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DIAGEO PLC
Form 6-K
February 13, 2009

List identifying information required to be furnished
by Diageo plc pursuant to Rule 13a-16 or 15d-16 of
The Securities Exchange Act 1934
12 February 2009

Information

Required by/when

Public Announcements/Press

The Stock Exchange, London

Announcement

Interim results for the six months ended 31 December 2008.
(12 February 2009)

FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Report of Foreign Issuer
Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

Diageo plc

(Translation of registrant's name into English)

8 Henrietta Place, London W1G 0NB

(Address of principal executive offices)

indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F

Form Form
20-F ☒ 40-F ☐

indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ☐ No ☒

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b):82
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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

Diageo plc

(Registrant)

Date 12 February 2009

By /s/S Arsenić

Name: S Arsenić

Title: Assistant Company Secretary

Half year results, six months ended 31 December 2008

In a difficult market environment Diageo has delivered 3% organic net sales growth, 6% organic operating profit growth, 21% reported eps growth and maintained its financial strength.

Results at a glance

		First half F'09	First half F'08	Reported movement	Organic movement
Volume in millions of equivalent units		78.5	78.9	(1)%	(2)%
Net sales after deducting excise duties	£ million	5,068	4,287	18%	3%
Operating profit before exceptional items	£ million	1,649	1,414	17%	6%
Operating profit	£ million	1,636	1,414	16%	6%
Profit attributable to parent company's equity shareholders 1	£ million	1,137	975	17%	
Basic eps 1	pence	45.6	37.6	21%	

1 For six months ended 31 December 2008 reported tax rate 15% (2007 tax rate 26%). Includes exceptional items.

Paul Walsh, Chief Executive of Diageo, commenting on the six months ended 31 December 2008 said:

“Diageo's performance in this first half again demonstrates the resilience we have from our brand range across categories, price points and geography. The global economic slowdown has affected business in the period and in November and December this impact was more pronounced. In this difficult market environment Diageo has delivered 3% organic net sales growth, 6% organic operating profit growth and 9% underlying eps growth and we have maintained our financial strength. We have delivered value in the half from the brands we have added, Ketel One, Rosenblum Cellars and Zacapa. In addition we have benefited from exchange rate movements given the scale of our business in the United States and Europe and a reduction in our tax rate. This has resulted in 21% growth in reported eps for the period.

“We have returned £0.9 billion to shareholders in the half. Our share buyback programme slowed as we maintained our conservative approach to balance sheet management.

“Current economic trends indicate that consumer confidence will reduce further and the outlook for the second half is more difficult to predict. However, across Diageo we have an experienced management team which combined with the consumer appeal of our brands, the effectiveness of our routes to market and our geographic diversity gives us confidence in our business. In the second half we will be yet more agile in our response to changing consumer demand and we will continue to invest behind our business while achieving efficiencies across the regions particularly in marketing spend where we are seeing strong media rate deflation. Given these strengths, albeit with more uncertainty about the wider economic environment, we believe we can deliver organic operating profit growth for the full year in the range of 4% to 6%. We will continue to preserve our advantaged financial position and therefore we would not envisage reopening the share buyback programme in the current calendar year.

“In the second half we will implement a restructuring programme designed to ensure that Diageo emerges from this challenging time with improved routes to market, even stronger brand positions and enhanced financial strength. Anticipated full year savings, in both cost of goods sold and overheads, of £100 million will accrue largely in fiscal 2010. Restructuring costs, amounting to approximately £200 million will be taken as an exceptional charge in

the second half. Continued positive exchange rate impacts and the lower tax rate mean that growth in reported eps after the exceptional item will be double digit ”.

Highlights

- New brand additions, primarily Ketel One, contributed £97 million to net sales and £46 million to operating profit
- Organic marketing spend decreased 1% as cost efficiencies were delivered from media rate deflation and spend on ready to drink was reduced
 - Organic operating margin improved a further 0.4 percentage points
- Exchange rate movements, excluding the impacts of IAS 21 and IAS 39, increased operating profit by £103 million and net finance charges by £49 million
- 9% underlying growth in eps before exceptional items using an underlying tax rate of 22% (2007 - 26%) and adjusted for foreign exchange and acquisitions
 - Free cash flow of £387 million
 - Interim dividend per share increased by 5.3% to 13.9 pence
- £879 million returned to shareholders: £527 million in dividends and £352 million of share buybacks

Unless otherwise stated in this announcement: net sales are sales after deducting excise duties; percentage movements are organic movements; commentary refers to organic movements and share refers to value share. See page 31 for additional information for shareholders and an explanation of non-GAAP measures including the reconciliation of basic eps to underlying eps.

Regional summary

North America – Benefiting from brand range and superior route to market to deliver growth as industry slows

- Volume up 2%
- Net sales up 4%
- Marketing spend down 6%
- Operating profit up 7%

In North America the worsening economic environment has increasingly impacted consumer demand in the period. While US spirits' industry volume growth has slowed, Diageo maintained its 30.4% share and continued to outperform major competitors. Spirits net sales grew 8% as a result of 3% volume growth and price increases. This was driven by the performance of Smirnoff, Captain Morgan, Crown Royal and Ciroc in the US and strong growth across spirits brands in Canada. Beer net sales declined 2% and ready to drink declined with net sales down 10%. Wine net sales were down 7% as the consumer slowdown has led to consumers switching to less expensive wine varieties.

The new brand additions Ketel One, Rosenblum Cellars and Zacapa have all performed well and delivered £92 million of net sales in the half.

Marketing spend was down as a result of the decision to reduce spend on ready to drink brands and as a result of the deflation in media rates. This was partially offset by increased activity on spirits brands especially Smirnoff, Jose Cuervo, Captain Morgan and Ciroc.

Europe - Economic conditions in Spain deteriorated and beer markets were weak

- Volume down 5%
- Net sales down 3%
- Marketing spend down 4%
- Operating profit down 4%

The overall performance in Europe was primarily driven by the weaker Spanish market. Net sales there declined 18% as the worsening economy led to a steep decline in consumer demand and reduced distributor and wholesaler ability to fund stock at previous levels. The weak beer market in Western Europe also impacted performance. This offset continued strong growth in Russia in the half and growth in Continental Europe. From a category perspective in Europe, spirits net sales were down 2%, beer was down 4%, ready to drink down 12% and wine down 2%. Overall net sales declined at a slower rate than volume as a result of price increases taken across the region, driving two percentage points of price/mix. Marketing spend has benefited from procurement efficiencies resulting from deflation in media rates.

