker Black Label and several other brand variants. During the year ended 30 June 2010, Johnnie Walker Red Label sold 10 million equivalent units, Johnnie Walker Black Label sold 5.3 million equivalent units and the remaining variants sold 0.7 million equivalent units. The Johnnie Walker franchise was ranked, by volume, as the number one premium scotch whisky and the number three premium spirit brand in the world.

Smirnoff achieved volume of 28.3 million equivalent units in the year ended 30 June 2010. Smirnoff vodka volume was 24.3 million equivalent units. It was ranked, by volume, as the number one premium vodka and the number one premium spirit brand in the world. Smirnoff ready to drink volume totalled 3.9 million equivalent units.

Baileys was ranked, by volume, as the number one liqueur in the world, having sold 6.6 million equivalent units in the year ended 30 June 2010.

Captain Morgan was ranked number two in the world by volume, amongst its competitive set, the rum category, with volume of 8.9 million equivalent units in the year ended 30 June 2010.

Guinness is the group's only global priority beer brand, and for the year ended 30 June 2010 achieved volume of 10.7 million equivalent units.

Other global priority brands were also ranked, by volume, among the leading premium distilled spirits brands by Impact Databank. These include: Jose Cuervo, ranked the number one premium tequila in the world; JεB scotch whisky (comprising JεB Rare, JεB Reserve, JεB Exception and JεB Jet), ranked the number three premium scotch whisky in the world; and Tanqueray, ranked the number

Business description (continued)

four premium gin brand in the world. During the year ended 30 June 2010, Jose Cuervo, J&B and Tanqueray sold 4.5 million, 4.9 million and 2.0 million equivalent units, respectively.

Other spirits brands include:
Crown Royal Canadian whisky
Buchanan's scotch whisky
Ketel One vodka (exclusive worldwide distribution rights)
Windsor Premier scotch whisky
Gordon's gin and vodka
Old Parr scotch whisky
Seagram's 7 Crown whiskey and Seagram's VO whisky
Cacique rum
Bundaberg rum
Bell's scotch whisky
The Classic Malts scotch whiskies
Cîroc vodka
White Horse scotch whisky
Don Julio tequila
Bushmills Irish whiskey

For the year ended 30 June 2010, other spirits brands contributed volume of 33 million equivalent units, representing 23% of total volume, and net sales of £2,811 million.

Other beer brands include:
Malta Guinness non-alcoholic malt
Harp lager
Tusker lager
Smithwick' sale
Senator lager
Red Stripe lager

In the year ended 30 June 2010, Diageo sold 14 million equivalent units of beers other than Guinness, achieving net sales of £985 million. Other beer volume was mainly attributable to owned brands with a minority being attributable to beers brewed and/or sold under licence, such as Tiger beer in Malaysia and Heineken lager in Jamaica.

Wine brands include:
Blossom Hill
Sterling Vineyards
Beaulieu Vineyard
Chalone Vineyard
Navarro Correas
Rosenblum Cellars
Santa Rita

For the year ended 30 June 2010, wine volume was 3.5 million equivalent units, contributing net sales of £545 million.

Production Diageo owns production facilities including maltings, distilleries, breweries, packaging plants, maturation warehouses, cooperages, vineyards, wineries and distribution warehouses. Production

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Business description (continued)

also occurs at plants owned and operated by third parties and joint ventures at a number of locations internationally.

Approximately 85% of total production is undertaken by Global Supply organised into four production centres, namely Europe Supply, America Supply, Global Beer Supply and Asia Supply. The remaining production activities of the group are integrated with the distribution organisation, principally in Africa within International. The majority of Global Supply's production centres have several production facilities. The locations, principal activities, products, packaging production capacity and packaging production volume of Global Supply's principal production centres in the year ended 30 June 2010 are set out in the following table:

Production centre	Location	Principal activities and products	Production capacity in millions of equivalent units*	Production volume in 2010 in millions of equivalent units
Europe Supply	United Kingdom	Scotch whisky, gin, vodka, rum, ready to drink	73	45
	Ireland (Baileys)	Irish cream liqueur, vodka	15	8
	Italy (Santa Vittoria)	Vodka, wine, rum, ready to drink	10	7
America Supply	United States, Canada	Vodka, gin, tequila, rum, Canadian whisky, American whiskey, progressive adult beverages, ready to drink	45	39
	United States	Wine	1	1
Global Beer Supply	Ireland (Guinness)	Beer	11	8
	Jamaica	Beer	1	1
Asia Supply	Australia	Rum, vodka, ready to drink	2	2

* Capacity represents ongoing production capacity at any production centre. The production capacities quoted in the table are based on actual production levels for the year ended 30 June 2010 adjusted for the elimination of unplanned losses and inefficiencies, and taking into account planned manning levels for the coming year.

Spirits are produced in distilleries located worldwide. The group owns 30 scotch whisky distilleries in Scotland, an Irish whiskey distillery in Northern Ireland, two whisky distilleries in Canada, and vodka/gin distilleries in the United Kingdom and the United States. Diageo produces Smirnoff vodka internationally, Popov vodka and Gordon's vodka in the United States, and Baileys in the Republic of Ireland and Northern Ireland. Rum is blended and bottled in the United States, Canada, Italy and the United Kingdom, and is distilled, blended and bottled in Australia and Venezuela. All of Diageo's maturing scotch whisky is located in warehouses in Scotland (primarily at Blackgrange), its maturing Canadian whisky in La Salle and Gimli in Canada and all its maturing American whiskey in Kentucky and Tennessee in the United States.

On 1 July 2009, the group announced a restructuring of its operations in Scotland. The plans included the consolidation of distilling, packaging and warehousing activities and involved the closure of a packaging plant, a distillery and a cooperage over a two-year period. New investment is concentrated

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in the production sites at Leven in Fife where work has begun on the expansion of the packaging facility which is due to be fully operational within two years, at Shieldhall near Glasgow and at Cambus near Alloa.

In June 2008, Diageo and the government of the US Virgin Islands announced a public/private initiative for the construction and operation of a high capacity distillery in St Croix. This new facility, expected to become operational by January 2011, will have the capacity to distil up to 12 million equivalent units annually and will supply all bulk rum used to produce Captain Morgan branded products for the United States.

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

Diageo's principal brewing facilities are at the St James's Gate brewery in Dublin and in Kilkenny, Waterford and Dundalk in the Republic of Ireland, and in Nigeria, Kenya, Ghana, Cameroon, Malaysia and Jamaica. Ireland is the main export centre for the Guinness brand. In other countries, Guinness is brewed by third parties under licence arrangements.

All Guinness Draught production is at the St James's Gate brewery in Dublin in the Republic of Ireland. Guinness Draught in cans and bottles, which uses an in-container system to replicate the taste of Guinness Draught, is packaged at Runcorn and Belfast in the United Kingdom. The Runcorn facility performs the kegging of Guinness Draught, transported to the United Kingdom in bulk for the Great Britain market.

Diageo announced the restructuring of its brewing operations in Ireland in 2008 with the intention of consolidating operations to a new greenfield brewery in the Dublin area and decommissioning the existing brewing infrastructure. The project was reviewed in 2009 due to the changing economic conditions both globally and locally in Ireland. A review of options continued in 2010 to examine the desirability of network consolidation. The project remains under review and a business case for investment behind consolidation is being developed for approval.

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

Property, plant and equipment Diageo owns or leases land and buildings throughout the world. The principal production facilities are described above. As at 30 June 2010, Diageo's land and buildings are included in the group's consolidated balance sheet at a net book value of £746 million. Diageo's largest individual facility, in terms of book value, is St James's Gate brewery in Dublin. Diageo's properties are primarily a variety of manufacturing, distilling, brewing, bottling and administration facilities spread across the group's worldwide operations, as well as vineyards and wineries in the United States. Approximately 39%, 22% and 20% of the book value of Diageo's land and buildings comprise properties located in Great Britain, Ireland and the United States, respectively. Approximately 91% by value of the group's properties are owned and approximately 3% are held under leases running for 50 years or longer.

In June 2010 Diageo entered into a sale and leaseback arrangement in respect of vineyards and facilities located in Napa Valley, California. The vineyards and facilities were purchased and leased back to Diageo under a 20-year lease, with Diageo holding options to extend the lease at fair value for up to 80 years in total. Diageo remains the operator of the properties under the lease agreement and

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retains ownership of the brands, vines and grapes, which remain a strategic part of Diageo's wine business.

Raw materials The group has a number of long term contracts in place for the purchase of significant raw materials including glass, other packaging, tequila, bulk whisky, neutral spirits, cream, rum and grapes. In addition, forward contracts are in place for the purchase of other raw materials including sugar and cereals to minimise the effects of short term price fluctuations.

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

The majority of products are supplied to customers in glass bottles. Glass is purchased from suppliers located around the world, the principal supplier being the Owens Illinois group.

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

Diageo has a supply agreement with Destiléria Serrallés Inc, a Puerto Rican corporation, under which Diageo purchases all bulk rum for use in Captain Morgan products sold in the United States. Diageo is entitled to terminate this contract with effect from the end of December 2011, at which time Diageo intends to source rum for its Captain Morgan products from the distillery that is being built in the US Virgin Islands.

Marketing and distribution Diageo is committed to investing in its brands. In the year ended 30 June 2010, £1,419 million was spent worldwide on marketing brands with a focus on the eight global priority brands that accounted for 64% of total marketing spend.

Diageo makes extensive use of magazine, newspaper, point of sale and poster and billboard advertising, and uses radio, cinema, television and internet advertising where appropriate and permitted by law. Diageo also runs consumer promotional programmes in the on trade (for example, licensed bars and restaurants). Diageo also uses sponsorship to market its brands and is a sponsor of the Formula One Racing Team Vodafone McLaren Mercedes, a NASCAR racing team and the Johnnie Walker golf championships.

Diageo markets and distributes its brands through four regions: North America, Europe, International and Asia Pacific.

Business analysis In the year ended 30 June 2010, North America, Europe, International and Asia Pacific contributed 39%, 29%, 26% and 6%, respectively, of the group's operating profit before exceptional items and corporate costs.

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An analysis of net sales and operating profit by operating segment for the year ended 30 June 2010 is as follows:

	Net sales	Operating profit/(loss) before exceptional items	Operating profit/(loss)
	£ million	£ million	£ million
North America	3,306	1,170	1,132
Europe	2,759	859	806
International	2,627	771	766
Asia Pacific	1,018	176	146
Global Supply			(39)
Corporate	70	(225)	(237)
Total	**9,780**	**2,751**	**2,574**

For details see note 2 to the consolidated financial statements.

North America North America is the largest market for Diageo in terms of operating profit, and the largest market for premium drinks in the world. Diageo markets its products through four operating units: US Spirits, Diageo-Guinness USA, Diageo Chateau & Estate Wines and Diageo Canada.

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

Diageo-Guinness USA markets Diageo's US beer brands (including Guinness stout, Harp lager, Red Stripe lager and Smithwick's ale) as well as the group's progressive adult beverages (including Smirnoff Ice, Smirnoff premium mixed drinks and Captain Morgan Parrot Bay Tropical Malt Beverage). Diageo Chateau & Estate Wines (DC&E) owns and operates wineries in California and Washington State (including Beaulieu Vineyard, Sterling Vineyards, Chalone Vineyard and Provenance Vineyards) and markets these and other wines across the United States. In the year ended 30 June 2010, Diageo undertook a review of the DC&E wine business and announced the restructuring of its wine division including a reduction in the sales force, the sale and leaseback of vineyards and facilities in Napa Valley, California, and the anticipated sale of non-strategic wine brands in the year ending 30 June 2011.

The Canada business unit distributes the group's collection of spirits, wine and beer brands across all Canadian territories.

Within the United States, there are generally two types of regulatory environments: open states and control states. In open states, spirits companies are allowed to sell spirits, wine and beer directly to independent distributors. In these open states, Diageo generally trades through a three-tier distribution system, where the product is initially sold to distributors, who then sell it to on and off trade retailers. In most control states, Diageo markets its spirits products to state liquor control boards through the bailment warehousing system, and from there to state or agency liquor stores. There are variations

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Business description (continued)

for example, certain states control distribution but not retail sales. Generally, wines are treated in the same way as spirits, although most states that are control states for spirits are open states for wines. Beer distribution generally follows open states regulation across the United States. In Canada, beer and spirits distribution laws are generally consistent and similar to those of control states in the United States.

Diageo, however, has some licences to deliver keg beer directly to licensed accounts, which account for approximately 20% of Diageo's beer business in Canada.

Across the United States, Diageo's distributors and brokers have over 2,500 dedicated sales people focused on selling its spirits and wine brands. Diageo has pursued a distribution strategy centred around consolidating the distribution of Diageo's US spirits and wine brands into a single distributor or broker in each state where possible. The strategy is designed to provide a consolidated distribution network, which will limit the duplication of activities between Diageo and the distributor, improve Diageo's and distributors' selling capabilities and enable a number of alternative approaches to optimise product distribution. To date, Diageo has consolidated its business in 41 markets (40 states plus Washington DC), representing over 80% of Diageo's US spirits and wine volume. The remaining states will be consolidated as opportunities arise. Diageo is now focused on building the capabilities and selling tools of the distributors' dedicated sales forces and creating a more efficient and effective value chain.

Europe Diageo Europe comprises six operating units: Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe.

In Great Britain, Diageo sells and markets its products via three business units: Diageo GB (spirits, beer and ready to drink), Percy Fox & Co (wines) and Justerini & Brooks Retail (private client wines). Products are distributed both through independent wholesalers and directly to the major grocers, convenience and specialist stores. In the on trade (for example, licensed bars and restaurants), products are sold through the major brewers, multiple retail groups and smaller regional independent brewers and wholesalers. The customer base in Great Britain has seen consolidation in recent years in both the on trade and home consumption channels. In particular, Great Britain's top four national multiple grocers together make up over 60% of home consumption total spirits volume.

Ireland comprises the Republic of Ireland and Northern Ireland. In both territories, Diageo sells and distributes directly to both the on trade and the off trade (for example, retail shops and wholesalers) through a telesales operation, extensive sales calls to outlets and third party logistics providers. The Guinness, Smirnoff and Baileys brands are market leaders in their respective categories of long alcoholic drinks, vodka and liqueurs. Budweiser and Carlsberg lagers, also major products in the Diageo collection of brands in Ireland, are brewed and sold under licence in addition to Smithwick's ale and Harp lager.

In Russia, Diageo operates through its wholly owned subsidiary.

Across the remainder of mainland Europe, Diageo distributes its spirits brands primarily through its own distribution companies with the following exceptions. In France Diageo sells its spirits and wine products through a joint arrangement with Moët Hennessy, and its beer products through Brasseries Kronenbourg (part of the Carlsberg group). In Hungary Diageo sells its brands through its associate company Zwack. In the Baltic states, Czech Republic, Slovakia, Romania, Bulgaria, Cyprus, Malta, various territories in the Balkans, CIS and Israel, Diageo sells and markets its brands via local distributors. In the Nordic countries Diageo has sales offices in Sweden, Norway and Denmark, and representation through third party distributors in Finland and Iceland. In all Nordic markets except

Business description (continued)

Denmark, off trade sales are controlled by state monopolies, with alcohol tax rates among the highest in the world, and border trade and duty free are important sources of sales. Smirnoff Ice is sold in Nordic countries through Carlsberg.

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

International Diageo International comprises Latin America and the Caribbean (including Mexico), Africa (excluding North Africa) and Global Travel and Middle East business.

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

Africa provides some of the longest established and largest markets for the Guinness brand, with the brewing of Guinness Foreign Extra Stout in a number of African countries, either through subsidiaries or under licence. Diageo has a three-way venture with Heineken and Namibia Breweries Limited in South Africa for a combined beer, cider and ready to drink collection of brands. Diageo also has a 25% equity interest in a venture with Heineken which owns a brewery in Gauteng, South Africa. Diageo has a wholly owned brewery in Cameroon and also has majority owned breweries in Nigeria, Kenya, Ghana, Uganda and the Seychelles.

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

Asia Pacific Diageo Asia Pacific comprises India, the People's Republic of China, South Korea, Japan, Thailand, Vietnam, Singapore, Malaysia and other Asian markets, Australia and New Zealand.

Diageo works with a number of joint venture partners in Asia Pacific. In Singapore, Malaysia, Hong Kong and Macau, the People's Republic of China and Thailand, Diageo distributes the majority of its spirits brands through joint venture arrangements with Moët Hennessy. Diageo also has a wholly owned subsidiary in China for brands not included in the joint venture such as Smirnoff, Windsor and Baileys. In South Korea, India, Vietnam and Taiwan, Diageo's own distribution companies distribute the majority of Diageo's brands. In Japan, the joint venture with Moët Hennessy distributes super premium brands, such as the super deluxe variants of Johnnie Walker, while the joint venture with Kirin distributes Diageo's other premium spirits, like Johnnie Walker Black Label and Smirnoff, as well as Guinness and Smirnoff Ice. Other spirit brands, which are not distributed by either Moët Hennessy or the Kirin joint venture, are handled by third parties. In Malaysia, Diageo's own and third party beers are brewed and distributed by a listed business (Guinness Anchor Berhad) in which Diageo and its partner, Asia Pacific Breweries, have a majority share through a jointly controlled joint venture company. In Singapore, Diageo's beer brands are brewed and distributed by Asia Pacific Breweries.

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Business description (continued)

Generally, the remaining markets in Asia are served by third party distribution networks monitored by regional offices.