International - Strong performance in Africa and price increases in Latin America drove net sales growth in the region

- Volume down 2%
- Net sales up 11%
- Marketing spend up 2%
- Operating profit up 11%

The International region is again the key contributor to Diageo's growth. The performance in Africa remained very strong and in the half net sales grew 20% primarily driven by the continued strong performance of Guinness up 25%. In Latin America Diageo's three largest markets, Venezuela, Brazil and Mexico each delivered double digit net sales growth. Elsewhere in Latin America and the Caribbean there has been an increasingly difficult trading environment as a result of slowing economic growth and currency devaluation, however Diageo has successfully managed these market conditions and delivered net sales growth primarily driven by price increases across the scotch brands in the region. However volume was impacted and led to the overall decline in volume in the region. The impact of the slowing global economy on travel has led to a significant slowdown in global travel retail and volume was down but net sales grew slightly. Following a number of years of building marketing spend to optimum levels in Latin America and Caribbean, spend in the half was in line with the prior period. In Africa marketing spend increased mainly behind the growth of scotch, beer and ready to drink brands.

Asia Pacific - Strong growth in spirits and beer across Asia Pacific offset by ready to drink decline in Australia post the excise duty increase

- Volume down 8%
- Net sales up 2%
- Marketing spend up 12%
- Operating profit down 5%

In Asia Pacific the decline in ready to drink in Australia, following a significant increase in duties for ready to drink at the end of the last financial year, reduced volume growth by 4 percentage points and net sales growth by 6 percentage points. The region delivered spirits net sales growth of 11% (excluding ready to drink) and 16% growth in beer. This led to further share gains across important categories such as scotch in China. The benefit of the return to in-market distribution in Korea was somewhat offset by the decline in the scotch category as a result of the marked economic slowdown there. Investment in the in-market organisation in China, India and Vietnam increased costs in the period, which contributed to the fall in operating profit.

Financial

- The deficit in respect of post employment plans increased by £69 million from £408 million at 30 June 2008 to £477 million at 31 December 2008. For the full year ending 30 June 2009, finance income under IAS 19 is expected to be minimal compared with the benefit of £46 million in the year ended 30 June 2008.
- In the six months ended 31 December 2008, exchange rate movements (excluding the exchange impact under IAS 21 and IAS 39) increased operating profit by £103 million and increased net finance charges by £49 million.
- For the year ending 30 June 2009, at current exchange rates, foreign exchange movements (excluding the exchange impact under IAS 21 and IAS 39) are forecast to increase operating profit by approximately £210 million and increase the interest charge by approximately £80 million.
- For the year ending 30 June 2010, at current exchange rates, foreign exchange movements (excluding the exchange impact under IAS 21 and IAS 39) are estimated to increase operating profit by £200 million and increase the interest charge by £30 million.

Brand summary

	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	(3)	3	(3)	16
Local priority brands**	(2)	3	6	26
Category brands**	(1)	5	(1)	17
Total	(2)	3	(1)	18
Key spirits brands*:				
Smirnoff	1	8	1	22
Johnnie Walker	(6)	5	(6)	14
Captain Morgan	7	13	7	33
Baileys	(5)	(2)	(5)	11
J B	(13)	(9)	(13)	3
Jose Cuervo	(2)	2	(2)	23
Tanqueray	(5)	(4)	(5)	15
Crown Royal - North America	6	6	6	29
Buchanan's – International	(9)	6	(9)	11
Windsor - Asia Pacific	(24)	31	(24)	23
Guinness	(1)	7	(1)	21
Ready to drink***	(15)	(12)	(13)	(2)

- * Spirits brands excluding ready to drink
- ** Brand additions Ketel One vodka and Rosenblum Cellars wine are included as local priority brands in North America and are reported as category brands in other regions. Zacapa rum is reported as a category brand globally.
- *** The transfer of Smirnoff ready to drink brands to the new joint venture company in South Africa has resulted in a difference between reported and organic volumes

Management reports

The interim report for the six months ended 31 December 2008 forms one of the management reports Diageo is required to publish under the EU Transparency Directive. Diageo will issue the next interim management statement on 7 May 2009. The year end preliminary results announcement will be issued on 27 August 2009.

BUSINESS REVIEW
For the six months ended 31 December 2008

OPERATING REVIEW – analysis by business area

North America

Summary:

- Growth of standard and premium spirits brands has driven overall growth
- Price increases across most brands drove net sales growth
- Innovation again drove significant net sales growth
- Marketing was refocused against changing consumer demand and media efficiencies were delivered
- The integration of Ketel One was completed and brand performance has benefited from integration into Diageo's distribution network

Key measures:

	First half F'09 £ million	First half F'08 £ million	Reported movement %	Organic movement %
Volume			6	2
Net sales	1,755	1,321	33	4
Marketing spend	237	201	18	(6)
Operating profit	682	491	39	7

Reported performance:

Net sales were £1,755 million in the six months ended 31 December 2008 up £434 million from £1,321 million in the comparable prior period. Reported operating profit increased by £191 million from £491 million to £682 million in the six months ended 31 December 2008.

Organic performance:

The weighted average exchange rate used to translate US dollar sales and profit moved from £1 = \$2.03 in the six months ended 31 December 2007 to £1 = \$1.66 in the six months ended 31 December 2008. Exchange rate impacts increased net sales by £274 million and acquisitions increased net sales by £92 million; there was an organic increase in net sales of £68 million. Exchange rate impacts increased operating profit by £108 million, acquisitions increased operating profit by £44 million and there was an organic increase in operating profit of £39 million.

Brand performance:	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	1	2	1	23
Local priority brands**	2	2	25	50
Category brands**	4	15	4	39
Total	2	4	6	33
Key spirits brands*:				
Smirnoff	4	13	4	36
Johnnie Walker	(1)	(3)	(1)	18
Captain Morgan	7	12	7	36
Baileys	-	3	-	23
Jose Cuervo	-	2	-	25
Tanqueray	(8)	(7)	(8)	13
Crown Royal	6	6	6	29
Guinness	(7)	(3)	(7)	16
Ready to drink	(12)	(10)	(12)	8

* Spirits brands excluding ready to drink

** Brand additions Ketel One vodka and Rosenblum Cellars wine, are included in local priority brands. Zacapa rum is included in category brands.

In the first half, volume growth of the beverage alcohol market in North America slowed. Growth has also shifted from the super and ultra premium segments to value and premium brands. Diageo's strong position in the premium segment has however driven volume growth of 3% in spirits, excluding ready to drink. Spirits' stock levels (measured as future days' sales) are estimated to have risen at the period end with higher distributor stock levels partially offset by lower retail stocks. The planned stock reduction in beer and malt based ready to drink brands was the main driver of a volume decline of 5% in beer and 12% in ready to drink. The slowdown in the wine category led to an 8% decrease in volume of Diageo wines. Price increases across many brands helped drive total net sales up 4% despite negative mix as a result of stronger growth in premium brands than deluxe brands. Innovation in the half drove 30% net sales growth led by Captain Morgan 100 and Baileys Coffee.

Smirnoff delivered another strong performance in the first half growing volume 4% driven by continued effective media campaigns that reinforced the quality message first endorsed by The New York Times blind taste test. The Smirnoff James Bond Campaign has promoted responsibility in addition to building brand equity. Price increases on approximately 80% of the volume together with mix improvements drove net sales growth of 13%. Smirnoff Flavours grew volume 12% on the introduction of two new flavours, White Grape and Passion Fruit. While Smirnoff is outperforming its major competitors, it lost some share to new premium brands and some lower end brands.

The scotch category declined as consumers traded out of super premium and deluxe segments. Johnnie Walker volume declined 1% and negative mix reduced net sales by 3%. Price increases were taken on 65% of volume increasing Johnnie Walker's price premium to competitors, however Johnnie Walker still gained 0.4 percentage points of share.

Captain Morgan volume grew 7% driven by the new launches of Captain Morgan 100 and Parrot Bay Key Lime. Price increases across over 50% of Captain Morgan Original Spiced rum volume led to net sales growth of 12% and Captain Morgan grew share 0.2 percentage points.

Baileys maintained volume in one of the most difficult segments of the spirits category gaining share of 0.4 percentage points. The introduction of Baileys Coffee with increased TV advertising and support for the launch over the holiday period offset a decline in Baileys Original and weakness in other Baileys Flavours. Price increases on Baileys Original drove net sales growth of 3%.

Jose Cuervo volume was flat despite growth in the premium segment through Jose Cuervo Classico. Price increases in most markets helped drive net sales growth of 2%. Share increased 0.4 percentage points, with Jose Cuervo Especial growing 1.8 percentage points.

Tanqueray volume declined 8% as it lapped the Rangpur launch of the previous period. Price increases only partially offset volume declines with net sales down 7%. The imported gin segment lost share to domestic gin, a reversal of last year's trend and Tanqueray lost 1.1 percentage points of share.

Crown Royal total volume increased 6% on the strong growth of Crown Royal Canadian Whisky. Lower volume growth on the higher marques, such as Crown Royal Cask 16, which lapped a successful initial launch, led to negative mix and therefore net sales also grew by 6% despite price increases taken on 85% of volume. Crown Royal remained the best performing Canadian whisky and gained share.

Guinness volume declined by 7% as the planned stock reduction was implemented. Price increases on over half the volume of packaged Guinness and on kegs led to a net sales decline of only 3%. Guinness share was down 0.1 percentage points.

Local priority brands grew both volume and net sales 2% driven by the performance of Crown Royal and good growth in Buchanan's, volume up 7% and net sales up 8%, and in Seagram's 7, volume up 3% and net sales up 11%, offset by the decline of US wine brands. Wine volume was down 10% while price increases led to 9% decline in net sales. Weakness in Beaulieu Vineyard, Sterling and Chalone was slightly offset by the introduction of an organic Sterling line.

The performance of Ketel One and Rosenblum Cellars has benefited from the integration into Diageo's superior distribution network in the US.

Category brand volume grew by 4% and net sales grew 15% driven by growth of the vodka category. In contrast to the consumer trend away from super and ultra premium brands to premium and value brands Ciroc achieved an outstanding performance as volume and net sales trebled albeit from a small base. Growth was also seen across Gordon's vodka, volume up 3% and net sales up 8%, Popov, volume up 8% and net sales up 15% and Bushmills, volume up 2% and net sales up 4%. Growth was tempered by a decline in Godiva and in Diageo's French Agency brands, which declined as consumers switched to domestic and less expensive varieties.

There has been an encouraging start for Zacapa with the brand seeded in high end and high volume on and off premise outlets.

Ready to drink volumes declined 12% driven mainly by the planned stock reduction in malt based ready to drink products and the overall decline in the segment. The introduction of three new Smirnoff Ice Flavours and the success of Smirnoff Cocktails led to mix improvement and net sales decreased by 10%.

The overall reduction in marketing spend reflects the decision to reduce spend on beer and ready to drink brands and marketing efficiency benefited from deflation in media rates. Spend on spirits brands increased by 1% focused on Smirnoff, Captain Morgan and Jose Cuervo. Spend was also increased on Ciroc, fuelling the strong performance of the brand. Tactical support at the local and regional level was increased on select value and popular brands to reflect changes in consumer demand.

Europe

Summary:

- Deteriorating economic situation in Spain was the key driver of the region's performance
- Volume decline in beer, however Guinness gained share both in Great Britain and in the on-trade in Ireland
 - Strong performance in Russia in the half
 - Spirits brands performed well in Great Britain

Key measures:

	First half F'09 £ million	First half F'08 £ million	Reported movement %	Organic movement %
Volume			(5)	(5)
Net sales	1,560	1,433	9	(3)
Marketing spend	248	228	9	(4)
Operating profit	534	509	5	(4)

Reported performance:

Net sales were £1,560 million in the six months to 31 December 2008 up by £127 million from £1,433 million in the comparable prior period. Reported operating profit increased by £25 million to £534 million in the six months to 31 December 2008. Exceptional costs of £13 million in respect of restructuring costs for the Irish brewing operations are included within operating expenses in the six months ended 31 December 2008. Reported operating profit excluding exceptional items increased by £38 million to £547 million in the six months ended 31 December 2008.