In Australia, Diageo has its own production and distribution company, which handles the majority of products sold in the Australian market. It also has production and distribution arrangements with VOK Beverages and a licensed brewing arrangement with Foster's. In New Zealand, Diageo operates through third party distributors and has a licensed brewing arrangement with Lion Nathan.

Global Supply Global Supply is responsible for the production of approximately 85% of Diageo's products sold globally, for sourcing materials and services through global procurement, for providing consistent technical support through the global technical function and providing logistic and customer services through the global supply chain organisation.

Production is managed by four Global Supply production centres, Europe Supply, America Supply, Global Beer Supply and Asia Supply. Europe Supply comprises Scotland (scotch whisky, gin, vodka, rum and ready to drink), Baileys Ireland (Irish cream liqueur and vodka) and Santa Vittoria Italy (vodka, wine, rum and ready to drink), all producing goods for markets globally. America Supply comprises North America Spirits Supply located in the United States and Canada (vodka, gin, tequila, rum, Canadian whisky, American whiskey, progressive adult beverages, wine and ready to drink) with domestic distribution, Venezuela (bulk rum) and North America wines. Global Beer Supply produces Guinness and other beers in Ireland distributed primarily in Europe and North America and beer, vodka and ready to drink in Jamaica. Asia Supply comprises Singapore (Baileys and scotch whisky packaging), the Philippines and Australia (rum, vodka and ready to drink).

The global procurement organisation also forms part of Global Supply and has responsibility for sourcing goods and services for the group.

A global network of suppliers provides for a wide range of raw materials and packaging items that are necessary to ensure consistency of quality to support the brands. With the high level of dependency on agricultural commodities such as cereals, hops, agave and sugar, forward-buying takes place to minimise value at risk. In marketing, global procurement supports the business in sourcing creative media solutions, sponsorship and point of sale activities. Global procurement also supports business services, facilities and computer services.

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

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

Seasonal impacts The festive holiday season provides the peak period for sales. Approximately 40% of annual net sales occur in the last four months of each calendar year.

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

	2010	2009	2008
Average number of employees			
North America	**1,615**	2,258	2,234
Europe	**3,007**	3,253	3,144
International	**5,097**	4,952	5,000
Asia Pacific	**2,636**	2,668	2,923
Global Supply	**8,171**	8,116	8,238
Corporate and other	**2,761**	2,792	2,605
	23,287	24,039	24,144

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

Diageo aims to be amongst the most admired companies in all key geographies. Consistent with this, Diageo participated in independent surveys during the year and is currently rated in the top 10 employers in six of its key markets. Further to this aim, Diageo endeavours to create a workplace that is both welcoming and challenging for all employees. Diageo values diversity in its workforce and works to ensure that the group is inclusive of all people, regardless of their background or style. To enhance diversity, Diageo aims to create opportunities that are attractive to a wide range of candidates, including those with disabilities, and seeks to make working for Diageo compatible with a variety of lifestyles. Diageo sponsors a number of employee networks around the world that seek to support diverse interest groups. The company also seeks to design and adjust roles to accommodate people's lifestyles, and increasingly encourages flexible working. Not only is this approach to inclusion and diversity consistent with Diageo's values, it is also believed to be important for the long term health of the organisation. As part of Diageo's global policies, Diageo has emphasised the importance of treating individuals justly and in a non-discriminatory manner in all aspects of employment, including recruitment, compensation and benefits, training, promotion, transfer and termination. Accordingly, factors not relevant to the requirements of a role, including without limitation race, religion, colour, ethnic or national origin, disability, sexual orientation, gender or marital status, are not considered, and reasonable adjustments are considered (and if necessary appropriate training provided) so that no individual is disadvantaged.

Inspirational leadership to deliver great results is critical to the success of the business. The Diageo Leadership Performance Programme, which was launched in 2007, is a key programme for the organisation. The programme continued in 2010 with the participation of 130 new leaders in Diageo. The aim is for Diageo to be recognised for the outstanding quality of its business leaders and their ability to deliver great performance for the group.

We strongly believe in the value of our employees sharing in the company's success and actively encourage employees to become shareholders. We seek out opportunities to extend employee share ownership around the world and in calendar year 2010 the number of countries operating an employee share plan will have increased from 25 to 32. The launch of Diageo's international sharematch plan in 2010 combined with existing employee share plans, will further extend the opportunity to the majority of employees across a significant number of Diageo's markets to share in the company's growth and

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success. As at 30 June 2010, 15,785 past and present employees held 0.74% (2009 1.2%) of Diageo's issued ordinary share capital.

Diageo strives to keep its employees well informed on and engaged with the company's strategy and business goals as a high priority, focusing on dialogue and consultation (both formal and informal) on changes that affect its employees.

The review of the organisation announced in 2009 has been largely concluded. The objectives of the review to deliver significant cost savings and create a more effective organisation are judged to have been achieved. There was no significant disruption to business performance as a result of this review. Further organisational changes at the local level have since been announced as Diageo continues to seek improvements and efficiencies.. Consistent with the Diageo value of 'valuing each other' where people are impacted by a restructuring programme they will be treated with sensitivity and dignity and will be supported through the change.

Environmental, social and community matters Diageo realises that it is an increasingly important factor for investors to understand not only its financial performance, but also the manner in which it manages and operates its business. Diageo seeks to fulfil its responsibilities as a corporate citizen in a number of areas, including examining its impact on the environment, its policies relating to employees as well as social and community matters. The company believes these programmes help build a foundation for the business to succeed. Diageo consults its stakeholders to help identify its responsibilities as a corporate citizen and develop strategies that address the interests of the business and society.

Environment Diageo has set stretching targets to reduce its impact on the environment. The Diageo executive environmental working group is responsible for setting environmental policy. In the year ended 30 June 2009, the working group revised and re-issued Diageo's environmental policy to reflect the increased ambition the company has for environmental improvement. The policy is supported by Global Supply's risk management framework, which sets implementation criteria and provides a mechanism for monitoring compliance. As stated in Diageo's policy, the company's actions on the environment are planned in light of prevailing scientific knowledge and do not depend on having absolute proof of specific damage, thus supporting the concept of a precautionary approach.

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

Diageo uses the *World Resources Institute (WRI)/World Business Council for Sustainable Development (WBCSD) Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard, Revised Edition* as a basis for reviewing its emissions and includes the facilities over which it has operational control in its analysis. In the year ended 30 June 2010, Diageo's greenhouse gas emissions decreased compared to the prior year. During the year ended 30 June 2009, Global Supply achieved the Carbon Trust Standard for its efforts in Scotland, an award that certifies that the business there has measured, managed and reduced its carbon footprint rather than off-setting emissions. Reasons cited for the award were the ongoing reduction of the Scottish business's carbon emissions through implementation of a number of

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projects at various facilities, such as steam pipe installations; new thermostats; and steam recovery. During the year ended 30 June 2010, Diageo set aside a special reserve fund of £10 million specifically dedicated to carbon and water reduction projects worldwide. Diageo spent this money improving metering and monitoring systems and implementing projects to drive efficiency such as flash steam recovery at its Scottish malt distilleries, conversion of boilers from diesel to natural gas at the George Dickel distillery in Tennessee in the United States, and waste heat recovery at the brewery in Nigeria.

A reliable supply of water is essential to Diageo's business as water is the main ingredient in substantially all of Diageo's products and is used for cleaning and cooling at production sites.

Water resources are under pressure from development in many parts of the world and from climatic changes that may restrict their availability in the future, impacting not only Diageo's business but also Diageo's business partners and local communities who rely on water for their livelihoods. Diageo strives to better understand its water footprint, impact of its water usage, and how a further reduction in impact may be achieved. Using United Nations and WBCSD data, Diageo has designated ten of its production sites as being located in areas which are 'water stressed', identifying them as higher risk in terms of having a sustainable water supply in the coming years, and in Africa, approximately half of its production sites are located in water stressed areas. In the year ended 30 June 2010, Diageo specifically targeted reductions in water usage at beer production facilities, seeking to drive improvement in water efficiency through appropriate engineering solutions.

Diageo reviews water consumption data from across the production sites over which it has operational control using internally developed guidelines, which define water usage based on the total amount of water abstracted from source (such as groundwater, surface water or mains) less any clean water provided back to local communities directly from a site and water returned for agricultural irrigation. Cooling water abstracted and returned to the same source is excluded from the total water used. In addition to reviewing total water usage, Diageo also strives to improve its efficiency, monitoring the amount of water used to produce one litre of product packaged. In the year ended 30 June 2010, total water usage decreased as compared to the prior year, while water efficiency improved meaning that fewer litres of water were required to produce each litre of Diageo's product packaged.

Ongoing improvements have been identified and implemented across a number of sites in the regions. For example, in Scotland, a process of continuous analysis and improvement delivered a significant improvement in water efficiency at the Cameronbridge grain distillery during the year ended 30 June 2010 compared to the prior year. Replacing the water-intensive pre-cooler at that distillery with more efficient equipment delivered immediate positive results, but also highlighted the role of a boiler feed valve in reducing water usage. Automating this boiler feed valve helped to deliver a total saving of approximately 250 million litres of bore water and resulted in savings of about £25,000 of electricity pumping costs during the fiscal year. Similarly, the Diageo bottling plant in Huntingwood, Australia implemented an innovative technology invented by a member of the site's Water-Watch team to re-use water in vacuum pumps. The invention significantly reduces the site's water consumption and has been implemented at several other Diageo sites around the globe. In May 2010 Diageo launched a new water strategy: The Diageo Blueprint. This will guide Diageo's approach to managing water and protecting water tables in the regions where Diageo operates over the coming years. It is based in large part on the advice of external stakeholders, on the targets set in the UN's Millennium Development Goals (MDGs) and on the experience gained through leading business roundtables on water resource issues in Africa. The aim of the strategy is to optimise Diageo's impact on water resource use by

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Business description (continued)

focusing efforts on countries where Diageo has a significant presence that face the greatest challenges in meeting the water-related MDGs.

Diageo couples these initiatives with its community programmes designed to increase local access to safe water as described in more detail below.

Society and community Diageo takes great care to market its brands responsibly to adults, to support programmes and to promote practices and policies that create a more positive role for alcohol in society. With more than 200 initiatives in over 40 countries in the year ended 30 June 2010, Diageo works with industry, government and other groups to establish high company and industry standards on responsible marketing, to invest in programmes that aim to minimise alcohol misuse, and to promote effective government alcohol policies. Among its many activities, in the year ended 30 June 2010 Diageo actively supported industry initiatives such as the UK Campaign for Smarter Drinking and ICAP Global Action on Harmful Drinking. Diageo also continued to partner and train retailers on how to prevent underage purchase of alcohol, and launched a bartender training toolkit designed to help the on trade address some of the issues it faces, such as preventing underage sale of alcohol, drink driving and serving intoxicated customers. In addition, a toolkit on implementing initiatives against drink driving was launched within Diageo to allow the business to draw on its experiences of successful responsible drinking campaigns such as Guardian Angels, Johnnie Walker's Join the Pact, Crown Royal's Safe Rides sponsorship of NASCAR and Drive Your Friends.

Diageo recognises that its success in the future will depend in part on the prosperity of the communities in which it operates and the strength of its relationship with those communities. Diageo is committed to contributing to those communities by encouraging local hiring and local sourcing of raw materials when possible, as well as contributing through the payment of local taxes and community investment. Supporting long term sustainable initiatives in the communities where Diageo does business advances the development of those communities, engages employees, builds Diageo's reputation and enhances its relationships with governments and other stakeholders.

Community investment, which in the year ended 30 June 2010 amounted to about 1% of Diageo's operating profit before exceptional items, is primarily focused on providing safe water access to local communities, supporting skills training to help disadvantaged people find employment and contributing to organisations that drive local economic development. Most of Diageo's investment comes from its businesses around the world in the form of cash, in-kind donations and volunteer time, together with grants from the Diageo Foundation. Diageo's largest community programmes are Water of Life, which focuses on bringing sustainable access to safe drinking water to local communities (primarily in Africa), and Learning for Life, which provides education and vocational training in Latin America and the Caribbean to help enable people to find employment. Many Diageo brands also helped drive awareness and support for its community programmes. In the year ended 30 June 2010, Buchanan's launched its third annual fundraiser campaign 'Buchanan's Forever' to contribute to Diageo's Learning for Life programme and Guinness established the Arthur Guinness Fund as part of the Guinness '250th Celebrations'. The Arthur Guinness Fund has pledged support to social entrepreneurs to help contribute to local economic development across Ireland, Africa, Asia, Great Britain and North America.

In addition to global initiatives, Diageo supports involvement by its employees to benefit local communities and takes proactive measures to react rapidly to natural disasters affecting communities in the markets in which it operates, most recently delivering food, water and emergency supplies to victims of the earthquake in Haiti. Through the employee giving programme Giving for Good, Diageo employees raised enough money to donate 3,500 water filter kits to schools and health clinics in Uganda.

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Business description (continued)

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

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

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

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

Research and development The overall nature of the group's business does not demand substantial expenditure on research and development. However, the group has ongoing programmes for developing new drinks products. Innovation forms an important part of Diageo's growth strategy, playing a key role in positioning its brands for continued growth. The strength and depth of Diageo's brand range provide solid platforms from which to drive innovation, while insights into shopper trends and changing consumer habits inform product and packaging development.

In the year ended 30 June 2010, the group's research and development expenditure amounted to £13 million (2009 £17 million; 2008 £17 million). Research and development expenditure is generally written off in the year in which it is incurred.

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

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

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

Import and excise duties can have a significant impact on the final pricing of Diageo's products to consumers. These duties have an impact on the competitive position as compared to other brands. The

Business description (continued)

group devotes resources to encouraging the equitable taxation treatment of all beverage alcohol categories and to reducing government-imposed barriers to fair trading.

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

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

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

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

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

Diageo uses shared services operations to deliver transaction processing and certain central finance activities, using captive and outsourced centres. A captive business service centre in Budapest, Hungary, performs various process tasks for markets and operational entities. Diageo uses third party service centres in Manila, Shanghai and Bucharest to perform these tasks for basic processes. Certain central finance activities, including elements of group financial planning and reporting and treasury, are performed in the business service centre in Budapest.

Associates Diageo's principal associate is Moët Hennessy. It also owns shares in a number of other associates. In the year ended 30 June 2010, the share of profits of associates after tax was £142 million (2009 £164 million; 2008 £176 million), of which Moët Hennessy accounted for £134 million (2009 £151 million; 2008 £160 million).

Diageo owns 34% of Moët Hennessy, the spirits and wine subsidiary of LVMH Moët Hennessy Louis Vuitton SA (LVMH). LVMH is based in France and is listed on the Paris Stock Exchange. Moët Hennessy is also based in France and is a producer and exporter of a number of brands in its main

Business description (continued)

business areas of champagne and cognac. Its principal champagne brands are Moët & Chandon (including Dom Pérignon), Veuve Clicquot and Mercier, all of which are included in the top 10 champagne brands worldwide by volume. Moët Hennessy also owns Hennessy, which is the top cognac brand worldwide by volume, and Glenmorangie, a malt whisky.

Since 1987, a number of joint distribution arrangements have been established with LVMH, principally covering distribution of Diageo's premium brands of scotch whisky and gin and Moët Hennessy's premium champagne and cognac brands in the Asia Pacific region and France. Diageo and LVMH have each undertaken not to engage in any champagne or cognac activities competing with those of Moët Hennessy. The arrangements also contain certain provisions for the protection of Diageo as a minority shareholder in Moët Hennessy. The operations of Moët Hennessy in France are conducted through a partnership in which Diageo has a 34% interest and, as a partner, Diageo pays any tax due on its share of the results of the partnership to the tax authorities.

Acquisitions and disposals Diageo has made a number of acquisitions of brands, distribution rights and equity interests in premium drinks businesses. In the three years ended 30 June 2010 acquisitions include the following:

On 29 February 2008, Diageo acquired Rosenblum Cellars in North America for a total cost of £53 million (including acquisition costs).

On 1 May 2008, Diageo formed a new venture with Heineken and Namibia Breweries Limited (NBL) for their combined beer, cider and ready to drink businesses in South Africa, called DHN Drinks (Pty) Limited (DHN Drinks). Diageo and Heineken each own 42.25% of DHN Drinks and NBL owns 15.5%. The original cost of this acquisition was £43 million, with an additional cost of £29 million recognised in the year ended 30 June 2010 (2009 £3 million). Each party shares in the profits of DHN Drinks in proportion to their shareholding. Brandhouse continues to market and distribute the parties' products in South Africa. On 1 May 2008, Diageo and Heineken also entered into a second venture in South Africa called Sedibeng Brewery (Pty) Limited whereby a brewery and bottling plant was constructed in Gauteng province, South Africa, which produces Amstel and certain other key brands. Heineken owns 75% and Diageo owns 25% of Sedibeng Brewery (Pty) Limited. The original cost of this acquisition was £8 million, with an additional cost of £19 million in the year ended 30 June 2009.

On 9 June 2008, Diageo completed the acquisition of Ketel One Worldwide BV (KOW), a 50:50 company based in the Netherlands, with the Nolet Group, owners of the Ketel One brand. The company owns the exclusive and perpetual global rights to market, sell and distribute Ketel One vodka products, including Ketel One vodka, Ketel One Citroen vodka and any line extensions of Ketel One vodka and Ketel One Citroen vodka. Diageo paid a total of £471 million (including acquisition costs) for a 50% equity stake in the company and is entitled to certain governance rights under the global agreement pursuant to which KOW is operated. Diageo consolidates the company with a minority interest. The Nolet Group has an option to sell their stake in the company to Diageo for $900 million (£600 million) plus interest from 9 June 2011 to 9 June 2013. If the Nolet Group exercises this option but Diageo chooses not to buy their stake, Diageo will pay $100 million (£67 million) and the Nolet Group may then pursue a sale of their stake to a third party, subject to rights of first offer and last refusal on Diageo's part.