Organic performance:

The weighted average exchange rate used to translate euro sales and profit moved from £1 = €1.43 in the six months ended 31 December 2007 to £1 = €1.21 in the six months ended 31 December 2008. Exchange rate impacts increased net sales by £163 million. Acquisitions increased net sales by £4 million and there was an organic decrease of £40 million. Exchange rate impacts increased operating profit by £63 million. Exceptional costs decreased operating profit by £13 million and there was an organic decrease in operating profit of £25 million.

Brand performance:	Organic volume movement %	Organic net sales movement %	Reported volume movement %	Reported net sales movement %
Global priority brands	(5)	(2)	(5)	9
Local priority brands	(6)	(5)	(6)	7
Category brands**	(4)	(2)	(3)	10
Total	(5)	(3)	(5)	9
Key spirits brands*:				
Smirnoff	(4)	-	(4)	9
Johnnie Walker	2	7	2	23
Baileys	(5)	(4)	(5)	7
J B	(13)	(12)	(13)	2
Guinness	(8)	(2)	(8)	7
Ready to drink	(18)	(12)	(18)	(4)

* Spirits brands excluding ready to drink

** Brand additions Ketel One vodka, Rosenblum Cellars wine and Zacapa rum are included in category brands.

In Europe the worsening economic environment has led to a decline in beverage alcohol consumption in many markets and has led to further momentum behind the switch from on-trade to off-trade. Diageo's performance reflects this wider trend, however it also reflects out-performance in Great Britain, continued positive performance in Continental Europe and strong growth in Russia. Price increases offset duty increases and delivered 2 percentage points of price/mix.

In Great Britain net sales were down 1% driven by the decline in the beer category and in ready to drink offset by a strong spirits performance which benefited from price increases in the second half of the year ended 30 June 2008. Advertising and promotional spend also declined by 1% primarily as a result of Guinness lapping increased spend in the prior year during the Rugby World Cup.

Performance in Ireland was impacted by the further decline in the total alcoholic drinks market where volume declined 3% and sales declined 2%. Against this, Guinness net sales have grown 2% and share has increased in both the Republic of Ireland and Northern Ireland on-trade channels. Local priority beer brands net sales were down 6%. Harp gained share in the key Northern Ireland on-trade following the successful launch of Harp Ice Cold.

In Spain a gradual deterioration in trading conditions became a steep decline during November across virtually all consumer driven categories leading to a volume decline of 20% and a net sales decline of 18%. While J B has held share of scotch, consumers traded down particularly in the off-trade where value brands and the discount channel are gaining share.

Smirnoff volume was down 4% and net sales were flat driven by the brand's performance in Great Britain where volume was down 5% however net sales were up 2% as a result of price rises introduced in the second half of fiscal 2008. Despite increasing competition from value brands, Smirnoff maintained its position as the number one premium spirit in Great Britain. Elsewhere, volume growth in Continental Europe offset further volume declines in Ireland and Spain while price increases were achieved across the region.

Johnnie Walker volume was up 2% with strong performances in Continental Europe and Russia partly offset by a decline in Iberia. In Russia print and digital campaigns based on Johnnie Walker Strides drove volume of the trademark up 6% with a strong performance of Johnnie Walker Red Label. Johnnie Walker Black Label performed well in the Russian domestic market though overall volume was down due to de-stocking in the duty free channel. Net sales increased 7% as a result of the continuation of our scotch pricing strategy implemented in fiscal 2008.

Baileys volume was down 5% and net sales down 4%. The overall decline is mainly due to the performance in Iberia where despite the weakness in the category Baileys has maintained share through relevant investment in key growth drivers. In Great Britain Baileys showed good volume and net sales growth in both the core brand and Baileys Flavours variants following introduction of a new bottle design and strong gifting focus.

J B volume was down 13% and net sales were down 12%. In Iberia J B volume declined 25% as a result of both the sharp and accelerated decline in consumption from November and the impact of Diageo's decision not to supply to a number of customers to minimise the risk of credit defaults.

Guinness volume was down 8% and net sales were down 2%. In Great Britain, against a declining beer market and a strong prior year including the positive impact of the Rugby World Cup, Guinness has achieved 24 consecutive months of share growth achieving its highest ever share of the beer market. This growth has been driven by a shift in strategy to focus on less frequent purchasers and through driving footfall into the on-trade supported by the successful execution of the 17:59 campaigns. Guinness in Ireland has maintained the strategy to invest behind strong share of voice growth through the 'It's Alive Inside' communications platform, helping to drive share gains in the key on-trade channels and overall year on year net sales growth for the brand.

Local priority brands volume was down 6% and net sales were down 5% driven by local beer brands in Ireland reflecting the decline in the category and Cacique and Cardhu in Iberia. Cacique was impacted in part by supply issues out of Venezuela whilst Cardhu performance suffered from the weak market and on-trade contraction in Spain.

Category brands have improved gearing as a result of the scotch pricing strategy and improved mix from Diageo's range of scotch brands.

Ready to drink volume has declined 18% versus the prior period driven by further segment weakness in Great Britain where Smirnoff Ice was down 23% but the brand gained share in the segment.

Marketing spend in Spain was reduced, though marketing as a percentage of net sales has increased. Spend was reduced on beer brands in Ireland in line with the category decline while spend was increased in Russia behind Johnnie Walker.

International

Summary:

- Strong performance in Africa and price increases across the scotch brands in International drove net sales growth of 11%
 - Continued strong performance by Guinness driving volume and net sales growth in Africa
- Marketing effectiveness in Latin America was offset by increased spend on scotch, beer and ready to drink in Africa

Key measures:

First half F'09 £ million	First half F'08 £ million	Reported movement %	Organic movement %
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Volume			(1)	(2)
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Net sales	1,237	1,050		
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The Company entered into a capital lease of approximately \$16.0 million in December 2005 for a new building in Florence, Italy, with subsequent build-outs which were completed in 2006. Key functions related to the Company's Italian operation are represented in this building, including design and merchandising. This transaction resulted in a capital lease obligation of \$19.8 million as of August 4, 2007. The Company entered into separate interest rate swap agreements designated as non-hedging instruments resulting in a fixed rate of 3.55%. These interest rate swap agreements mature through 2016 and convert the nature of the capital lease obligation from Euribor floating rate debt to fixed rate debt.

The fair value of the interest rate swap asset as of August 4, 2007 was approximately \$0.9 million.

(8) Stock-Based Compensation

The following table summarizes the stock-based compensation expense recognized under all of the Company's stock plans during the three and six months ended August 4, 2007 and July 29, 2006 (in thousands):

	Three Months Ended		Six Months Ended	
	Aug. 4, 2007	Jul. 29, 2006	Aug. 4, 2007	Jul. 29, 2006
Stock options	\$ 1,375	\$ 951	\$ 2,689	\$ 2,032
Nonvested stock awards/units	2,888	585	5,467	709
Employee Stock Purchase Plan	191	151	273	267
Total stock-based compensation expense	\$ 4,454	\$ 1,687	\$ 8,429	\$ 3,008

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$11.4 million and \$41.4 million, respectively, as of August 4, 2007.

The weighted average fair values of options at their grant date during the six months ended August 4, 2007 and July 29, 2006 were \$20.10 and \$11.19, respectively.

On January 1, 2007, the Company granted Paul Marciano, Chief Executive Officer and Vice Chairman, one million nonvested stock awards which are subject to certain performance-based vesting conditions over a five year period. On March 19, 2007, the Company made an annual grant of 206,500 stock options and 243,830 nonvested stock awards/units to its employees.

On August 6, 2007, the Company granted Carlos Alberini, President and Chief Operating Officer, 150,000 nonvested stock awards which are subject to certain performance-based vesting conditions over a four and one-half year period.

(9) Related Party Transactions

The Company is engaged in various transactions with entities affiliated with trusts for the respective benefit of Maurice and Paul Marciano, who are executives of the Company, Armand Marciano, their brother and former executive of the Company, and certain of their children (the Marciano Trusts).

The Company leases manufacturing, warehouse and administrative facilities from partnerships affiliated with the Marciano Trusts and certain of their affiliates. There were three of these leases in effect at August 4, 2007, with expiration dates in February 2008, July 2008 and December 2014.

Aggregate rent expense under the related party leases in effect was \$1.7 million for both of the six months ended August 4, 2007 and July 29, 2006. The Company believes the related party leases have not been significantly affected by the fact that the Company and the lessors are related.

The Company periodically charts aircraft owned by MPM Financial, LLC (MPM Financial), an entity affiliated with the Marciano Trusts, through an independent third party management company contracted by MPM Financial to manage its aircraft. Pursuant to the original arrangements with MPM Financial and The Air Group, Inc. (the Air Group), MPM Financial's original third party aircraft management company, the Company was entitled to receive a 10% discount from the standard hourly charter rates charged by the Air Group. The arrangements among the Company, MPM Financial and the Air Group were subsequently terminated and a new independent third party, Avjet Corporation (Avjet), has been engaged by MPM Financial to manage its aircraft. Under an informal arrangement with MPM Financial and Avjet, the Company has and may from time to time continue to charter aircraft owned by MPM Financial through Avjet at a discount from Avjet's preferred customer hourly charter rates. The total fees paid under these arrangements during the first six months ended August 4, 2007 and July 29, 2006, were \$0.4 million and \$0.2 million, respectively.

On January 1, 2003, the Company entered into a license agreement with BARN S.r.l. (BARN), an Italian corporation, under which the Company granted BARN the right to manufacture and distribute children's clothing in certain territories of Europe for a term of three years. The license agreement was amended as of June 19, 2006 to, among other things, extend the term until December 31, 2009. The license agreement has terms substantially similar to the Company's other license agreements. Two key employees of the Company's wholly-owned subsidiary, GUESS? Italia, S.r.l., own BARN. During the six months ended August 4, 2007 and July 29, 2006, the Company recorded \$0.8 million and \$0.6 million in revenues, respectively, related to this license. At August 4, 2007, the Company had \$0.3 million royalty receivables due from BARN. The

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receivables outstanding at February 3, 2007 were negligible.

These related party disclosures should be read in conjunction with the disclosure concerning related party transactions in the Company's Form 10-K for the year ended December 31, 2006.

(10) Commitments and Contingencies

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The Company leases its showrooms and retail store locations under operating lease agreements expiring on various dates through June 2018. Some of these leases require the Company to make periodic payments for property taxes, utilities and common area operating expenses. Certain leases include lease incentives, rent abatements and fixed rent escalations, which are amortized and recorded over the initial lease term on a straight-line basis. The Company also leases some of its equipment under operating lease agreements expiring at various dates through 2011.

Incentive Bonuses

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Certain officers and key employees of the Company are entitled to incentive bonuses, primarily based on net earnings of the Company or earnings of the particular operations impacted by these key employees. In addition, on September 27, 2005 the Compensation Committee of the Board of Directors of the Company approved performance criteria for the payment of special bonuses to Paul Marciano, Chief Executive Officer and Vice Chairman of the Board of the Company, under the Company's 2004 Equity Incentive Plan if the performance targets with respect to future earnings from operations for the Company's licensing segment are met. The Company recorded bonus related expense of \$0.7 million, including payroll taxes, in the six months ended August 4, 2007 related to these special licensing bonuses. If the pre-established licensing performance targets are achieved in calendar 2007 and 2008 and the Company receives a fixed cash rights payment of \$35.0 million due in 2012 from one of its licensees, the Company will record an expense of \$5.0 million in special bonus, plus applicable payroll taxes, which will be payable to Paul Marciano through January 2012.

Litigation

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On February 1, 2005, a complaint was filed by Michele Evets against the Company in the Superior Court of the State of California for the County of San Francisco. The complaint purported to be a class action filed on behalf of current and former GUESS? store managers in California. Plaintiffs seek overtime wages and a preliminary and permanent injunction. The Company answered the complaint on April 28, 2005. The parties participated in a voluntary mediation in August 2006 and in February 2007 executed a settlement agreement, which shall become effective upon final court approval. A hearing date for final court approval has been set for November 2007. During the third quarter of 2006, the Company accrued \$1.0 million related to net charges in connection with the proposed settlement arrangement.