On 17 December 2008 Diageo purchased the remaining 25% stake in the company that owns the Smirnov brand in Russia for £35 million. This company unites the Smirnoff/Smirnov brands in Russia

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under common ownership and is the exclusive distributor of Smirnov and Diageo's spirits brands in Russia. Diageo currently operates in Russia through this wholly owned subsidiary.

On 16 June 2009, Diageo acquired the remaining 80% of equity in Stirrings LLC for £6 million and provided £7 million as deferred consideration payable in 2014. Diageo initially acquired a 20% equity stake for £5 million in the year ended 30 June 2007.

On 1 March 2010, Diageo entered into an equity transfer agreement to acquire an additional 4% equity stake in Sichuan Chengdu Quanxing Group Company Ltd. (Quanxing) from Chengdu Yingsheng Investment Holding Co., Ltd. for £14 million. The acquisition of the 4% equity stake, which is subject to a number of regulatory approvals, would bring Diageo's shareholding in Quanxing to 53%. Quanxing is a holding company controlling a 39.7% stake in Sichuan ShuiJingFang Co., Ltd. (ShuiJingFang), a super premium Chinese white spirits company listed on the Shanghai Stock Exchange. Diageo acquired a 43% equity stake in Quanxing for £37 million on 27 January 2007 and a further 6% on 30 July 2008 raising its investment to 49%. If the acquisition of the 4% equity stake is approved, Diageo would become the indirect controlling shareholder of ShuiJingFang and, in accordance with Chinese takeover regulations, would be required to make a mandatory tender offer to all the other shareholders of ShuiJingFang. Were all other ShuiJingFang shareholders to accept the tender offer, the amount payable would be approximately £615 million. As required by Chinese law, 20% of the maximum consideration payable under the tender offer (£123 million) was deposited with China's securities depositary and clearing agency, Shanghai branch.

On 29 June 2010, Diageo acquired a further 28.75% stake in London Group, owner of the Nuvo brand, for a consideration of £29 million. This increased Diageo's equity stake in London Group to 71.25%. Diageo has an obligation to purchase the remaining stake of 28.75% at a pre-agreed profit multiple, reflecting fair value in 2013.

Risk factors

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

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

If there is an extended period of constraint in the capital markets, with debt markets in particular experiencing a lack of liquidity, at a time when cash flows from Diageo's business may be under pressure, this may have an impact on Diageo's ability to maintain current long term strategies, with a

Business description (continued)

consequent effect on the group's growth rate. Such developments may adversely affect shareholder returns or share price. Additionally, continued volatility in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo's reported results. Decreases in the trustees' valuations of Diageo's pension plans may also increase pension funding requirements.

Diageo faces competition that may reduce its market share and margins Diageo faces substantial competition from several international companies as well as local and regional companies in the countries in which it operates. Diageo competes with drinks companies across a wide range of consumer drinking occasions. Within a number of categories, consolidation or realignment is still possible. Consolidation is also taking place amongst Diageo's customers in many countries. Increased competition and unanticipated actions by competitors or customers could lead to downward pressure on prices and/or a decline in Diageo's market share in any of these categories, which would adversely affect Diageo's results and hinder its growth potential.

Diageo may not be able to derive the expected benefits from its strategy to focus on premium drinks or its cost-saving and restructuring programmes designed to enhance earnings Diageo's strategy is to focus on premium drinks to grow its business through organic sales, operating profit growth and the acquisition of premium drinks brands that add value for shareholders. There can be no assurance that Diageo's strategic focus on premium drinks will result in opportunities for growth and improved margins.

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further business combinations, acquisitions, disposals, joint ventures and/or partnerships (including any associated financing or the assumption of actual or potential liabilities, depending on the transaction contemplated). There can be no assurance that any transaction will be completed. The success of any transaction will depend in part on Diageo's ability to successfully integrate new businesses with Diageo's existing operations and realise the anticipated benefits, cost savings or synergies. There can be no guarantee that any such business combination, acquisition, disposal, joint venture or partnership would deliver the benefits, cost savings or synergies anticipated, if any.

Similarly, there can be no assurance that the cost-saving or restructuring programmes implemented by Diageo in order to improve efficiencies and deliver cost-savings will deliver the expected benefits.

Regulatory decisions and changes in the legal and regulatory environment could increase Diageo's costs and liabilities or limit its business activities Diageo's operations are subject to extensive regulatory requirements which include those in respect of production, product liability, distribution, importation, marketing, promotion, sales, pricing, labelling, packaging, advertising, labour, pensions, compliance and control systems, and environmental issues. Changes in laws, regulations or governmental or regulatory policies and/or practices could cause Diageo to incur material additional costs or liabilities that could adversely affect its business. In particular, governmental bodies in countries where Diageo operates may impose new labelling, product or production requirements, limitations on the advertising and/or promotion activities used to market beverage alcohol, restrictions on retail outlets, other restrictions on marketing, promotion and distribution or other restrictions on the locations or occasions where beverage alcohol is sold which directly or indirectly limit the sales of Diageo products. Regulatory authorities under whose laws Diageo operates may also have enforcement power that can subject the group to actions such as product recall, seizure of products or other sanctions, which could have an adverse effect on its sales or damage its reputation. An increase in the stringency of the regulatory environment could cause Diageo to incur material additional costs or liabilities that could adversely affect its business.

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

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

Diageo is subject to litigation directed at the beverage alcohol industry and other litigation Companies in the beverage alcohol industry are, from time to time, exposed to class action or other litigation relating to alcohol advertising, product liability, alcohol abuse problems or health consequences from the misuse of alcohol, Diageo may be subject to litigation with tax, customs and other regulatory authorities, including with respect to the methodology for assessing importation value, transfer pricing and compliance matters, and Diageo is routinely subject to litigation in the ordinary course of its operations. Such litigation may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and as a result, Diageo's business could be materially adversely affected. For additional information with respect to legal proceedings, see 'Additional information for shareholders Legal proceedings' and note 31 to the consolidated financial statements.

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

In addition, to the extent that third parties sell products which are either counterfeit versions of Diageo brands or inferior brands that look like Diageo brands, consumers of Diageo brands could confuse Diageo products with them. This could cause them to refrain from purchasing Diageo brands in the future and in turn could impair brand equity and adversely affect Diageo's business.

Demand for Diageo's products may be adversely affected by many factors, including changes in consumer preferences and tastes and adverse impacts of a declining economy Diageo's collection of brands includes some of the world's leading beverage alcohol brands as well as brands of local prominence. Maintaining Diageo's competitive position depends on its continued ability to offer products that have a strong appeal to consumers. Consumer preferences may shift due to a variety of factors including changes in demographic and social trends, public health regulations, changes in travel, vacation or leisure activity patterns, weather effects and a downturn in economic conditions, which may reduce consumers' willingness to purchase premium branded products. In addition, concerns about

Business description (continued)

health effects due to negative publicity regarding alcohol consumption, negative dietary effects, regulatory action or any litigation or customer complaints against companies in the industry may have an adverse effect on Diageo's profitability.

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

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

If the social acceptability of Diageo's products declines, Diageo's sales volume could decrease and the business could be materially adversely affected In recent years, there has been increased social and political attention directed to the beverage alcohol industry. Diageo believes that this attention is the result of public concern over problems related to alcohol abuse, including drink driving, underage drinking and health consequences from the misuse of alcohol. If, as a result, the general social acceptability of beverage alcohol were to decline significantly, sales of Diageo's products could materially decrease.

Diageo's business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates Diageo may be adversely affected by political and economic developments or industrial action in any of the countries where Diageo has distribution networks, production facilities or marketing companies. Diageo's business is dependent on general economic conditions in the United States, Great Britain and other important markets. A significant deterioration in these conditions, including a reduction in consumer spending levels, customer destocking, the failure of customer, supplier or financial counterparties or a reduction in the availability of, or an increase in the cost of financing to, Diageo, could have a material adverse effect on Diageo's business and results of operations. Moreover, a substantial portion of Diageo's operations, representing approximately one third of Diageo's net sales for the year ended 30 June 2010, are carried out in developing markets, including Brazil, Venezuela, Mexico, Russia and developing markets in Africa and Asia.

Diageo's operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Political and/or social unrest, potential health issues (including pandemic issues) and terrorist threats and/or acts may also occur in various places around the world, which will have an impact on trade, tourism and travel. Many of these risks are heightened, or occur more frequently, in developing markets. These disruptions can affect Diageo's ability to import or export products and to repatriate funds, as well as affecting the levels of consumer demand (for example, in duty free outlets at airports or in on trade premises in affected regions) and therefore Diageo's levels of sales or profitability. Developing markets are also generally exposed to relatively

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higher risk of liquidity, inflation, devaluation, price volatility, currency convertibility and country default. Due to Diageo's specific exposures, any or all of the foregoing factors may affect Diageo disproportionately or in a different manner as compared to its competitors.

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

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

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

Diageo's operating results may be adversely affected by disruption to production facilities or business service centres Diageo would be affected if there were a catastrophic failure of its major production facilities or business service centres. See 'Business description Premium drinks Production' for details of Diageo's principal production areas. Diageo operates production facilities around the world. If there were a technical integrity failure, fire or explosion at one of Diageo's production facilities, it could result in damage to the facilities, plant or equipment, their surroundings or the environment, could lead to a loss in production capacity, or could result in regulatory action, legal liability or damage to Diageo's reputation. In addition, the maintenance and development of information systems may result in systems failures which may adversely affect business operations.

Diageo has a substantial inventory of aged product categories, principally scotch whisky and Canadian whisky, which may mature over periods of up to 30 years or more. The maturing inventory is stored primarily in Scotland, and the loss through contamination, fire or other natural disaster of all or a portion of the stock of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, Diageo would not be able to meet consumer demand for those products as it arises. There can be no assurance that insurance proceeds would cover the replacement value of Diageo's maturing inventory or other assets, were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third

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parties. In addition, there is an inherent risk of forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption. This could lead to an inability to supply future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks.

Systems failures could lead to business disruption and systems change programmes may not deliver the benefits intended Any failure of information systems could adversely impact Diageo's ability to operate. As with all large systems, Diageo's information systems could be penetrated by outside parties intent on extracting information, corrupting information or disrupting business processes. Such unauthorised access could disrupt Diageo's business and/or lead to loss of assets. The concentration of processes in business service centres also means that any disruption arising from system failure or physical plant issues could impact a large portion of Diageo's global business. Certain change programmes designed to improve the effectiveness and efficiency of end-to-end operating, administrative and financial systems and processes continue to be undertaken. This includes moving transaction processing from a number of markets to business service centres. There can be no certainty that these programmes will deliver the expected operational benefits. There may be disruption caused to production processes and possibly to administrative and financial systems as further changes to such processes are effected. They could also lead to adverse customer or consumer reaction.

Climate change, or legal, regulatory or market measures to address climate change, may negatively affect Diageo's business or operations, and water scarcity or poor quality could negatively impact Diageo's production costs and capacity There is a growing concern that carbon dioxide and other greenhouse gases in the atmosphere may have an adverse impact on global temperatures, weather patterns and the frequency and severity of extreme weather and natural disasters. In the event that such climate change has a negative effect on agricultural productivity, Diageo may be subject to decreased availability or less favourable pricing for certain raw materials that are necessary for Diageo's products, such as sugar, cereals, hops, agave and grapes. Water is the main ingredient in substantially all of Diageo's products. It is also a limited resource in many parts of the world, facing unprecedented challenges from climate change, overexploitation, increasing pollution, and poor management. As demand for water continues to increase around the world, and as water becomes scarcer and the quality of available water deteriorates, Diageo may be affected by increasing production costs or capacity constraints, which could adversely affect Diageo's results of operations and profitability.

Diageo's operations and financial results may be adversely affected by movements in the value of its pension funds, fluctuations in exchange rates and fluctuations in interest rates Diageo has significant pension funds. These funds may be affected by, among other things, the performance of assets owned by these plans, the underlying actuarial assumptions used to calculate the surplus or deficit in the plans, in particular the discount rate and long term inflation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. If there are significant declines in financial markets and/or a deterioration in the value of fund assets or changes in discount rates or inflation rates, Diageo may need to make significant contributions to the pension funds in the future. Furthermore, if the market values of the assets held by Diageo's pension funds decline, or if the valuations of those assets by the pension trustees decline, pension expenses may increase and, as a result, could materially adversely affect Diageo's financial position. There is no assurance that interest rates or inflation rates will remain constant or that pension fund assets can earn the assumed rate of return annually, and Diageo's actual experience may be significantly more negative. Diageo may be adversely affected by fluctuations in exchange rates. The results of operations of Diageo are accounted for in pounds sterling. Approximately 36% of sales in the year ended 30 June 2010 were in US dollars,

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approximately 17% were in euros and approximately 12% were in sterling. Movements in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo's reported results of operations from year to year.

Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense. To partly delay any adverse impact from interest rate movements, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of projected net borrowings, and the overall net borrowings portfolio is managed according to a duration measure. See 'Business review Risk management'.

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

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

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

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Cautionary statement concerning forward-looking statements

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

These factors include, but are not limited to:

- global and regional economic downturns;
- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact on Diageo's market share, increase expenses and hinder growth potential;
- the effects of Diageo's strategic focus on premium drinks, the effects of business combinations, partnerships, joint ventures, acquisitions or disposals, existing or future, and the ability to realise expected synergies and/or cost savings;
- Diageo's ability to complete existing or future business combinations, restructuring programmes, acquisitions and disposals;
- legal and regulatory developments, including changes in regulations regarding consumption of, or advertising for, beverage alcohol, changes in tax law (including tax rates) or accounting standards, changes in taxation requirements, such as the impact of excise tax increases with respect to the business, and changes in environmental laws, health regulations and laws governing labour and pensions;
- developments in any litigation or other similar proceedings directed at the drinks and spirits industry generally or at Diageo in particular, or the impact of a product recall or product liability claim on Diageo's profitability or reputation;
- developments in the Colombian litigation, Turkish customs litigation, SEC investigation, Korean customs litigation or any similar proceedings;
- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues, or contamination, counterfeiting or other circumstances which could harm the integrity or sales of Diageo's brands;
- changes in the cost or supply of raw materials, labour and/or energy;
- changes in political or economic conditions in countries and markets in which Diageo operates, including changes in levels of consumer spending, failure of customer, supplier and financial counterparties or imposition of import, investment or

currency restrictions;

levels of marketing, promotional and innovation expenditure by Diageo and its competitors;

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Business description (continued)

- renewal of supply, distribution, manufacturing or licence agreements on favourable terms when they expire;
- termination of existing distribution or licence manufacturing rights on its brands and agency brands;
- disruption to production facilities or business service centres, and systems change programmes, existing or future, and the ability to derive expected benefits from such programmes;
- technological developments that may affect the distribution of products or impede Diageo's ability to protect its intellectual property rights; and
- changes in financial and equity markets, including significant interest rate and foreign currency exchange rate fluctuations and changes in the cost of capital, which may reduce or eliminate Diageo's access to or increase the cost of financing or which may affect Diageo's financial results.

All oral and written forward-looking statements made on or after the date of this document and attributable to Diageo are expressly qualified in their entirety by the above factors and those described in 'Business description Risk factors'. Any forward-looking statements made by or on behalf of Diageo speak only as of the date they are made. Diageo does not undertake to update forward-looking statements to reflect any changes in Diageo's expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that Diageo may make in any documents which it publishes and/or files with the US Securities and Exchange Commission. All readers, wherever located, should take note of these disclosures. The information in this document does not constitute an offer to sell or an invitation to buy shares in Diageo plc or an invitation or inducement to engage in any other investment activities.

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

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Business review

Introduction

Information presented Diageo is the world's leading premium drinks business and operates on an international scale selling all types of beverage alcohol. It is one of a small number of premium drinks companies that operate across spirits, beer and wine. Diageo's brands have broad consumer appeal across geographies, and as a result, the business is organised under the business areas of North America, Europe, International, Asia Pacific and Global Supply. In view of the focus on reporting results by the location of third party customers in explaining the group's performance in the business review, the results of the Global Supply segment have been allocated to the geographic segments. The following discussion is based on Diageo's results for the year ended 30 June 2010 compared with the year ended 30 June 2009, and the year ended 30 June 2009 compared with the year ended 30 June 2008.

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

The underlying performance on a constant currency basis and excluding the impact of exceptional items and acquisitions and disposals is referred to as 'organic' performance, and further information on the calculation of organic measures as used in the discussion of the business is included in the organic movements calculation and in the notes to that calculation.

Presentation of information in relation to the business In addition to describing the significant factors impacting on the income statement compared to the prior year for both of the years ended 30 June 2010 and 30 June 2009, additional information is also presented on the operating performance and cash flows of the group.

There are several principal financial key performance indicators not specifically used in the consolidated financial statements themselves (non-GAAP measures) used by the group's management to assess the performance of the group in addition to income statement measures of performance. These are volume, the organic movements in volume, sales, net sales, marketing spend and operating profit and free cash flow. These key performance indicators are described below:

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

Organic movements in volume, sales, net sales, marketing spend and operating profit are non-GAAP measures. The performance of the group is discussed using these measures.

Business review (continued)

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

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

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

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

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

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

Free cash flow is a non-GAAP measure that comprises the net cash flow from operating activities as well as the net purchase and disposal of investments, property, plant and equipment and computer software that form part of net cash flow from investing activities. The group's management believes the measure assists users of the financial statements in understanding the group's cash generating performance as it comprises items which arise from the running of the ongoing business.