In 2006, the Officers of the Florence Customs Authorities (Customs Authorities) began an import customs audit with respect to the Company's Italian subsidiary, Maco Apparel S.p.A. (Maco), in Florence, Italy, acquired on January 3, 2005. Maco was the Italian licensee of GUESS? jeanswear for men and women in Europe. As part of the audit, the Customs Authorities considered whether the Italian subsidiary should have included the royalty expense payable to Guess?, Inc., the parent company, as part of the cost of the product subject to customs duties. The Customs Authorities have subsequently reviewed specific transactions which occurred in 2003, 2004 and 2005 and provided a preliminary assessment that the royalty expenses are subject to customs duties and related penalties. The Company is disputing the Customs Authorities assessment and intends to vigorously defend its position. In addition, under the terms of the Maco purchase agreement, the seller is required to indemnify the Company for 90% of any loss with respect to Maco for periods prior to the acquisition. A hearing with the Florence Provincial Tax Commission has been set for October 29, 2007. The Company has concluded that the amount of any possible loss would not be material to the Company's consolidated financial statements and that the likelihood of incurring a loss is less than probable. Accordingly, no liability related to this matter has been accrued.

The Company is also involved in various other employment-related claims and other matters incidental to the Company's business, the resolution of which are not expected to have a material adverse effect on the Company's consolidated results of operations or financial position. With the exception of the class action accrual discussed above, no material amounts were accrued as of August 4, 2007 related to any of the Company's other legal proceedings.

Corporate Aircraft

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In May 2006, the Company entered into an agreement to acquire a new corporate aircraft with a scheduled delivery date in December 2007 and has made down payments of approximately \$16.5 million, with additional progress payments totaling \$2.4 million to be made through the expected delivery date. The Company is currently considering entering into a sale and leaseback arrangement on completion of construction of the aircraft.

(11)

Supplemental Executive Retirement Plan

The components of net periodic pension cost for the three and six months ended August 4, 2007 and July 29, 2006 were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	Aug. 4, 2007	Jul. 29, 2006	Aug. 4, 2007	Jul. 29, 2006
Service cost	\$ 53	\$ 35	\$ 106	\$ 70
Interest cost	431	295	862	590
Net amortization of unrecognized prior service cost	436	436	872	872
Net amortization of actuarial losses	145		290	
Net periodic defined benefit pension cost	\$ 1,065	\$ 766	\$ 2,130	\$ 1,532

As a non-qualified pension plan, no funding of the SERP is required. However, the Company expects to make annual payments into an insurance policy held in a rabbi trust to fund the expected obligations arising under the non-qualified SERP. The Company has made two payments into the policy as of August 4, 2007. The cash surrender value of the insurance policy was \$9.9 million as of August 4, 2007 and is included in other assets. The amount of future payments may vary, depending on the future years of service, future annual compensation of the participants and investment performance of the trust.

(12)

Focus Acquisition

Effective December 31, 2006, Guess?, Inc., through its wholly-owned subsidiary, GUESS? Europe, B.V. (Purchaser), completed the acquisition of 75% of the equity interest of Focus Europe S.r.l. (Focus) from Focus Pull S.p.A. (Seller). The Focus agreement also provides for the acquisition of 75% of the equity interest of Focus Spain S.A. (Focus Spain), subject to certain closing conditions.

Since 1997, the Company has licensed to Focus the right to manufacture, distribute and retail GUESS by MARCIANO contemporary apparel for women and men in Europe, the Middle East and Asia. The acquisition of the licensee is expected to further accelerate the Company's expansion in Europe.

The Focus purchase price was finalized in May 2007 in the amount of 18.4 million (\$24.3 million) after resolving certain purchase price contingencies with the Seller. The assets included in the Focus entity acquired at closing comprised inventories not older than one year, certain long term assets used to operate the business including leasehold interests related to four GUESS by MARCIANO stores and approximately 1.1 million (\$1.5 million) in cash to pay for certain acquired obligations. These obligations, that included certain royalties payable to the Company under the pre-existing license agreement and certain amounts due under a loan agreement, are explicitly limited to the 1.1 million (\$1.5 million) cash acquired. The Purchaser did not assume any trade receivables, other payables or other debt as part of the acquisition.

At closing, the Purchaser paid approximately 10.0 million (\$13.2 million) in cash and the Company issued 2.0 million (\$2.6 million) in Guess?, Inc. common stock based on the stock price at the closing date. After resolving the Focus purchase price contingencies, additional payments of 6.4 million (\$8.5 million) were paid to the Seller as of May 23, 2007.

The agreement also provides that at specific times during 2008, 2009 and 2010, Seller may require the Purchaser to acquire the remaining 25% of equity interests in Focus and Focus Spain for cash based upon a multiple of Focus consolidated net income for the immediately preceding fiscal year. The agreement further provides that, at a specific time in 2011, the Purchaser will have the option to purchase the remaining 25% of equity interest in Focus and Focus Spain for cash based upon a multiple of Focus consolidated net income for the immediately preceding fiscal year.

11

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The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition of Focus (in thousands):

	Dec. 31, 2006
Current assets	\$ 18,217
Property and equipment, net	1,609
Goodwill	4,590
Intangible assets	8,739
Total assets acquired	33,155
Current liabilities	(1,680)
Deferred Tax Liabilities	(4,547)
Minority interest	(4,148)
Net assets acquired, excluding cash of \$1.5 million	\$ 22,780

The \$8.7 million of acquired intangible assets primarily represents the acquisition value of the pre-existing license arrangement and lease acquisition costs, both of which are subject to amortization. The acquired intangible assets have a weighted-average useful life of approximately 4.0 years. The annual amortization expense over the next four years for these acquired intangible assets is estimated to be approximately \$2.2 million each year for fiscal 2008 through fiscal 2011 and is recorded as an expense in the European operations segment. Goodwill associated with this acquisition is recorded in the European operations segment and is non-deductible for tax purposes.

(13) Derivative Financial Instruments

The Company operates in foreign countries, which exposes it to market risk associated with foreign currency exchange rate fluctuations. The Company has entered into certain forward contracts and swaps to hedge the risk of foreign currency rate fluctuations. The Company has elected to apply the hedge accounting rules as required by SFAS No. 133 (SFAS 133), Accounting for Derivative Instruments and Hedging Activities, for certain of these hedges. The Company's objective is to hedge the variability in forecasted cash flow due to the foreign currency risk (USD/Canadian exchange rate) associated with certain anticipated inventory purchases on a first dollar basis for specific months.

The Company had USD forward contracts in Canada, totaling \$20.5 million at August 4, 2007, to hedge forecasted merchandise purchases that were designated as cash-flow hedges. The Company's derivative financial instruments are recorded on the consolidated balance sheet at fair value based on quoted market rates. These forward contracts are used to hedge forecasted merchandise purchases over specific months. Changes in the fair value of forward contracts designated as cash-flow hedges are recorded as a component of accumulated other comprehensive earnings within stockholders' equity, and are recognized in cost of goods sold in the period which approximates the time the hedged merchandise inventory is sold. An unrealized loss of approximately US\$1.4 million, net of tax, has been recorded in accumulated other comprehensive income at August 4, 2007, and will be recognized as a charge to cost of goods sold over the next thirteen months at the then current values, which can be different than the current quarter-end values. At August 4, 2007, the unrealized loss valuation of these forward contracts was approximately US\$1.8 million and was recorded in current liabilities on the consolidated balance sheet.

(14) Subsequent Events

On September 4, 2007, the Board of Directors declared a regular quarterly cash dividend of \$0.08 per share on the Company's common stock, an increase of 33.3% over the \$0.06 per share paid in the prior quarter. The dividend will be payable on October 5, 2007 to shareholders of record at the close of business on September 19, 2007.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

IMPORTANT NOTICE REGARDING FORWARD-LOOKING STATEMENTS

[illegible]

Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed. These forward-looking statements may include, among other things, statements relating to the Company's expected results of operations, the accuracy of data relating to, and anticipated levels of, future inventory and gross margins, anticipated cash requirements and sources, cost containment efforts, estimated charges, plans regarding store openings and closings, plans regarding business growth, E-commerce, business seasonality, industry trends, consumer demands and preferences, competition and general economic conditions. We do not intend, and undertake no obligation, to update our forward-looking statements to reflect future events or circumstances. Such statements involve risks and uncertainties, which may cause actual results to differ materially from those set forth in these statements. Important factors that could cause or contribute to such difference include those discussed under Item 1A. Risk Factors contained in the Company's most recent Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Summary

The business segments of the Company are retail, wholesale, European and licensing operations. Information relating to these segments is summarized in Note 6 to the Condensed Consolidated Financial Statements. The Company believes this segment reporting reflects how its four business segments are managed and each segment's performance is evaluated. The retail segment includes the Company's retail operations in North America. The wholesale segment includes the wholesale operations in North America, and internationally, excluding Europe. The European segment includes both wholesale and retail operations in Europe. The licensing segment includes the worldwide licensing operations of the Company. The business segments results exclude corporate overhead costs, which consist of shared costs of the organization. These costs are presented separately and generally include, among other things, the following unallocated corporate costs: information technology, human resources, accounting and finance, executive compensation, facilities and legal.

We derive our net revenue from the sale of GUESS? men's and women's apparel, MARCIANO women's apparel, G by GUESS men's and women's apparel, GUESS by MARCIANO men's and women's apparel, and our licensees' products through our worldwide network of retail stores, wholesale customers and distributors, as well as our on-line stores. We also derive royalty revenues from worldwide licensing activities.

Unless the context indicates otherwise, when we refer to we, us or the Company in this Form 10-Q, we are referring to Guess?, Inc. and its subsidiaries on a consolidated basis.

On January 18, 2007, the Board of Directors of the Company approved a change in the Company's fiscal year end from December 31 to the Saturday nearest January 31 of each year. The change, which aligned the Company's reporting cycle with the National Retail Federation, or NRF, fiscal calendar and is expected to provide for more consistent quarter-to-quarter comparisons, is effective for the Company's 2008 fiscal year. The Company's 2008 fiscal year began on February 4, 2007 and will end on February 2, 2008, resulting in a one-month transition period that began January 1, 2007 and ended February 3, 2007. The unaudited results of the one month ended February 3, 2007 were included in the Company's Form 10-Q filed on June 13, 2007. The audited results for the one month ended February 3, 2007 will be included separately in the Company's Annual Report on Form 10-K for the fiscal year ending February 2, 2008.

The quarter ended August 4, 2007 had the same number of days as the quarter ended July 29, 2006.

The Company reports NRF calendar comparable store sales on a quarterly basis for its full-price retail and factory outlet stores in the U.S. and Canada. A store is considered comparable after it has been open for 13 full months. If a store remodel results in a square footage change of more than 15%, or involves a relocation or a change in store concept, the store is removed from the comparable store base until it has been opened at its new size, in its new location or under its new concept for 13 full months.

Executive Summary

The Company

The Company's operations generated net earnings of \$37.5 million, or diluted earnings of \$0.40 per share, for the quarter ended August 4, 2007, compared to net earnings of \$20.6 million, or diluted earnings of \$0.22 per share, for the quarter ended July 29, 2006. All of our business segments contributed to this growth. The European segment was the largest contributor to the growth in revenues and earnings from operations, representing 46.8% of the consolidated revenue growth and 43.4% of the consolidated earnings from operations growth. These results also reflect higher comparable store sales growth, retail store expansion, and improved retail occupancy leverage in the U.S. and Canada. During the period, our wholesale business increased revenues, driven by our new South Korea operation and stronger product performance in North America. Our licensing business increased revenues across all key accessories categories and footwear.

Total net revenues increased 48.2% to \$388.3 million for the quarter ended August 4, 2007, from \$261.9 million for the quarter ended July 29, 2006, with all segments contributing to this improvement. Our European segment contributed almost half and our retail segment contributed more than a quarter of this revenue growth. Gross margin improved 250 basis points to 44.6% for the quarter ended August 4, 2007, compared to the same prior year period. The gross margin improvement was driven by the relative growth of the Company's European business, which yields a higher gross margin than the retail and wholesale segments, occupancy leverage in our retail segment and the favorable impact to revenues relating to gift card breakage (see below). SG&A expenses increased 48.7% to \$114.0 million for the quarter ended August 4, 2007 compared to \$76.7 million for the quarter ended July 29, 2006. This increase in SG&A expenses was driven by investments in new businesses, including Focus Europe S.r.l. (Focus), the Company's South Korea operation and the launch of our new G by GUESS concept, along with additional selling and merchandising costs, increased advertising and design costs, increased European infrastructure costs, and additional performance-based compensation expenses. As a percentage of revenues, SG&A expense was flat at 29.3% for the quarter ended August 4, 2007, compared to the prior-year period, reflecting the impact of higher expenses from our new investments offset by leveraging the fixed costs on increased sales volume in our existing businesses. Overall, the improved gross margin and flat SG&A spending as a percentage of net revenues resulted in an increase in the Company's operating margin to 15.3% for the quarter ended August 4, 2007, up 250 basis points from 12.8% for the quarter ended July 29, 2006. During the period, the Company completed its analysis of its unredeemed gift card liabilities for the U.S retail business and adopted the redemption method of accounting for gift cards. This resulted in a one-time increase to revenues for gift card breakage of \$3.1 million or \$0.02 per diluted share. Gift card breakage is income recognized due to the non-redemption of a portion of gift cards sold by the Company for which a liability was recorded in prior periods. The reduction in the effective tax rate to 39.1% for the quarter compared to 39.9% in the prior year quarter also contributed positively to the improvement in net earnings and diluted earnings per share.