The remaining components of net cash flow from investing activities that do not form part of free cash flow, as defined by the group's management, are in respect of the purchase and disposal of subsidiaries, associates and businesses. The group's management regards the purchase and disposal of property, plant and equipment and computer software as ultimately non-discretionary since ongoing investment in plant, machinery and technology is required to support day-to-day operations, whereas acquisitions and disposals of businesses are discretionary. However, free cash flow does not necessarily reflect all amounts which the group has either a constructive or legal obligation to incur. Where appropriate, separate discussion is given for the impacts of acquisitions and disposals of businesses, equity dividends paid and the purchase of own shares, each of which arises from decisions that are independent from the running of the ongoing underlying business.

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

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Business review (continued)

Restatement of prior years' operating profit

As reported in note 1 in the consolidated financial statements, Diageo adopted the amendment to *IAS 38 Intangible assets* and *IFRS 8 Operating segments* from 1 July 2009. In addition, Diageo changed its accounting policy in respect of the accounting for returnable bottles and crates. The segmental figures for operating profit before exceptional items for the years ended 30 June 2009 and 2008 have been restated as follows:

Year ended 30 June 2009

	As previously reported	Amendment to IAS 38	IFRS 8	Returnables	Restated	Restated organic growth
	£ million	£ million	£ million	£ million	£ million	%
North America	1,156	(2)	(16)		1,138	(1)
Europe	856	(10)	7		853	(1)
International	645	(3)	17	(10)	649	11
Asia Pacific	164		(5)		159	3
Corporate	(208)		(3)		(211)	
	2,613	(15)		(10)	2,588	4

Year ended 30 June 2008

	As previously reported	Amendment to IAS 38	IFRS 8	Returnables	Restated
	£ million	£ million	£ million	£ million	£ million
North America	907	(3)	24		928
Europe	798	1	(11)		788
International	593	(2)	(6)	(9)	576
Asia Pacific	170	(1)	(10)		159
Corporate	(164)		3		(161)
	2,304	(5)		(9)	2,290

For further information and the impact on the group's consolidated results and financial position, see note 1 in the consolidated financial statements. All amounts shown in the tables above under 'Amendment to IAS 38' are in respect of marketing spend on which the other restatements have no impact. The following table summarises the impact of the restatement on marketing spend by operating segment for the years ended 30 June 2009 and 2008:

	Year ended 30 June 2009		Year ended 30 June 2008	
	As previously reported	Restated	As previously reported	Restated
	£ million	£ million	£ million	£ million
	£ million	£ million	£ million	
North America	429	431	366	369
Europe	419	429	438	437
International	256	259	244	246
Asia Pacific	208	208	191	192
	1,312	1,327	1,239	1,244

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Business review (continued)

Operating results 2010 compared with 2009

Summary consolidated income statement

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

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

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

Exceptional operating items Exceptional items are those that, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information.

Exceptional operating costs of £177 million for the year ended 30 June 2010 (2009 £170 million) comprised a net charge of £142 million (2009 £170 million) in respect of restructuring programmes

Business review (continued)

and an impairment charge of £35 million (2009 £nil) in respect of the Ursus brand reflecting the impact of the significant downturn in the economy in one of its principal market, Greece. Restructuring programmes comprise £85 million (2009 £166 million) for the global restructuring programme announced in February 2009 primarily in respect of employee and contract termination charges, £93 million (2009 £nil) for the restructuring of Global Supply operations announced in July 2009 principally in Scotland, £12 million (2009 £4 million) for the restructuring of brewing operations in Ireland announced in 2008 in respect of accelerated depreciation, and a £48 million net credit (2009 £nil) for the restructuring of the wines business in the United States comprising an £89 million gain on the sale and leaseback of land, a £17 million charge for the write down of inventories and other charges of £24 million.

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

Post employment plans Post employment net costs for the year ended 30 June 2010 were a charge of £133 million (2009 £63 million) comprising £92 million (2009 £98 million) included in operating costs before exceptional items, pension curtailment gains of £6 million (2009 £33 million) in exceptional operating items and a charge of £47 million (2009 gain of £2 million) in net finance charges. In the year ending 30 June 2011, the finance charge under IAS 19 is expected to be £5 million.

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

Operating profit Reported operating profit for the year ended 30 June 2010 increased by £156 million to £2,574 million from £2,418 million in the prior year. Exchange rate movements increased operating profit for the year ended 30 June 2010 by £122 million. Before exceptional operating items, operating profit for year ended 30 June 2010 increased by £163 million to £2,751 million from £2,588 million in the prior year. Exchange rate movements increased operating profit before exceptional items for the year ended 30 June 2010 by £126 million.

Exceptional non-operating items A loss of £15 million on sale of businesses comprises a charge of £26 million in respect of the anticipated loss on the disposal of certain non-strategic wine brands in the United States in the year ending 30 June 2011 and a gain of £11 million arising on the revaluation of the current equity holding in the London Group, the owner of the Nuvo brand, to revalue Diageo's stake to fair value, following the acquisition of a majority equity stake in the London Group.

Net finance charges Net finance charges comprising net interest charge and net other finance charges decreased from £592 million in the year ended 30 June 2009 to £462 million in the year ended 30 June 2010.

The net interest charge decreased by £141 million from £516 million in the prior year to £375 million in the year ended 30 June 2010. The reduction in the interest charge arose principally from a decrease in average floating interest rates which resulted in a reduction in interest charges of £90 million, from a decrease in average net borrowings in the year driven by strong cash flow generation and from a positive movement on the revaluation to year end market rates of interest swaps under IAS 39 of £20 million.

Business review (continued)

The income statement interest cover was 7.7 times and cash interest cover was 10.3 times.

Net other finance charges for the year ended 30 June 2010 were £87 million (2009 £76 million). There was an increase of £49 million in finance charges in respect of post employment plans from £2 million finance income in the year ended 30 June 2009 to a £47 million charge in the year ended 30 June 2010. Other finance charges also include £18 million (2009 £21 million) on unwinding of discounts on liabilities, a hyperinflation adjustment of £16 million (2009 £nil) in respect of the Venezuela operations, £10 million (2009 £33 million) in respect of exchange rate translation differences on inter-company funding arrangements where hedge accounting was not applicable and £4 million income (2009 £13 million charge) in respect of other finance charges. In the year ended 30 June 2009 £11 million was recognised in respect of exchange movements on net borrowings not in a hedge relationship.

Associates The group's share of associates' profits after interest and tax was £142 million for the year ended 30 June 2010 compared to £164 million in the prior year. Diageo's 34% equity interest in Moët Hennessy contributed £134 million (2009 £151 million) to share of associates' profits after interest and tax.

Profit before taxation Profit before taxation increased by £249 million from £1,990 million in the prior year to £2,239 million in the year ended 30 June 2010.

Taxation The reported tax rate for the year ended 30 June 2010 was 21.3% compared with 14.4% for the year ended 30 June 2009. Factors that reduced the reported tax rate in the prior year included settlements agreed with tax authorities that gave rise to changes in the value of deferred tax assets and tax provisions.

Discontinued operations Discontinued operations in the year ended 30 June 2010 represent a charge after taxation of £19 million in respect of anticipated future payments to new thalidomide claimants. The credit of £2 million in the year ended 30 June 2009 relates to the Pillsbury disposal.

Exchange rate and other movements Exchange rate movements are calculated by retranslating the prior year results as if they had been generated at the current year exchange rates. The difference is excluded from organic growth.

The estimated effect of exchange rate and other movements on profit before exceptional items and taxation for the year ended 30 June 2010 was as follows:

	Gains/(losses) £ million
Operating profit before exceptional items	
Translation impact	**37**
Transaction impact	**133**
Impact of IAS 21 on operating profit	**(44)**
Total exchange effect on operating profit before exceptional items	**126**
Interest and other finance charges	
Net finance charges translation impact	**2**
Mark to market impact of IAS 39 on interest expense	**20**
Impact of IAS 21 and IAS 39 on other finance charges	**34**
Associates translation impact	**4**
Total effect on profit before exceptional items and taxation	**186**

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Business review (continued)

	Year ended 30 June 2010	Year ended 30 June 2009
Exchange rates		
Translation £1 =	**$1.57**	$1.60
Transaction £1 =	**$1.67**	$2.29
Translation £1 =	**€1.13**	€1.17
Transaction £1 =	**€1.30**	€1.40

The current situation in Venezuela with respect to currency controls and the official exchange rate is uncertain. In the year ended 30 June 2010 the Venezuelan denominated operating profit amounted to VEF485 million which was translated at the official exchange rate, $1 = VEF2.15 (£1 = VEF3.51) in the six months ended 31 December 2009 and $1 = VEF4.3 (£1 = VEF6.4) in the six months ended 30 June 2010. If the translation exchange rate is changed in fiscal 2011 this would most likely give rise to an adverse currency movement.

Dividend The directors recommend a final dividend of 23.50 pence per share, an increase of 6% from the year ended 30 June 2009. The full dividend would therefore be 38.10 pence per share, an increase of 5.5% from the year ended 30 June 2009. Subject to approval by shareholders, the final dividend will be paid on 19 October 2010 to shareholders on the register on 10 September 2010. Payment to US ADR holders will be made on 25 October 2010. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 27 September 2010.

Analysis by business area and brand

In order to assist the reader of the financial statements, the following comparison of 2010 with 2009 includes tables which present the exchange, acquisitions and disposals and organic components of the year on year movement for each of volume, sales, net sales, marketing spend and operating profit. Organic movements in the tables below are calculated as follows:

(a) The organic movement percentage is the amount in the column headed Organic movement in the tables below expressed as a percentage of the aggregate of the amount in the column headed 2009 Reported, the amount in the column headed Exchange and the amount, if any, in respect of disposals included in the column headed Acquisitions and disposals. The inclusion of the column headed Exchange in the organic movement calculation reflects the adjustment to recalculate the prior year results as if they had been generated at the current year's exchange rates.

(b) Where a business, brand, brand distribution right or agency agreement was disposed of, or terminated, in the current year, the group, in organic movement calculations, adjusts the results for the comparable prior year to exclude the amount the group earned in that year that it could not have earned in the current year (i.e. the period between the date in the prior year, equivalent to the date of the announcement of the disposal in the current year, and the end of the prior year). As a result, the organic movement numbers reflect only comparable performance. Similarly, if a business was disposed of part way through the prior year then its contribution would be completely excluded from that prior year's performance in the organic movement calculation, since the group recognised no contribution from that business in the current year. In the calculation of operating profit, the overheads included in disposals are only those directly attributable to the businesses disposed of, and do not result from subjective judgements of management. For acquisitions, a similar adjustment is made in the organic movement calculations. For acquisitions subsequent to the end of the prior year, the post acquisition results in the current year 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 only included from the

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Business review (continued)

anniversary of the acquisition date in the current year. The acquisition adjustment also eliminates the impact of transaction costs directly attributable to acquisitions that have been publicly announced and charged to operating profit in either year.

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

	2009 Reported units million	Acquisitions and disposals units million	Organic movement units million	2010 Reported units million	Organic movement %
Volume					
North America	53.0	0.1	**(1.3)**	**51.8**	**(2)**
Europe	39.0	(0.1)	**0.3**	**39.2**	**1**
International	37.0*	0.3	**3.0**	**40.3**	**8**
Asia Pacific	11.8		**0.3**	**12.1**	**2**
Total	140.8*	0.3	**2.3**	**143.4**	**2**

* Decreased by 0.5 million equivalent units from the figures reported for the year ended 30 June 2009.

	2009 Reported £ million	Exchange(1) £ million	Acquisitions and disposals(2) £ million	Organic movement £ million	2010 Reported £ million	Organic movement %
Sales						
North America	3,858	103	15	**(123)**	**3,853**	**(3)**
Europe	4,279	78	13	**1**	**4,371**	
International	2,803	18	10	**391**	**3,222**	**14**
Asia Pacific	1,268	146		**28**	**1,442**	**2**
Corporate	75	1		**(6)**	**70**	
Total sales	12,283	346	38	**291**	**12,958**	**2**

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Business review (continued)

	2009 Reported £ million	Exchange[1] £ million	Acquisitions and disposals[2] £ million	Organic movement £ million	2010 Reported £ million	Organic movement %
Net sales						
North America	3,290	91	15	**(90)**	**3,306**	**(3)**
Europe	2,750	53	10	**(54)**	**2,759**	**(2)**
International	2,286	21	9	**311**	**2,627**	**13**
Asia Pacific	910	101		**7**	**1,018**	**1**
Corporate	75	1		**(6)**	**70**	
Total net sales	9,311	267	34	**168**	**9,780**	**2**
Excise duties	2,972				**3,178**	
Total sales	12,283				**12,958**	
Marketing spend[4]						
North America	431	12	1	**28**	**472**	**6**
Europe	429	9		**(26)**	**412**	**(6)**
International	259	7	1	**35**	**302**	**13**
Asia Pacific	208	18		**7**	**233**	**3**
Total marketing spend	1,327	46	2	**44**	**1,419**	**3**
Operating profit[4]						
North America	1,138	26	3	**3**	**1,170**	
Europe	853	11	1	**(6)**	**859**	**(1)**
International	649	(27)	(6)	**155**	**771**	**25**
Asia Pacific	159	14	(7)	**10**	**176**	**6**
Corporate	(211)	102		**(116)**	**(225)**	
Total operating profit before exceptional items	2,588	126	(9)	**46**	**2,751**	**2**
Exceptional items[3]	(170)				**(177)**	
Total operating profit	2,418				**2,574**	

Notes

(1) The exchange adjustments for sales, net sales, marketing spend and operating profit are primarily the retranslation of prior year reported results at current year exchange rates and are principally in respect of the strengthening of the euro and the US dollar partially offset by the weakening of the Nigerian naira and the Venezuelan bolivar fuerte.

(2) The impacts of acquisitions and disposals are excluded from the organic movement percentages. In the year ended 30 June 2010 there were no acquisitions or disposals impacting organic growth but adjustment is made to exclude the impact of the disposal of the Bordeaux wine agency business in the United States and the acquisitions of Stirrings LLC and the distribution rights of Grand Marnier and Windhoek completed in the year ended 30 June 2009. Adjustment is also made to exclude directly attributable transaction costs incurred in the year ended 30 June 2010 of £12 million primarily in respect of the potential acquisitions of an additional equity stake in

Quanxing and of Serengeti Breweries.

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Business review (continued)

(3)

Operating exceptional items in the year ended 30 June 2010 comprised charges of £85 million in respect of the global restructuring programme, £93 million (2009 £166 million) for the restructuring of Global Supply operations, £12 million (2009 £4 million) in respect of the restructuring of Irish brewing operations, £48 million net credit for the restructuring of wine business in the United States and £35 million charge in respect of impairment of the Ursus brand.

(4)

The figures for the year ended 30 June 2009 have been restated following the adoption of the amendment to *IAS 38 Intangible assets and IFRS 8 Operating segments* and the change to the accounting treatment of returnables. See note 1 to the consolidated financial statements and page 35 for an explanation of the effect of the restatements.

Brand performance overview

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Global priority brands		(1)	3
Other brands**	4	5	8
Total	**2**	**2**	**5**
Global priority brands* **			
Johnnie Walker	11	7	12
Smirnoff	(1)	(4)	
Baileys	(1)	(4)	
Captain Morgan	3	2	5
Jose Cuervo	(13)	(14)	(12)
J&B	(7)	(8)	(3)
Tanqueray	1	(1)	2
Guinness	(3)		
Other brands			
Crown Royal North America		(1)	2
Buchanan's International	11	15	13
Ketel One North America	2	4	6
Windsor Asia Pacific			9

*

Volume movement is both reported and organic.

**

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

***

Spirits brands excluding ready to drink.

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

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Business review (continued)

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

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

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

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

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

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

Tanqueray: Double-digit net sales growth in Spain and Great Britain only partially offset 4% net sales decline in North America. Weakness of the higher priced Rangpur and Tanqueray 10 variants led to negative price/mix of 2 percentage points.

Guinness: Guinness, comprising a little over half of total beer net sales, posted flat net sales with strong double-digit growth in South East Asia broadly offsetting a 2% decline in Europe and flat net sales in Africa. In Great Britain and Ireland, Guinness once again gained share but net sales declined as a result of the continued decline of beer in those markets. In Africa, where the brand typically sells at a significant price premium to local lagers, performance slowed as some consumers chose to trade down to less expensive lagers; Performance by market, however, was varied. Strong net sales growth in East Africa was offset by declines in Ghana, due to utility shortages and higher taxes, and in Nigeria where some consumers traded down to less expensive lager brands.

Business review (continued)

Marketing spend

Marketing spend was up 3% driven by major increases in proven campaigns behind Diageo's most important brands and categories in the second half. This resulted in double-digit increases in full year spend behind the vodka and rum categories. Spend on vodka was up 13% mainly behind Smirnoff in North America and International. Marketing spend was also up on Cîroc in the United States and on Ketel One vodka worldwide. Investment behind Captain Morgan grew 36% in the year, up 25% in North America, up over 60% in International and almost doubled in Europe. Marketing spend on scotch represents Diageo's biggest category spend and while the percentage increase was in single digits the absolute increase was similar to that in vodka and rum. Over half of the increase in spend on scotch was behind Johnnie Walker in International. Baileys marketing spend reduced in absolute terms and as a percentage of net sales as the brand team reviewed the marketing campaign. Reduction in marketing spend behind Guinness in Europe was driven by media deflation and comparison against the prior year when spend was up behind innovation. This was broadly offset by increased marketing spend in beer in the other regions. Spend was down 2% on ready to drink and up 7% on wine.

Customer marketing

Diageo continued to invest to enhance the capabilities of its customer marketing function which now consists of about 500 people in over 30 countries covering over 80% of Diageo's net sales. This had a tangible impact, creating demand for Diageo's brands at the point of purchase, where on average 40% of final purchase decisions are made. Diageo made it easier for shoppers to find, choose and buy products in the spirits category forming partnerships with customers which helped them offer the right range of products, the appropriate amount of shelf space and providing enhanced navigation through signage. Diageo also delivered a large number of cross brand and category focused campaigns such as the "Summer Spirits" campaign in Great Britain, the multi-brand Christmas campaign in Latin America and the "Whiskey Festival" which was executed in multiple markets.

Corporate revenue and costs Net sales were £70 million in the year ended 30 June 2010, down £5 million from £75 million in the prior year. Net operating costs before exceptional items, increased by £14 million in the year ended 30 June 2010 to £225 million.

Diageo undertakes the majority of its currency transaction hedging centrally and therefore £104 million of positive year on year transaction impact was taken to corporate. In addition there was a negative year on year translation impact of £2 million in corporate. The geographical regions are reported using forecast transaction exchange rates with the difference between forecast and achieved rates being included in corporate. This amounted to an incremental £82 million cost this year. There was a £34 million increase in underlying corporate net costs mainly due to higher systems investment and business development charges together with the legal and accounting costs associated with ongoing regulatory matters.

North America

Key highlights

- Diageo's key spirits brands gained share, outperforming most major competitors
- Shipments and depletions were in line and therefore comparison against fiscal 2009, when shipments exceeded depletions, contributed to the volume decline against the prior year

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Business review (continued)

Strong performance by reserve brands improved mix in the second half as the super premium segment returned to growth

Diageo's brands continued to sell at a price premium

Diageo's beer brands outperformed other imported beers and gained share

Innovation in the year added significantly to net sales as Diageo addressed changing consumer trends

Ready to drink declined overall but innovation in the year improved the performance of Smirnoff ready to drink in the United States

Marketing spend increased by 20% in the second half with investment behind innovation launches and key brands

Margins benefited from production and overhead cost savings and lower raw material costs

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

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

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

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Business review (continued)

profit before exceptional items by £3 million and there was an organic increase in operating profit of £3 million.

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

* Other brands consist of local priority brands and category brands. Movements in organic volume, reported volume, organic net sales and reported net sales for local priority brands are (1)%, (1)%, (1)% and 1%, respectively, and for category brands (1)%, 0%, 3% and 9%, respectively. The classification of brands as local priority brands and category brands has been discontinued for reporting purposes.

** Spirits brands excluding ready to drink.

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

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

Despite continued consumer sentiment that liqueurs are luxury products, Baileys' performance markedly improved in the second half, driven by a reduction in the price gap against its leading competitor and targeted promotions. Baileys gained 0.4 percentage points of volume share and maintained its value share. Marketing spend reduced as focus was limited to the holiday season and a reduction in non-working dollars, which increased efficiency of the total marketing spend.

Captain Morgan volume declined as stock levels were maintained against an increase in fiscal 2009 and a slowdown of growth in the rum category. Captain Morgan Original Spiced Rum posted strong

Business review (continued)

share gains of 0.6 percentage points despite decline in net sales and volume. This was partially offset by the introduction of Captain Morgan Lime Bite. Increased discounting to meet consumer demand for lower priced alternatives contributed to the decline in net sales. Marketing spend increased dramatically behind the 'Calling All Captains' campaign, 'Captain and Cola' programming and the launch of Captain Morgan Lime Bite.

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

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

Crown Royal net sales were flat for the full year, but the brand grew strongly in the second half driven by innovation and growth of some of the higher priced variants. Crown Royal Black quickly became the number 1 new product in IRI's new product tracker. Price/mix was flat as price reductions on Crown Royal Extra Rare and Crown Royal Cask 16 offset mix improvement from Crown Royal Black. Crown Royal outperformed the category and gained 0.3 percentage points of share. Marketing on the brand increased behind the NASCAR sponsorship, multicultural marketing programmes and the launch of Crown Royal Black.

Guinness volume growth was driven by the performance of Guinness Draft in Can, Guinness Extra Stout and Guinness Kegs, as it lapped the planned destock of the prior year. Although imported beers declined, Guinness grew share by 0.1 percentage points. Marketing spend increased behind the '250th Celebration', Arthur's Day and the integrated campaign 'Fortune Favors the Bold'.

The reserve brands performed strongly with volume up 7% and net sales up 9% as the super premium segment returned to growth.

Net sales growth was driven predominantly by innovation in the year around Ketel One vodka up 4% and Cîroc up 48%, each supported by strong marketing campaigns. Bulleit Bourbon performed well especially in the on trade with net sales up 23%. Buchanan's Special Reserve and Red Seal grew net sales 44% and 32% respectively and became the fastest growing blended scotch brand in the United States. Buchanan's is the clear leader in the US Hispanic market.

Following the planned destock of the prior year, Diageo's beer brands grew volume 4% and net sales 4% driven predominantly by Guinness. Harp and Smithwicks also grew volume and net sales, albeit off a small base. The introduction of Red Stripe Light helped grow net sales of Red Stripe 3%.

Diageo's wine business gained 0.1 percentage points of volume share and held value share. Volume growth in Sterling Vineyards, San Telmo and Stellani di Notte were offset by declines in Beaulieu Vineyard, Chalone Vineyard and Barton & Guestier. Net sales declined as consumers continued to trade down to lower price points. Diageo introduced nine new wine brands or varietals aimed at addressing the consumer demand for quality wines at value price points and the appeal for blends. In March 2010, Diageo announced the restructuring of the North American wine division (which included a sale and leaseback transaction and the intended sale of non-strategic brands) to reduce the cost base and improve returns.

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Business review (continued)

Ready to drink remains challenging for Diageo. Net sales were down 5% and Diageo lost share. Smirnoff malt-based products grew net sales 6% as the strong performance of Smirnoff Ice Mango, Smirnoff Ice Multipack and the introduction of Smirnoff Mixed Drinks, offset the decline of established products. Similarly in the ready to serve segment innovation offset a decline in existing products. In the second half innovation behind Jose Cuervo Margaritas drove improved performance with the introduction of pomegranate and mango flavored margaritas but the segment remains highly competitive.

Diageo launched over 30 innovations during the year spanning spirits, beer, wine and ready to drink and through the fiscal year averaged 5 of the top 10 new items in IRI. Innovation included extensions, which enhanced core brands such as Captain Morgan Lime Bite, Smirnoff Dark Roasted Espresso, Cîroc Coconut and Ketel One Oranje, as well as new brands such as Wily Jack wine and Moon Mountain vodka. Performance of innovation was led by Crown Royal Black, Cîroc Red Berry and Smirnoff mixed drinks.

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

Diageo has worked with key accounts at national, regional and local levels to bring shopper and category insights to optimise sales of beverage alcohol in their stores. In addition, Diageo has developed and rolled out shopper-insight driven programmes behind Diageo's brands. These programmes capture the shoppers' attention in off trade stores and on trade restaurants, bars and clubs, meeting shoppers' needs at the point of purchase. Focus on the customer marketing agenda resulted in improved visibility for Diageo's brands in thousands of on and off trade accounts.

Canada Performance in Canada declined with volume down 1% and net sales down 4%. Spirits volume was impacted by destocking in the first half but Captain Morgan and J&B grew in the full year. Net sales declined as consumers continued to trade down and there was a shift from spirits to beer and ready to drink. Beer volume increased 17% and net sales grew 15% due to the good performance of Harp and Red Stripe. Wine grew volume 27% and net sales 31% on the strong growth of Sterling Vineyards. Ready to drink volume declined 15% and net sales declined 18% due to competition in the ready to serve segment.

Europe

Key highlights

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

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Business review (continued)

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

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

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

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

* Other brands consist of local priority brands and category brands. Movements in organic volume, reported volume, organic net sales and reported net sales for local priority brands are 2%, 2%, (4)% and (2)%, respectively, and for category brands 7%, 8%, 4% and 7%, respectively. The classification of brands as local priority brands and category brands has been discontinued for reporting purposes.

** Spirits brands excluding ready to drink.

Great Britain A strong performance was delivered in Great Britain with volume up 9% and net sales up 5%, driven by double-digit volume growth from spirits and wine. Solid share gains were achieved in spirits in the key off trade channel through a continued promotional strategy although key Diageo

Business review (continued)

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

Ireland Diageo's volume and net sales declined 6% and 8% respectively in Ireland, primarily driven by the weakness of the key on trade channel, but with share gains in beer and spirits. Guinness net sales decreased 5% but grew share, especially in the key Republic of Ireland on trade channel, where it has shown over 30 months of consecutive share growth, driven partly by the success of the '250th Celebration' campaign. Harp and Smithwicks also grew share following the successful launch of Harp Ice Cold and the repositioning of Smithwicks brand. Carlsberg performed broadly in line with the market while Budweiser lost share.

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

Eastern Europe Double-digit volume and net sales growth were delivered in Russia, reflecting the successful introduction of lower priced scotch brands into the market to appeal to value conscious consumers and maintain category participation. White Horse and Bell's captured this momentum, delivering strong volume and net sales growth. Captain Morgan also achieved good growth following the introduction of smaller sized bottles. In Eastern Europe, net sales declined as distributors and wholesalers continued to reduce their inventories and consumer demand remained weak. However, growth was achieved in certain countries on key brands, such as the double-digit net sales increase on Johnnie Walker Red Label in Poland and Bushmills in Bulgaria.

Other European markets In Greece, net sales declined 4% for the year. Growth in the first half and the resilience of Diageo's scotch brands partly offset the decline in the second half as the government introduced tough austerity measures and excise taxes on alcohol were increased 87%. In Northern Europe, net sales and volume declined 1%, driven by the competitive pricing environment in Germany. Captain Morgan grew volume and net sales strongly following the recent focus on the brand.

Brands and activities Johnnie Walker volume and net sales declined 6% and 4% respectively, driven by a weak performance in the first half in Eastern Europe and Russia. Price increases in Greece and the growth of Johnnie Walker Black Label in Spain, Greece and Turkey, led to 2 percentage points of positive price/mix. Similarly, Johnnie Walker Red Label showed a very strong performance in Spain and in Poland, gaining share and significantly growing volume and net sales.

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Business review (continued)

Smirnoff volume was flat and net sales were down 6%. This performance was driven by the sharp decline of the vodka category in Ireland and heightened competition in Poland, where local vodka brands returned to popularity during the economic downturn. Despite the difficult context, Smirnoff grew share in Ireland, driven by the on trade and extending its market leading position. In Great Britain, Smirnoff's largest European market, the brand lost share in the on trade but remained the best selling vodka and made strong share gains in the growing off trade.

Baileys increased volume 3% with net sales down 3%. A strong performance in Great Britain, its largest European market, with volume and net sales up 17% and 5% respectively, was driven by the double-digit growth in the off trade and the rapid growth of Baileys Flavours. The marketing strategy focused on in-store activity to improve visibility during key selling periods, such as the joint display of Baileys Original and Baileys Flavours. This performance was offset by weak results in Germany and the decline of the liqueurs category in Eastern Europe.

JεB remained in decline with volume and net sales down 8% and 10% respectively, following the continued weakness of the scotch category in Spain and the increased competition by local and own label whisky brands in this market.

Guinness volume and net sales declined across the region by 4% and 2% respectively, mainly caused by the decline of the on trade. In Great Britain, Guinness outperformed the beer category with broadly flat net sales and achieved its highest ever share of the on trade at 8% through the success of the 'Bring it to Life' and '250^{th} Celebration' campaigns. Share gains were also achieved in Ireland, led by the performance in the key Republic of Ireland on trade channel. Price/mix was positive mainly because of a price increase on Guinness Draught in Great Britain.

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

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

As consumer behaviours evolved in Europe, innovation remained a crucial performance driver with particular success in Great Britain, Spain and Russia. In Great Britain performance was driven by a full rollout on Baileys with a hint of Coffee, premix cans and Smirnoff flavoured vodka. The launch of Cacique Mojito ready to serve cocktails in Spain addressed the at home consumption trend. In Russia the launch of Bell's in the scotch value segment provided a lower priced alternative as consumers traded down from higher priced scotch brands.

The reserve brands grew in Europe focused on Diageo's single malt scotch brands and good growth was achieved on the Classic Malts range in France, Italy and Great Britain. Talisker and The Singleton of Dufftown also performed well, however Cardhu was impacted by the decline of the brand's principal on trade channel in Spain. Zacapa benefited from distribution gains across the region and grew net sales 19%.

Marketing spend was down 6% in response to the challenging trading conditions across the region and more particularly in Ireland, Iberia and Eastern Europe. It was increased selectively behind proven

Business review (continued)

campaigns on key brands such as Captain Morgan in Northern Europe, the launch of new flavours of Smirnoff in Great Britain and Johnnie Walker in Russia. Media rate deflation in the largest markets led to the realisation of savings on Guinness and Baileys.

Customer marketing initiatives were designed to ensure the right products are supplied, available and merchandised in the most effective manner in order to win at the point of purchase. The successful collaboration with key grocery customers continued with seasonal campaigns to increase sales at these key occasions.

International

Key highlights

Latin America and the Caribbean delivered 15% net sales growth, driven by scotch brands Johnnie Walker, Buchanan's and Old Parr

Growth of lager brands led to 10% net sales growth in Africa

Global Travel and Middle East returned to growth, led by the strong growth of premium and super premium brands

Marketing spend increased ahead of net sales behind the key categories of scotch, beer and vodka

Key measures	2010	2009	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			**9**	**8**
Net sales	**2,627**	2,286	**15**	**13**
Marketing spend	**302**	259	**17**	**13**
Operating profit before exceptional items	**771**	649	**19**	**25**
Operating profit	**766**	627	**22**	

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

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

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Business review (continued)

acquisitions and disposals decreased operating profit before exceptional items by £6 million and there was an organic increase in operating profit before exceptional items of £155 million.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	**7**	**9**	**7**	**11**
Other brands*	**9**	**19**	**10**	**19**
Total	**8**	**13**	**9**	**15**
Key brands**				
Johnnie Walker	**22**	**17**	**22**	**26**
Smirnoff	**7**	**7**	**7**	**18**
Baileys	**1**	**2**	**1**	**8**
Buchanan's	**11**	**15**	**11**	**13**
Guinness	**(6)**	**(1)**	**(6)**	**(8)**
Ready to drink	**(7)**	**7**	**(7)**	**10**

*

Other brands consist of local priority brands and category brands. Movements in organic volume, reported volume, organic net sales and reported net sales for local priority brands are 9%, 9%, 16% and 14%, respectively, and for category brands 9%, 11%, 21% and 22%, respectively. The classification of brands as local priority brands and category brands has been discontinued for reporting purposes.

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Spirits brands excluding ready to drink.

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

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

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

Africa Despite a challenging economic environment in South Africa, volume and net sales grew 1%. The scotch category was most affected by the reduction in consumer confidence, however Bell's

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Business review (continued)

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

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

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

Global Travel and Middle East GTME recovered well from the travel reduction in 2009, with volume growth of 15% and net sales growth of 19%. Marketing spend was increased significantly reflecting the important role of GTME as a brand and category building channel. A greater focus on priority customers, increased resources behind shopper understanding and a step-up in programmes to encourage consumers into stores all contributed to the success. The stand out brand performance was from Johnnie Walker, particularly Black Label where net sales grew 38%. The largest non-scotch brands, Baileys, Smirnoff, Captain Morgan and Tanqueray, also grew net sales. Innovation played a significant role in driving growth, especially the launch of Johnnie Walker Double Black and the sustained momentum of Johnnie Walker King George V and The Singleton single malt scotch.

Brands and activities Johnnie Walker volume grew 22% and net sales 17% with the rebound in performance from last year evident across Red, Black and Blue Labels. Negative price/mix reflected the reinstatement of promotional activity on scotch in Global Travel and price reductions on Johnnie Walker Red Label in Brazil. Johnnie Walker Red Label responded well to the 'Adventure in a Glass' global marketing programme activated across Latin America while improved trading with customers supplying the duty free outlets on the United States/Mexico border also contributed to the improved growth levels. The majority of growth of Johnnie Walker Black and Blue Labels was driven by GTME where the 'Walking with Giants' campaign was activated in 30 airports in the second half.

Volume and net sales of Smirnoff grew 7%, with the three largest markets of Brazil, South Africa and GTME all posting single-digit increases. In Brazil, a price increase partially offset the reduction taken in fiscal 2009, while strong marketing spend behind the Smirnoff 'Be There' campaign contributed to the brand returning to growth.

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Business review (continued)

Baileys net sales were up 2% across the region as good growth in the largest markets of GTME and Mexico of 7% and 10% respectively were partly offset by a slowdown in the Caribbean and Central America and an initial adverse impact due to a change of route to market for spirits in Nigeria.

Buchanan's volume and net sales grew 11% and 15% respectively and marketing spend was increased ahead of net sales supporting the 'Buchanan's Forever' programme, which, in its third year, featured sold out concerts in Caracas, Bogota and Mexico City. Father's Day and Whisky Festival promotions across Latin America contributed to improved net sales momentum in the second half.

Guinness volume declined 6% and net sales 1% as some consumers in Africa traded down to lower priced beers. In the largest markets of Nigeria, Cameroon and Ghana, the brand commands a price premium of upwards of 75% compared to mainstream lager brands. To support brand equity and this strong pricing position, marketing spend was significantly increased behind the '250th Celebration' in the first half and in strengthening the brand's association with football in the second half.

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

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

International was the largest contributor to Diageo's innovation net sales growth mainly due to new beer formats in Nigeria and Kenya and the introduction of super deluxe variants of scotch brands in the domestic markets of Latin America. The launch of premix cans in South Africa and Johnnie Walker Double Black in GTME both showed encouraging early results.

Reserve brands recovered from a difficult year in fiscal 2009 to deliver 9% net sales growth. GTME performed strongly as increased visibility of Johnnie Walker Blue Label, especially in Asian airports, led to strong growth. Higher up the price range, successful launch events for The John Walker gave the brand visibility in some of the most sought after top tier outlets across the region and most importantly attracted high net worth consumers to the brand. In Mexico, a focused strategy of expanding reserve brand distribution into high-end bars and increasing distribution in department stores led to a 44% increase in net sales.

Reflecting the region's focus on improving customer collaboration and shopper understanding, a dedicated customer marketing function was established in all three hubs. In Latin America and the Caribbean, the 'Ease of Shop' programme was rolled out across 3,500 stores. The Whisky Festival, activated in many markets across the region, was a great example of activating a category platform at scale. In South Africa, strategic partnerships were developed with key customers and Diageo now holds category captaincy positions in its top ten national accounts. Elsewhere in Africa the sales focus was on developing the capabilities of distributor partners. In Global Travel, Diageo has shown leadership in bringing together suppliers, airport authorities and retailers to deliver exciting category events to consumers, both in and out of store.

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Business review (continued)

Asia Pacific

Key highlights

Double-digit growth in South East Asia was driven by strong growth in Johnnie Walker and Guinness

Australia volume and net sales declined slightly driven by weakness of Bundaberg ready to drink in an increasingly competitive segment

Good depletions of Johnnie Walker and Windsor drove share growth in China as the scotch category returned to growth, although overall performance was held back by destock of Dimple

The scotch category was weak in Korea, however share gains extended Diageo's leadership position

A strong performance from The Singleton led to 10% net sales growth in Taiwan

India was impacted by a destock in the first half but the business performed more strongly in the second half

Marketing spend increased 3% with focused investment on Windsor, Guinness, Johnnie Walker and Smirnoff

Key measures	2010	2009	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			**2**	**2**
Net sales	**1,018**	910	**12**	**1**
Marketing spend	**233**	208	**12**	**3**
Operating profit before exceptional items	**176**	159	**11**	**6**
Operating profit	**146**	124	**18**	

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

Organic performance Exchange rate impacts increased net sales by £101 million and there was an organic increase in net sales of £7 million. Exchange rate impacts increased operating profit before

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Business review (continued)

exceptional items by £14 million and there was an organic increase in operating profit before exceptional items of £10 million.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	**5**	**3**	**5**	**14**
Other brands*	**(2)**	**(2)**	**(2)**	**10**
Total	**2**	**1**	**2**	**12**
Key brands**				
Johnnie Walker	**14**	**2**	**14**	**10**
Smirnof	**(5)**	**(1)**	**(5)**	**11**
Bundaberg rum	**(8)**		**(8)**	**22**
Windsor				**9**
Guinness	**2**	**13**	**2**	**27**
Ready to drink		**(4)**		**15**

* Other brands consist of local priority brands and category brands. Movements in organic volume, reported volume, organic net sales and reported net sales for local priority brands are 2%, 2%, 1% and 4%, respectively, and for category brands 3%, 3%, 6% and 16%, respectively. The classification of brands as local priority brands and category brands has been discontinued for reporting purposes.

** Spirits brands excluding ready to drink.

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

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

South East Asia South East Asia, which includes Vietnam, Malaysia and Indonesia, performed well, delivering double-digit volume and net sales growth. Negative price/mix was driven by the increase in the level of business done through third party distributors, which led to a reduction in net sales per case and some destocking of super deluxe brands. Johnnie Walker performed well, as a result of a 15% increase in marketing spend which focused on the 'Keep Walking' campaign and Grand Prix sponsorship, and drove both share gains and increased brand equity. Guinness posted strong performance and the brand's price premium drove strong price/mix backed by a significant increase in marketing spend behind the '250th Celebration' and sponsorship of World Series Pool in Indonesia.

Business review (continued)

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

China The second half performance in China was very strong although the destocking of Dimple in the first half of the year impacted overall performance, with volume down 1% and net sales down 2% for the full year. Global priority brands grew in China and the strong performance of Johnnie Walker Black Label, delivered over 2 percentage points of share in a scotch category which had returned to growth. Smirnoff and Baileys also performed well, albeit from a smaller base, as brand equity improved. Both brands increased share in their respective categories and trade investment efficiencies delivered positive price/mix. Increased focus behind Windsor delivered strong growth in volume and net sales. A double-digit increase in marketing spend focused on Johnnie Walker and Windsor increased Diageo's share of voice in the scotch category by 4 percentage points.

India The business in India was impacted by destocking in the first half following inappropriate shipments in the prior year. As a result both volume and net sales were down. Marketing spend as a percentage of net sales was also below last year as the business was rebased. Marketing spend was focused behind Johnnie Walker, Smirnoff and Vat 69 and investment behind sales capabilities accelerated. Price increases on Smirnoff and Vat 69 in the second half delivered price/mix improvement.

Rest of Asia Elsewhere in Asia there was strong growth of The Singleton of Glen Ord in Taiwan. In Japan net sales were down, however margins improved as the distribution of premium brands moved to the joint venture with Kirin.

Brands and activities Johnnie Walker volume grew 14%. Negative price/mix was a result of an increase of competitively priced promotions at Easter in Australia and increased sales through third party distributors in South East Asia and therefore net sales grew 2%. Marketing spend increased behind 'Keep Walking', Grand Prix sponsorship and gifting occasions in China and South East Asia and a major television campaign to drive the quality perception of the brand in Taiwan.

Smirnoff volume declined 5% driven by destocking in India and an increase in the competitive landscape in Australia. A price increase in Australia combined with a strong performance in Thailand and China broadly offset the volume decline with net sales down 1%. Marketing spend was directed towards the 'Be There' campaign and innovation. However total spend was down 9% as increased investment in South East Asia and Australia was offset by spend efficiencies in China and a reduction in line with the destock in India.

Bundaberg rum volume was down 8% due to a slowdown in the growth in dark spirits in the second half of the year, which led to more intense competition. A price increase held net sales for the year flat. Growth of Bundaberg Red mitigated some volume decline on the core brand.

Windsor volume and net sales were flat as increased distribution in China offset the decline caused by scotch contraction in Korea. The brand maintained category leadership in Korea, supported by increased investment in the new 'Diamond Jubilee Club' campaign, and grew volume share in China, as new packaging of Windsor XR combined with focused brand building activity increased brand equity, supporting further distribution expansion.

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Business review (continued)

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

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

Marketing spend grew 3%, primarily driven by increases in Korea, South East Asia and China. Investment increased behind the Johnnie Walker Grand Prix sponsorship and 'Keep Walking' campaigns and the Windsor 'Diamond Jubilee Club' programme, driving share gains in those markets. Marketing spend also increased behind Guinness, including the '250th Celebration', delivering a strong performance and share gains in Indonesia. In addition, investment increased behind Smirnoff innovation in South East Asia and Australia, whilst Baileys and J&B spend declined in the region.

Innovation was focused on increasing the accessibility of spirits with Smirnoff Cocktails in Australia and Johnnie Walker gift packs in key scotch markets. Bundaberg Red continued to perform well in Australia, a year after launch.

The performance of reserve brands in the region was mixed. The Singleton of Glen Ord in Taiwan delivered double-digit growth supported by television advertising, but this was more than offset by the destocking of super deluxe scotch in South East Asia and India.

Fiscal 2010 was the inaugural year for customer marketing in Asia Pacific and a dedicated team was established across the region. The strong on trade bias in the region was the focus of this customer marketing activity with investments behind bar staff training across the region, an on trade solutions website in Australia which was used by about 75% of Diageo's on trade accounts, and a Smirnoff versatility tool, 'Smirnoff Tower' in China and India. In the Thai off trade, 'Ease of Shop' was introduced and delivered increased spend per basket for customers and brand uplift for Diageo in the accounts where the programme was implemented.

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Business review (continued)

Operating results 2009 compared with 2008

Summary consolidated income statement

	Year ended 30 June 2009 (restated)	2008 (restated)
	£ million	£ million
Sales	**12,283**	10,643
Excise duties	**(2,972)**	(2,553)
Net sales	**9,311**	8,090
Operating costs	**(6,723)**	(5,800)
Operating profit before exceptional items	**2,588**	2,290
Exceptional items	**(170)**	(78)
Operating profit	**2,418**	2,212
Sale of businesses		9
Net finance charges	**(592)**	(319)
Share of associates' profits after tax	**164**	176
Profit before taxation	**1,990**	2,078
Taxation	**(286)**	(518)
Profit from continuing operations	**1,704**	1,560
Discontinued operations	**2**	26
Profit for the year	**1,706**	1,586
Attributable to:		
Equity shareholders	**1,605**	1,513
Minority interests	**101**	73
	1,706	1,586

Sales and net sales On a reported basis, sales increased by £1,640 million from £10,643 million in the year ended 30 June 2008 to £12,283 million in the year ended 30 June 2009. On a reported basis net sales increased by £1,221 million from £8,090 million in the year ended 30 June 2008 to £9,311 million in the year ended 30 June 2009. Exchange rate movements increased reported sales by £1,362 million and reported net sales by £1,095 million. Acquisitions increased reported sales by £160 million and reported net sales by £151 million for the year.

Operating costs before exceptional items On a reported basis, operating costs before exceptional items increased by £923 million in the year ended 30 June 2009 due to an increase in cost of sales of £624 million, from £3,254 million to £3,878 million, an increase in marketing expenses of £83 million, from £1,244 million to £1,327 million, and an increase in other operating expenses of £216 million, from £1,302 million to £1,518 million. The impact of exchange rate movements increased total operating costs before exceptional items by £926 million.

Exceptional operating items Exceptional items are those that, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information.

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Business review (continued)

Exceptional costs totalling £170 million, being £166 million in respect of the global restructuring programme and £4 million in respect of the restructuring of Irish brewing operations are included Diageo Annual Report 2010 within operating costs for the year ended 30 June 2009. Exceptional costs of £78 million in respect of the restructuring of Irish brewing operations were included within operating costs in the year ended 30 June 2008.

Post employment plans Post employment costs for the year ended 30 June 2009 were £63 million (2008 £53 million) of which £65 million (2008 £99 million) was included in operating costs and income of £2 million (2008 £46 million) was included in net finance charges. Exceptional pension curtailment gains were £32 million for the year ended 30 June 2009.

The deficit before taxation in respect of post employment plans increased by £975 million from £408 million at 30 June 2008 to £1,383 million at 30 June 2009. The increase in the deficit is primarily a result of a reduction in the value of the assets held by the plans, and a lower discount rate, partly offset by a lower inflation rate.

Operating profit Reported operating profit for the year ended 30 June 2009 increased by £206 million to £2,418 million from £2,212 million in the prior year. Exchange rate movements increased operating profit for the year ended 30 June 2009 by £152 million. Excluding exceptional costs, operating profit for the year ended 30 June 2009 increased by £298 million to £2,588 million from £2,290 million in the prior year. Exchange rate movements increased operating profit before exceptional items by £165 million.

Acquisitions Brand additions made in the year ended 30 June 2008, principally Ketel One vodka, Rosenblum Cellars wine and the distribution rights for Zacapa rum, contributed £151 million to net sales and £43 million to operating profit in the year ended 30 June 2009 in addition to the organic element.

Sale of businesses In the year ended 30 June 2008, a gain of £9 million arose from the sale of businesses.

Net finance charges Net finance charges increased from £319 million in the year ended 30 June 2008 to £592 million in the year ended 30 June 2009.

The net interest charge for the year ended 30 June 2009 increased by £175 million to £516 million from £341 million in the prior year. This increase resulted principally from the increase in net borrowings in the year, adverse exchange rate movements of £64 million and an increase in the adverse impact of the revaluation to year end market rates of interest rate swaps under IAS 39 of £8 million.

Net other finance charges for the year ended 30 June 2009 were £76 million (2008 net other finance income of £22 million). There was a reduction of £44 million in income in respect of the group's post employment plans from £46 million in the year ended 30 June 2008 to £2 million in the year ended 30 June 2009. Other finance charges also include £33 million (2008 £5 million income) in respect of exchange rate translation differences on inter-company funding arrangements that do not meet the accounting criteria for recognition in equity under IAS 21, £11 million (2008 £6 million) in respect of exchange movements on net borrowings not in a hedge relationship and therefore recognised in the income statement, £21 million (2008 £17 million) on unwinding of discounts on liabilities and £13 million (2008 £6 million) in respect of other finance charges.

Associates The group's share of associates' profits after interest and tax was £164 million for the year ended 30 June 2009 compared to £176 million in the prior year. Diageo's 34% equity interest in Moët

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Business review (continued)

Hennessy contributed £151 million (2008 £161 million) to share of associates' profits after interest and tax.

Profit before taxation Profit before taxation decreased by £88 million from £2,078 million to £1,990 million in the year ended 30 June 2009.

Taxation The reported tax rate for the year ended 30 June 2009 is 14.4% compared with 24.9% for the year ended 30 June 2008. Factors that reduced the reported tax rate in the year included settlements agreed with tax authorities that gave rise to changes in the value of deferred tax assets and tax provisions.

Discontinued operations In connection with the past disposal of the Pillsbury business, Diageo guaranteed debt of a third party until November 2009 and profit after tax from discontinued operations in the year ended 30 June 2009 of £2 million (2008 £2 million) represents a provision release in respect of this. In the year ended 30 June 2008 there was a £24 million tax credit relating to the disposal of the Pillsbury business.

Exchange rate and other movements Exchange rate movements are calculated by retranslating the prior year results as if they had been generated at the current year exchange rates and are excluded from organic growth.

The estimated effect of exchange rate and other movements on the results for the year ended 30 June 2009 was as follows:

	Gains/(losses) £ million
Operating profit before exceptional items	
Translation impact	**274**
Transaction impact	**(107)**
	167
Translation impact operating exceptional items	**(13)**
Total operating profit impact	**154**
Associates	
Translation impact	**30**
Interest and other finance charges	
Net finance charges transalation impact	**(66)**
Exchange in respect of IAS 21 and IAS 39	**(43)**
Mark to market impact of IAS 39 on interest expense	**(8)**
Total exchange effect on profit before taxation	**67**

	Year ended 30 June 2009	Year ended 30 June 2008
Exchange rates		
Translation £1=	**$1.60**	$2.01
Transaction £1=	**$2.29**	$1.90
Translation £1=	**€1.17**	€1.36
Transaction £1=	**€1.40**	€1.39

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Business review (continued)

Analysis by business area and brand

The organic movements for the year ended 30 June 2009 compared with the year ended 30 June 2008 are calculated using the same methodology as the organic movements for the year ended 30 June 2010 with the year ended 30 June 2009.

The organic movement calculations for volume, sales, net sales, marketing spend and operating profit before exceptional items for the year ended 30 June 2009 were as follows:

	2008 Reported units	Acquisitions and disposals(2) units	Organic movement units	2009 Reported units	Organic movement
	million	million	million	million	%
Volume					
North America	51.1	1.8	**0.1**	**53.0**	
Europe	41.6		**(2.6)**	**39.0**	**(6)**
International	38.6*		**(1.6)**	**37.0***	**(4)**
Asia Pacific	13.2		**(1.4)**	**11.8**	**(11)**
Total	144.5*	1.8	**(5.5)**	**140.8***	**(4)**

* Decreased by 0.5 million equivalent units from the figures reported for the years ended 30 June 2009 and 30 June 2008. All volume figures for the International region in this section have been amended accordingly.

	2008 Reported	Exchange(1)	Acquisitions and disposals(2)	Organic movement	2009 Reported	Organic movement
	£ million	£ million	£ million	£ million	£ million	%
Sales						
North America	2,965	715	149	**29**	**3,858**	**1**
Europe	4,046	353	7	**(127)**	**4,279**	**(3)**
International	2,376	192	3	**232**	**2,803**	**9**
Asia Pacific	1,168	99	1		**1,268**	
Corporate	88	3		**(16)**	**75**	
Total sales	10,643	1,362	160	**118**	**12,283**	**1**

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Business review (continued)

	2008 Reported £ million	Exchange(1) £ million	Acquisitions and disposals(2) £ million	Organic movement £ million	2009 Reported £ million	Organic movement %
Net sales						
North America	2,523	602	142	**23**	**3,290**	**1**
Europe	2,630	260	6	**(146)**	**2,750**	**(5)**
International	1,971	156	2	**157**	**2,286**	**7**
Asia Pacific	877	74	1	**(42)**	**910**	**(4)**
Corporate	89	3		**(17)**	**75**	
Total net sales	8,090	1,095	151	**(25)**	**9,311**	
Excise duties	2,553				**2,972**	
Total sales	10,643				**12,283**	
Marketing spend(4)						
North America	369	85	21	**(44)**	**431**	**(10)**
Europe	437	45	4	**(57)**	**429**	**(12)**
International	246	19	1	**(7)**	**259**	**(3)**
Asia Pacific	192	28		**(12)**	**208**	**(5)**
Total marketing spend	1,244	177	26	**(120)**	**1,327**	**(8)**
Operating profit(4)						
North America	928	180	45	**(15)**	**1,138**	**(1)**
Europe	788	73	(2)	**(6)**	**853**	**(1)**
International	576	10		**63**	**649**	**11**
Asia Pacific	159	(4)		**4**	**159**	**3**
Corporate	(161)	(94)		**44**	**(211)**	
Total operating profit before exceptional items	2,290	165	43	**90**	**2,588**	**4**
Exceptional items(3)	(78)				**(170)**	
Total operating profit	2,212				**2,418**	

Notes

(1)
The exchange adjustments for sales, net sales and operating profit are primarily the retranslation of prior period reported results at current period exchange rates and are principally in respect of the US dollar and the euro.

(2)
The impacts of acquisitions and disposals are excluded from the organic movement percentages. Acquisitions in the year ended 30 June 2008 that affected volume, sales, net sales and operating profit were Ketel One Worldwide BV, Rosenblum Cellars and the distribution rights for Zacapa rum. There were no disposals.

(3)

Operating exceptional items in the year ended 30 June 2009 comprised charges of £166 million in respect of the global restructuring programme and £4 million in respect of the restructuring of Irish brewing operations. Operating exceptional items in the year ended 30 June 2008 comprised restructuring costs for Irish brewing operations of £78 million.

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Business review (continued)

(4)

The figures for the years ended 30 June 2009 and 30 June 2008 have been restated following the adoption of the amendment to *IAS 38 Intangible assets and IFRS 8 Operating segments* and the change to the accounting treatment of returnables. See note 1 to the consolidated financial statements and page 35 for an explanation of the effect of the restatements.

Key brand performance

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Smirnoff	(2)	2	17
Johnnie Walker	(11)	(6)	4
Captain Morgan	3	7	29
Baileys	(10)	(9)	3
JεB	(13)	(12)	
Jose Cuervo	2	3	27
Tanqueray	(10)	(8)	12
Crown Royal North America	(1)	(1)	23
Buchanan's International	(15)	2	18
Windsor Asia Pacific	3	22	17
Guinness	(3)	4	16
Total key brands**	(5)	(1)	13

*

Volume movement is both reported and organic.

**

Spirits brands excluding ready to drink.

Smirnoff vodka: strong net sales growth in North America, International and Australia offset weakness in Europe. The performance of Smirnoff Black in all its markets along with price increases which were taken in the majority of markets delivered 4 percentage points of price/mix.

Johnnie Walker: the global economic environment had a significant impact on Johnnie Walker as it is the most global premium drinks brand. De-stocking, the reduction in travel which led to a decline in sales through travel retail outlets and a reduction in business entertaining and consumption in traditional on-trade outlets in Asia Pacific have led to a reduction in net sales.

Captain Morgan: strong performance mainly driven by share gains in North America which accounts for almost 90% of net sales. The successful introduction of the brand into markets in Europe and International has continued. Innovation with the launch of Captain Morgan 100 in North America, together with price increases drove overall price/mix improvement.

Baileys: weakness in Spain and de-stocking in many markets was partially offset by growth in Great Britain.

JεB: the weakness of the Spanish scotch category was the primary driver of the decline in JεB.

Jose Cuervo: share gains on Jose Cuervo Gold plus a successful launch of Jose Cuervo Silver in North America led to volume and net sales growth.

Tanqueray: weakness in North America drove overall performance although the brand grew in Europe and Asia Pacific.

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Business review (continued)

Crown Royal: volume reduction on the higher priced Reserve and Cask 16 variants led to a small decline in volume and net sales despite growth in Crown Royal.

Buchanan's: growth in the key markets of Venezuela, Mexico and Colombia was offset by the decline in the Caribbean and other Latin American markets. The brand continued to grow in North America and gained share. Price increases drove net sales growth.

Windsor: growth in Korea following the return to Diageo's normal route to market. The brand's share grew in Korea benefiting from a bottle re-design and also grew in China following its recent launch.

Guinness: strong growth in Africa with net sales up 18%. Its performance in Asia Pacific continued to improve and sales stabilised in Ireland. Out-performance in the declining Great Britain beer category delivered further share gains in that market.

Category summary

	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	(5)	(2)	(5)	11
Local priority brands*	(1)	1	5	24
Category brands*	(2)	4	(1)	17
Spirits**	(4)		(3)	16
Beer		5		16
Wine	1	(5)	2	12
Ready to drink	(11)	(8)	(11)	5

* Ketel One vodka and Rosenblum Cellars wine are included in local priority brands in North America and in category brands in other regions while Zacapa rum is reported in category brands globally.

** Spirits brand performance excludes ready to drink.

Spirits: Vodka net sales up 8% and rum net sales up 6% were the strongest categories in spirits. Scotch net sales declined 3% mainly as a result of de-stocking. The liqueurs category was weak as a result of de-stocking and declining consumer demand and net sales declined by 9%.

Beer: The strong performance of Diageo's beer brands in Africa was the key driver of the overall performance of beer. There was continued growth in Asia Pacific and while beer net sales declined in Ireland by 4% and in Great Britain by 1%, this performance was significantly stronger than that of the beer category in both countries.

Wine: The weakness of the higher priced wine segment in the US was the biggest contributor to the 5% overall decline in wine as the US accounts for over half of Diageo's total wine net sales. In contrast wine performed strongly in Great Britain and net sales grew 6%.

Ready to drink: The 2008 excise duty increase on ready to drink products in Australia drove much of the weakness in performance. While in International the segment continued to grow strongly, the planned de-stock of ready to drink brands in the US, together with weakness in the segment there and in Europe, contributed to the overall decline.

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Business review (continued)

Corporate revenue and costs Net sales decreased by £14 million in the year ended 30 June 2009 to £75 million, from £89 million in the prior year. Net operating costs before exceptional items increased by £50 million in the year ended 30 June 2009 to £211 million, from £161 million in the prior year.

Diageo undertakes the majority of its currency transaction hedging centrally and therefore £86 million of negative year on year transaction impact was taken to Corporate. In addition there was a negative year on year translation impact of £8 million in Corporate. The regions are reported using forecast transaction exchange rates with the difference between forecast and achieved rates being included in Corporate. This amounted to a benefit of £32 million in the year. There was a £12 million reduction in underlying Corporate net costs.

North America

Key highlights

- Despite the difficult economic environment, North America delivered net sales growth
- Total spirits volume grew 1% with 3 percentage points of price/mix. Smirnoff vodka, Captain Morgan and Jose Cuervo positioned in the more resilient premium segment contributed most to net sales growth
- Vodka remained the largest and most resilient of the major categories in the United States. Diageo out-performed the category as a whole, growing net sales 16% led by Smirnoff in the premium segment and Ciroc and Ketel One vodka at higher price points
- Stock levels of beer and malt based ready to drink brands were reduced adversely impacting mix
- Stock levels of spirits have reduced across the supply chain
- Innovation launches contributed significantly to overall performance as the focus on premium spirits line extensions and pre-mixed cocktails capitalised on consumer shifts
- Ketel One vodka performed ahead of expectations
- Marketing spend decreased as a result of media efficiencies and a refocus away from beer and ready to drink, however Diageo's share of voice in spirits improved
- Net sales growth of 7% in Canada was led by strong performances of Captain Morgan of 19% and Smirnoff vodka of 10%

Key measures	2009	2008	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			**4**	
Net sales	**3,290**	2,523	**30**	**1**
Marketing spend	**431**	369	**17**	**(10)**

Operating profit before exceptional items	**1,138**	928	**23**	**(1)**
Operating profit	**1,115**	928	**20**	

Reported performance Net sales increased by £767 million in the year ended 30 June 2009 to £3,290 million, from £2,523 million in the prior year. Reported operating profit before exceptional items increased by £210 million in the year ended 30 June 2009 to £1,138 million, from £928 million in the prior year. Operating profit increased by £187 million in the year ended 30 June 2009 to £1,115 million, from £928 million in the prior year.

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Business review (continued)

Organic performance The weighted average exchange rate used to translate US dollar sales and profit moved from £1 = $2.01 in the year ended 30 June 2008 to £1 = $1.60 in the year ended 30 June 2009. Exchange rate impacts increased net sales by £602 million, acquisitions increased net sales by £142 million and there was an organic increase in net sales of £23 million. Exchange rate impacts increased operating profit by £180 million, acquisitions increased operating profit by £45 million and there was an organic decrease in operating profit of £15 million.

Despite the economic climate, the total beverage alcohol market in North America grew in both volume and value. Within spirits, there has been a trend for consumers to trade out of the super and ultra premium segments and down to lower price segments; however the premium segment, where Diageo is most represented, has proved the most resilient and has gained share of the overall spirits category. As consumer demand slowed stock levels reduced in aggregate across the whole supply chain. Spirits stocks with distributors at the end of June 2009 were higher when compared to June 2008, although there has been a significant reduction in absolute levels since December. Stock levels held by retailers are down year on year. The planned beer and ready to drink stock reduction was completed successfully resulting in net sales declines of 6% in beer and 8% in ready to drink. The slowdown of the wine category, especially at price points above $25 per bottle has led to a decline in Diageo wine net sales of 7%. Overall price/mix of 1 percentage point was achieved by strong price increases in the first half on premium brands partially offset by negative mix driven by volume declines in the higher net sales per case scotch category and ready to drink segment.

Brand performance	**Organic volume movement**	**Organic net sales movement**	**Reported volume movement**	**Reported net sales movement**
	%	%	%	%
Global priority brands	**(2)**	**(2)**	**(2)**	**22**
Local priority brands*	**1**		**19**	**47**
Category brands*	**6**	**11**	**6**	**36**
Total		**1**	**4**	**30**
Key brands**				
Smirnoff	**1**	**6**	**1**	**30**
Johnnie Walker	**(6)**	**(8)**	**(6)**	**14**
Captain Morgan	**3**	**7**	**3**	**32**
Baileys	**(5)**	**(5)**	**(5)**	**16**
Jose Cuervo	**3**	**4**	**3**	**30**
Tanqueray	**(12)**	**(12)**	**(12)**	**10**
Crown Royal	**(1)**	**(1)**	**(1)**	**23**
Guinness	**(11)**	**(6)**	**(11)**	**15**
Ready to drink	**(10)**	**(8)**	**(10)**	**14**

* Brand additions in the year ended 30 June 2008 Ketel One vodka and Rosenblum Cellars wine are included in local priority brands while Zacapa rum is included in category brands.

** Spirits brands excluding ready to drink.

Smirnoff vodka grew as a result of higher marketing spend and price increases on Smirnoff Red. Marketing spend increased 2% behind core growth drivers reinforcing the quality message combined with investment behind innovation launches on the Smirnoff Flavours range.

Business review (continued)

Johnnie Walker was impacted by the economic climate that led to the total scotch category declining 3% in value with weaker performance in the deluxe segment. Johnnie Walker Red Label net sales declined 2% and Black Label declined 7% but both gained share of their segments while maintaining price premiums. In the super deluxe segment, Johnnie Walker Blue Label experienced double digit declines and marketing spend was re-directed towards Johnnie Walker Black Label Investment behind the 'Strides' marketing campaign and driving loyalty through relationship marketing have led to strong improvements across key brand equity measures.

Captain Morgan had a strong year, delivering volume and net sales growth and share gains. Four percentage points of positive price/mix was delivered through price increases on Original Spiced Rum and the launch of the higher priced Captain Morgan 100. Increased marketing spend behind the 'Got a little Captain in you' television campaign led to share gains in the rum category and improved brand equity scores.

The liqueur category has been among the hardest hit in the current economic environment and Baileys net sales declined but share was maintained. The decline of Original Irish Cream was partially offset by the successful launch of Baileys with a hint of Coffee.

Jose Cuervo grew volume 3% and net sales 4%. Share gains on Jose Cuervo Gold driven by an increase in distribution points and the launch of Jose Cuervo Silver more than offset weakness in the on-trade.

Tanqueray net sales declined 12% in line with volumes as price increases on the core London Dry variant were offset by faster declines on the higher priced variants Tanqueray No.10 and Rangpur. Marketing investment was reduced as spend was re-directed to fund proven growth drivers on other brands.

Crown Royal volume and net sales declined 1%. Positive net sales growth on the core variant was more than offset by the poor economic conditions impacting the higher priced Reserve and Cask 16 variants. Crown Royal in Canada under-performed the United States, as price increases were not followed by the competition leading to price gaps at retail that impacted volume.

Guinness net sales declined 6% as a result of three factors: the planned stock reduction, consumers trading out of the higher priced imported beer segment and into domestic beer, and overall weakness in the on-trade which particularly impacted keg volume. Price increases on both keg and packaged Guinness contributed 5 percentage points of price/mix.

Local priority brands grew volume 1% and held net sales flat driven by the organic contribution of Ketel One vodka and sales of Seagram's 7. This was offset by the decline in US wines, in particular on Chalone wines, as consumers traded down from higher price points. To offset this, Diageo wines increased promotional activity in the second half and launched a number of new products at price-points of $10 and below.

Category brand volume grew 6% and net sales grew 11% reflecting the opportunities presented by Diageo's broad brand range. Cîroc vodka continued its strong growth trajectory, as a result of the combination of Diageo, Sean Combs and the brand itself, and grew volume 137% and net sales 159%. At the other end of the pricing spectrum and capitalising on the consumer shift towards value brands were Gordon's gin with net sales up 9%, Gordon's vodka up 11% and Popov vodka up 14%.

Ready to drink net sales declined 8% as a result of segment decline and the planned stock reduction. Diageo continued to innovate in this segment with the launch of several new Smirnoff Ice

Business review (continued)

flavours and a range of ready to serve Smirnoff Cocktails, reflecting the trend for increased at-home consumption.

Marketing spend for the year decreased 10% due to a reduction of investment behind those brands and segments most impacted by the current economic climate and media rate deflation. While investment behind ready to drink, beer and Tanqueray decreased, proven growth drivers elsewhere in the brand range were fully supported, in particular on Captain Morgan, Cîroc vodka and innovation launches. Overall, Diageo's share of voice of total spirits advertising spend increased 4 percentage points.

Canada has also been affected by the global economic slowdown but it has not experienced contractions on the scale of the United States. Price increases on core spirits together with increased marketing spend behind Smirnoff and Captain Morgan delivered 7% net sales growth.

Gross margin was adversely affected by input cost increases, the negative mix effect of consumers trading down within brands and the volume decline of higher gross margin segments and categories such as ready to drink, scotch and liqueurs. Price increases on core variants taken in the first half plus reductions in overall marketing spend combined to deliver constant operating profit for the year.

Europe

Key highlights

- The region was severely impacted by the economic downturn, with conditions in Spain and Ireland deteriorating significantly

- Great Britain outperformed a declining total beverage alcohol market, growing net sales despite the difficult trading environment

- Russia net sales grew 1% following a strong first half although the worsening economic conditions in the second half led to consumers trading down, driving negative mix. In response to this trend, smaller bottle sizes at lower price points were introduced

- In a declining beer category, Guinness performed well with flat net sales across the region and grew share in the on-trade in Great Britain and Ireland supported by the 250th Anniversary and 'Alive Inside' campaigns

Key measures	2009	2008	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			(6)	(6)
Net sales	**2,750**	2,630	**5**	**(5)**
Marketing spend	**429**	437	**(2)**	**(12)**
Operating profit before exceptional items	**853**	788	**8**	**(1)**
Operating profit	**801**	788	**13**	

Reported performance Net sales increased by £120 million in the year ended 30 June 2009 to £2,750 million, from £2,630 million in the prior year. Reported operating profit before exceptional items increased by £65 million in the year ended 30 June 2009 to £853 million, from £788 million in the prior year. Operating profit increased by £91 million in the year ended 30 June 2009 to £801 million, from £788 million in the prior year.

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Business review (continued)

Organic performance The weighted average exchange rate used to translate euro sales and profit moved from £1 = €1.36 in the year ended 30 June 2008 to £1 = €1.17 in the year ended 30 June 2009. Exchange rate impacts increased net sales by £260 million, acquisitions increased net sales by £6 million and there was an organic decrease in net sales of £146 million. Exchange rate impacts increased operating profit by £66 million, acquisitions decreased operating profit by £2 million and there was an organic decrease in operating profit of £6 million.

In Great Britain net sales were up 2% driven by strong spirits and wine performance and Diageo gained share of beer in the on-trade and of spirits and wine in the off-trade. Bell's and Baileys performed strongly with both brands gaining share in the on-trade and off-trade following a robust Christmas. Smirnoff vodka net sales declined 3% as the brand came under increased pressure from heavily promoted competitor brands.

The performance in Ireland was impacted by the continued decline of the total beverage alcohol market where volume declined by 4% and value by 3%. Against this, Guinness net sales were flat as Diageo maintained investment behind the brand with the 250th Anniversary and the 'Alive inside' campaigns. For the second consecutive year Guinness grew share in the key Republic of Ireland and Northern Ireland on-trade channels.

In Spain volume was down 21% and net sales were down 20% in line with market trends following the steep decline in the economy from mid-November onwards. Rising unemployment, lower consumer confidence and spending power reduced demand across consumer categories and led to a shift from on-trade to off-trade impacting spirits consumption. Significant de-stocking occurred as limited credit availability in the market led to some wholesalers being unable to fund their stock.

In Russia volume was up 2% and net sales were up 1% following a strong first half performance. Johnnie Walker remained the key brand and accounted for almost 50% of net sales. Price/mix was down 1 percentage point as consumers traded down from deluxe to standard scotch and both Johnnie Walker Red Label and White Horse grew share. In many markets in Eastern Europe Diageo's key brands gained share.

Brand performance	**Organic volume movement**	**Organic net sales movement**	**Reported volume movement**	**Reported net sales movement**
	%	%	%	%
Global priority brands	**(8)**	**(6)**	**(8)**	**4**
Local priority brands	**(6)**	**(6)**	**(6)**	**4**
Category brands*	**(1)**	**(2)**	**(1)**	**8**
Total	**(6)**	**(5)**	**(6)**	**5**
Key brands**				
Smirnoff	**(8)**	**(6)**	**(8)**	
Johnnie Walker	**(5)**	**(4)**	**(5)**	**7**
Baileys	**(9)**	**(10)**	**(9)**	
JεB	**(13)**	**(13)**	**(13)**	
Guinness	**(6)**		**(6)**	**8**
Ready to drink	**(17)**	**(11)**	**(17)**	**(2)**

* Brand additions in the year ended 30 June 2008 Ketel One vodka, Rosenblum Cellars wine and Zacapa rum are included in category brands.

** Spirits brands excluding ready to drink.

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Business review (continued)

Smirnoff vodka net sales were down 6% with declines in Great Britain and Spain partially offset by net sales growth in Continental Europe. Smirnoff continued to be the number one premium spirit in Great Britain and grew share in Ireland.

Johnnie Walker net sales decreased by 4% mainly driven by the performance in Spain and Russia. The brand continued to perform well in Greece where Johnnie Walker Black Label grew net sales by 14% following the successful launch of the anniversary pack supported by the 'Strides' and 'Crossroads' campaigns. The brand benefited from price increases in all markets leading to positive price/mix in the region.

Baileys net sales were down 10%. The overall decline of the brand was mainly due to performance in Iberia, where net sales declined in line with the category. In Great Britain both Baileys Original and the Baileys Flavours variants grew volume and net sales with positive price/mix following the successful launch of Baileys Coffee.

J&B volume and net sales were down 13%, principally due to performance in Iberia where the economic environment has driven a significant decline in consumption and customer stock levels.

In Great Britain Guinness has now delivered 30 consecutive months of volume share growth in the on-trade and therefore despite the difficult on-trade beer segment, net sales of Guinness declined only 1%. In the second half net sales were flat, while the beer market continued to decline driven by the switch from on-trade to off-trade and the increase in beer duty. This share gain was driven by the execution of a new strategy to focus on less frequent purchasers, investment behind the 250th Celebration and the '17:59' and 'Alive inside' campaigns. In Ireland net sales were also flat and Guinness grew share in key on-trade channels.

Local priority brand net sales were down 6% driven by Cacique and Cardhu in Iberia and the agency beer brands in Ireland partially offset by Harp, which benefited from the continued rollout of Harp Ice Cold. Bell's had good net sales and volume growth in Great Britain, driven by the launch of Bell's Original supported by a marketing programme called 'The Spirit of Arthur Bell' which included television, newspaper and direct mail advertising.

Category brand volume was down 1% and net sales were down 2% with declines in most markets offset by growth in Blossom Hill in Great Britain and growth of White Horse scotch in Russia.

Ready to drink volume was down 17% as the segment continued to decline. Smirnoff Ice volume was down 20% in Great Britain although the brand grew share in the on-trade.

Marketing spend was down 12% across the region particularly driven by Spain and Ireland, countries where the economic conditions were harder and the beverage alcohol consumption declined more significantly.

International

Key highlights

- Volume growth in Africa and price increases in both Africa and Latin America drove net sales growth of 7%
- Volume and net sales growth in Venezuela, Mexico and Brazil, the three largest markets in Latin America offset declines in the duty free channel in Latin America and in the Caribbean
- Strong growth in beer with volume up 5% and net sales up 17%

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Business review (continued)

Pressure on the Global Travel business due to declining passenger numbers and customer de-stocking

Marketing spend efficiencies in Latin America and the transition of spend on ready to drink, cider and beer brands into the new South Africa joint venture offset increases on beer and ready to drink elsewhere in Africa

Key measures	2009	2008	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			(4)	(4)
Net sales	2,286	1,971	16	7
Marketing spend	259	246	5	(3)
Operating profit before exceptional items	649	576	13	11
Operating profit	627	576	9	

Reported performance Net sales increased by £315 million in the year ended 30 June 2009 to £2,286 million, from £1,971 million in the prior year. Reported operating profit before exceptional items increased by £73 million in the year ended 30 June 2009 to £649 million, from £576 million in the prior year. Operating profit increased by £51 million in the year ended 30 June 2009 to £627 million, from £576 million in the prior year.

Organic performance Exchange rate impacts increased net sales by £156 million, acquisitions increased net sales by £2 million and there was an organic increase in net sales of £157 million. Exchange rate impacts decreased operating profit by £5 million and there was an organic increase in operating profit of £57 million.

Continued strong performance in Africa and net sales growth in Latin America drove International performance as Global Travel was impacted by the global economic weakness.

In International 70% of scotch net sales are in Latin America where significant price increases were taken in the first half to offset the impact of major devaluations of local currencies. The strengthening of the US dollar particularly impacted the US dollar priced duty free business in the region. In the second half a number of these currencies have strengthened easing volume pressure, and prices have been moderated in line with the currency movement. In Venezuela, Mexico and Brazil volume and net sales grew with strong performances of Buchanan's, Johnnie Walker and Smirnoff ready to drink.

Similarly Africa accounts for 90% of beer net sales in the region and performed strongly driven by Guinness, local beer brands and a strong innovation pipeline. Although growth slowed in the second half of the year as the region started to be impacted by the global economic downturn, volume was up 2% and net sales grew 16%.

Global Travel continued to be impacted as global economic weakness led to a decline in passenger numbers and de-stocking in travel retail. Lower volume in the super deluxe segment led to negative

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Business review (continued)

mix. In the Middle East, volume grew 3% and net sales grew 6% primarily from the growth in standard scotch.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	(5)	5	(5)	12
Local priority brands		9		20
Category brands	(5)	11	(5)	20
Total	(4)	7	(4)	16
Key brands*				
Smirnoff		9		17
Johnnie Walker	(12)	(3)	(12)	2
Baileys	(16)	(11)	(16)	(5)
J£B	(15)	2	(15)	18
Guinness	3	15	3	28
Ready to drink	6	13	6	23

*

Spirits brands excluding ready to drink.

Smirnoff vodka volume was flat and net sales were up 9%. Volume performance was driven by growth in Brazil and South Africa offset by declines in the Global Travel and Middle East business and the Caribbean. Net sales growth was driven by price increases in Brazil and South Africa.

Johnnie Walker volume declined by 12% and net sales by 3%. Johnnie Walker Red Label grew net sales following strong growth in Mexico while Johnnie Walker Black Label net sales were flat. Super deluxe variants net sales declined as growth in Latin America, Africa and the Middle East was offset by declines in Global Travel.

Baileys net sales declined 11% as growth in Venezuela and Africa was offset by the slowdown in the duty free channel.

Buchanan's net sales grew by 2% with strong volume and net sales growth in Venezuela, the brand's biggest market with net sales up 24% and in Mexico where net sales were up 28%. Volume and net sales saw declines in the duty free channel in Latin America as a result of de-stocking and credit and currency issues impacted performance.

Guinness volume was up 3% and net sales grew 15% driven by the continued performance of the brand in Africa where volume was up 4% and net sales up 18%. Strong double-digit net sales growth was achieved in Nigeria, Ghana and East Africa supported by on-trade promotion around English Premier League football.

Local priority brands net sales grew 9% with consistent performance across many markets. There was 8% volume and 15% net sales growth in Africa, notably from Malta Guinness in Nigeria, Pilsner and Tusker in East Africa and Bell's in South Africa. Price increases across the region offset the impact of the volume decline on scotch in Latin America.

Category brand net sales were up 11% primarily as a result of Harp in Nigeria, Cacique in Venezuela, Senator in East Africa and Star in Ghana. Ready to drink volume increased by 6% and net sales grew 13% on price increases on Smirnoff ready to drink brands in most markets and volume gains

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Business review (continued)

in Latin America, especially Brazil, and in Nigeria. Volume growth in Brazil, Nigeria and Cameroon offset a volume decrease in South Africa where the ready to drink segment declined compared to the prior year.

In a tough trading environment East Africa grew net sales 6%. Excise duty increases on non-malted beer led to declining volumes of Allsopps and Citizen though overall beer volumes were up driven by Guinness, Tusker and Senator. Further excise duty increases negatively impacted the spirits category with total spirits net sales declining 8%.

Nigeria had a strong performance with volume up 22% and net sales up 30% driven by Guinness, Malta Guinness and Harp which all took price increases in the period. Smirnoff Ice performed well with volume up over 50% while Malta Guinness continued to benefit from the bottle relaunch in 2008.

South Africa's global and local priority brands grew whilst category brands declined as a result of the focus on driving value in scotch. Smirnoff vodka drove global priority brand growth while growth in local priority brands was driven by Bell's, which grew share and maintained its position as the number one scotch in South Africa.

Ghana faced a challenging year as a result of the economic environment and water shortages in the first half which led to constrained production and a full year volume decline of 6%. Strong pricing led to net sales growth of 24% as price increases were taken to cover off the increase in cost of goods arising as a result of the devaluation of the Cedi.

Cameroon performed well with volume up 17% and net sales up 19%. Volume performance was driven by Guinness, Saltzenbrau and the successful launch of Smirnoff Ice in November. Net sales grew two percentage points ahead of volume as price increases on Guinness offset the small price decrease on Malta Quench, which brought it in line with competitor brands.

In Mexico strong volume and net sales growth of Johnnie Walker and Buchanan's drove overall scotch net sales up 38% and maintained Diageo's leadership position in the scotch category.

In Paraguay, Uruguay and Brazil volume declines in scotch were partially offset by growth in Smirnoff vodka while net sales grew as price increases, particularly on scotch brands were made in the individual markets. Positive channel mix with stronger volumes from the higher value Brazil domestic channel helped to grow the top line.

Strong performance of deluxe and super deluxe scotch along with Cacique growth ahead of the rum category drove volume and net sales growth in Venezuela. Johnnie Walker, Buchanan's and Old Parr all grew net sales by double digits as price increases were put through in line with Diageo's scotch strategy.

Marketing spend in the region declined by 3% as increased spend in Nigeria and Cameroon was offset by efficiencies in Latin America and the transfer of ready to drink, cider and beer brand spend to the new South African venture.

Asia Pacific

Key highlights

Net sales declines were primarily driven by the impact of the excise duty increase on ready to drink products in Australia

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Business review (continued)

Declining consumer confidence and supply chain inventory reductions have impacted performance particularly in China and South East Asia

Top and bottom line growth in Korea and share gains for Windsor following the return to in-market company distribution

Price/mix benefit of 7 percentage points came from the return to in-market distribution in Korea and strong price increases on scotch brands offset by negative product mix from lower volume in the higher net sales per case ready to drink segment

Marketing spend decreased 5% although investment behind spirits grew 7% reflecting the importance of this category to future growth of the region

Key measures	2009	2008	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			**(11)**	**(11)**
Net sales	**910**	877	**4**	**(4)**
Marketing spend	**208**	192	**8**	**(5)**
Operating profit before exceptional items	**159**	159		**3**
Operating profit	**124**	159	**(22)**	

Reported performance Net sales increased by £33 million in the year ended 30 June 2009 to £910 million, from £877 million in the prior year. Reported operating profit before exceptional items remained unchanged at £159 million in the year ended 30 June 2009. Operating profit decreased by £35 million in the year ended 30 June 2009 to £124 million, from £159 million in the prior year.

Organic performance Exchange rate impacts increased net sales by £74 million, acquisitions increased net sales by £1 million and there was an organic decrease in net sales of £42 million. Exchange rate impacts decreased operating profit by £6 million and there was an organic increase in operating profit of £4 million.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	**(14)**	**(8)**	**(14)**	**2**
Local priority brands	**(1)**	**8**	**(1)**	**8**
Category brands	**(10)**	**(8)**	**(10)**	**3**
Total	**(11)**	**(4)**	**(11)**	**4**
Key brands*				
Smirnoff	**1**	**13**	**1**	**24**
Johnnie Walker	**(20)**	**(12)**	**(20)**	**(1)**
Bundaberg rum	**17**	**29**	**17**	**34**
Windsor	**3**	**22**	**3**	**17**
Guinness	**5**	**6**	**5**	**20**
Ready to drink	**(26)**	**(22)**	**(26)**	**(17)**

* Spirits brands excluding ready to drink.

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Business review (continued)

Smirnoff vodka grew volume 1% and net sales 13% in the region led by a strong performance from Australia, which grew volume 12% and net sales 38%. Strong price/mix was delivered by price increases taken in the first half combined with positive mix from the strong volume growth of the higher priced Smirnoff Black variant due to the successful 'Bond' activation.

Johnnie Walker performance across the region was heavily impacted by the economic slowdown, which impacted consumer confidence and led to weakness in the on-trade and supply chain inventory reductions in key markets. Within the variants, Johnnie Walker Red Label performed well in the standard segment with net sales down 6% and grew share in its largest markets of Thailand and Australia. Johnnie Walker Black Label and super deluxe were down 13% as they were disproportionately affected by the weakness of the traditional on-trade in key markets such as China and South East Asia. The successful launch of Johnnie Walker Gold Label Reserve across the region provided a new premium offering for the brand and partially mitigated declines in the super deluxe segment.

Bundaberg rum in Australia benefited from consumers trading out of the ready to drink segment but remaining loyal to the brand, and delivered 17% volume growth. Price increases implemented in the first half taken together with the successful launch of the premium priced Bundaberg Red combined to deliver 12 percentage points of price/mix and share gains.

Windsor continued to grow share in its largest market of Korea, more than offsetting the scotch category decline and also benefited from the return of in-market distribution to deliver net sales growth of 23% in Korea. Price increases on the main 12 and 17 year-old variants plus the introduction of a new bottle design led to Windsor ending the year as the clear number one scotch brand in Korea having gained 5 percentage points of share.

Guinness grew net sales 6% as the brand proved resilient in the turbulent economic environment, growing 11% in its largest market of South East Asia.

Australia remained the key market for Diageo's ready to drink brands in Asia Pacific. A 70% duty increase on spirit-based ready to drink brands imposed by the Australian government in April 2008 resulted in a decrease of 27% in volume and 23% in net sales in Australia this year.

The impact of this duty increase was less severe in the final quarter as sales began to lap higher prices from the last financial year.

Local priority brands, mainly comprised of Windsor in Korea and Bundaberg in Australia, grew net sales 8%.

Category brands net sales declined 8% primarily as a result of volume decline in value scotch brands such as Haig in India and Spey Royal in Thailand in line with Diageo's scotch value strategy.

In Australia net sales declined 10% as the weakness in the ready to drink segment was partially offset by a 13% net sales increase on spirits. This was driven by share gains on Bundaberg and Johnnie Walker and a successful innovation programme on the Bundaberg and Smirnoff trademarks. Excluding ready to drink, Australia grew net sales 11%.

A full year of sales through the normal route to market in Korea had a positive effect on price/mix as volume was down 3% but net sales were up 16% reflecting higher net sales per case rates than in the comparable period. The two main brands in Korea, Windsor and Johnnie Walker, both grew volume and net sales, more than offsetting scotch category declines.

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Business review (continued)

In China, low consumer confidence levels severely impacted consumption occasions as consumers reduced purchase frequency, especially in the traditional on-trade channel which accounts for almost half of the sales of international spirits in the market. In addition, trade de-stocking at the secondary and tertiary tiers reduced volumes to wholesalers in the South and East of the country where Johnnie Walker is strongest. Net sales of brands through the Diageo China organisation grew strongly albeit from a low base as they derived the majority of sales through the modern on-trade channel which has been less impacted by the financial crisis.

In India net sales declined 3%. Inappropriately high stock levels across many brands at 31 December 2008 were de-stocked in the second half. For the full year the volume decline in Smirnoff and Haig was only partially offset by growth in Johnnie Walker, Shark Tooth and VAT 69.

Taiwan grew net sales 7%. Price increases on Johnnie Walker and the continued success of The Singleton roll out combined to outperform the 11% volume decline in the scotch category.

Thailand saw net sales decline 3% but recorded share gains on Johnnie Walker Red and Black Labels, Benmore and Smirnoff.

Marketing spend declined 5% overall as a result of the reduction in spend behind ready to drink in Australia. However, investment behind spirits increased 7% reflecting the benefit of the transfer of advertising spend back to the in-market company in Korea and the importance of this category to future growth.

Trend information

The following comments were made by Paul Walsh, chief executive of Diageo, in Diageo's preliminary results announcement on 26 August 2010:

'The impact of the global economic crisis varied by market and the strength of the recovery appears to be equally variable. However, as we demonstrated this year, the global diversity of our business, together with the strength and range of our brands and the agility we have demonstrated gives us confidence that in fiscal 2011 we will be able to improve on the organic operating profit growth we have delivered this year. We are recommending a 6% increase in the final dividend.'

Recent developments

On 25 August 2010, Lord Mervyn Davies of Abersoch was appointed a non-executive director of Diageo plc with effect from 1 September 2010.

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Business review (continued)

Liquidity and capital resources

Cash flow A summary of the cash flow and reconciliation to movement in net borrowings for the three years ended 30 June 2010 is as follows:

	Year ended 30 June		
	2010	2009 (restated)	2008 (restated)
	£ million	£ million	£ million
Operating profit after exceptional items	**2,574**	2,418	2,212
Depreciation and amortisation	**372**	300	248
Movements in working capital	**334**	(253)	(268)
Dividend income from associates	**111**	179	143
Other items	**(207)**	10	(10)

Cash generated from operations