The Company had \$200.5 million in cash and cash equivalents as of August 4, 2007, compared to \$196.0 million as of July 29, 2006. Total debt, including capital lease obligations, as of August 4, 2007, was \$21.2 million, down \$52.0 million from \$73.2 million as of July 29, 2006. The reduction of debt was driven primarily by the early redemption of the Company's 6.75% secured notes of \$32.8 million at the end of 2006. Receivables increased by \$77.8 million, or 71.4%, to \$186.9 million at August 4, 2007, compared to \$109.1 million at July 29, 2006. The increase in receivables primarily supported the revenue growth in Europe, including revenues from the recently acquired 75% interest in the Focus operation and the revenue growth in South Korea and Greater China. Inventory increased by \$93.9 million, or 70.9%, to \$226.4 million as of August 4, 2007, compared to \$132.5 million as of July 29, 2006. Approximately \$49.3 million of this increase was attributed to new businesses including Focus, our new South Korea operation, our Mexico and Greater China operations and our new G by GUESS store concept, with the remaining increase to support anticipated sales growth in our European and North American operations.

Retail

Our retail segment, comprising North American full-priced retail and factory outlet stores and E-commerce, generated net sales of \$201.6 million during the quarter ended August 4, 2007, an increase of 21.4% from \$166.1 million in the prior year period. This growth was driven by a comparable store sales growth of 16.2% and a larger store base, which represented a net 3.9% increase in average square footage compared to the quarter ended July 29, 2006. The increase in net revenue was primarily due to growth in our accessories, women's, men's, and footwear lines of business. Retail earnings from operations increased by \$6.9 million to \$27.8 million for the quarter ended August 4, 2007, compared to \$20.9 million for the quarter ended July 29, 2006. This increase was primarily driven by higher sales volume coupled with better store occupancy cost leverage and gift card breakage income, partially offset by increased spending to support a larger store base and investments in infrastructure to support our new G by GUESS brand initiative. For more details on gift card breakage income, see Application of Critical Accounting Policies. Operating margin increased 120 basis points to 13.8% in the quarter ended August 4, 2007, compared to 12.6% in the quarter ended July 29, 2006.

During the quarter, we opened 12 new stores and closed one underperforming store in the U.S. and Canada. At August 4, 2007, we operated 347 stores in the U.S. and Canada, comprised of 180 full-priced retail stores, 94 factory outlet stores, 32 Marciano stores, 16 GUESS? Accessories stores and 25 G by GUESS stores. This compares to 322 stores as of July 29, 2006. We have continued to develop the MARCIANO and GUESS? Accessories concept stores, and we believe that over time these concepts can grow to become significant chains in North America. The MARCIANO brand, a contemporary line that commands higher price points, is also available in approximately one third of our full-price GUESS? retail stores in the U.S. and Canada. G by GUESS, which launched early 2007, is a new brand and store concept that offers a full line of apparel for women and men and a full line of accessories and footwear to support the lifestyle of this customer and is aimed to capture a market demographic that is younger and shops price points between our factory and full-priced retail stores.

Wholesale

Wholesale segment revenues increased by \$24.5 million, or 74.5%, to \$57.3 million for the quarter ended August 4, 2007, from \$32.8 million for the quarter ended July 29, 2006. The increase in net revenues was primarily due to international expansion, including South Korea (which we began to operate directly in January 2007), which contributed more than half of this increase, coupled with growth in the North American wholesale business. Earnings from operations for the wholesale segment improved by \$4.8 million, or 89.0%, to \$10.2 million for the quarter ended August 4, 2007, from \$5.4 million for the prior year period, driven by increased sales unit volume and higher gross margin as a result of higher mark-ups, partially offset by increased spending on infrastructure to support growth of the new businesses in Asia. Operating margin increased 140 basis points to 17.8% in the quarter ended August 4, 2007, compared to 16.4% for the quarter ended July 29, 2006.

Europe

In Europe, revenues increased by \$59.1 million, or 121.2%, to \$107.9 million for the quarter ended August 4, 2007, compared to \$48.8 million for the quarter ended July 29, 2006. The majority of the revenue growth was generated by the European wholesale business, driven by continued growth in both our accessories and apparel businesses and our recent acquisition of a 75% equity interest in Focus, the Company's licensee for GUESS by MARCIANO contemporary apparel for women and men in Europe, the Middle East and Asia. At August 4, 2007, we directly operated 30 stores in Europe, which includes the four stores acquired as part of the Focus acquisition, versus 20 stores in the prior year quarter. Earnings from operations from our European segment increased by \$11.2 million, or 135.6%, to \$19.4 million for the quarter ended August 4, 2007, from \$8.2 million for the quarter ended July 29, 2006 due to the gross profit generated by the higher sales volume discussed above, partially offset by additional SG&A spending relating to selling expenses and our recent Focus acquisition. Operating margin increased 110 basis points to 18.0% in the quarter ended August 4, 2007, compared to 16.9% for the quarter ended July 29, 2006.

Licensing

Our licensing business revenues increased by \$7.2 million, or 51.1%, to \$21.5 million for the quarter ended August 4, 2007, from \$14.3 million for the quarter ended July 29, 2006. This increase was driven by growth in several product categories, especially handbags, watches, and footwear, and the increased recognition of licensing revenues as a result of the amortization of fixed cash rights payments received from licensees relating to previously renegotiated contracts based on the periods these contracts represent. The increase in net royalties was partially offset by the loss of royalty revenue from our GUESS by MARCIANO and South Korean licensees, both businesses which we now operate directly and are therefore no longer a part of the licensing segment. Licensing segment earnings from operations increased \$5.9 million, or 44.4%, to \$19.1 million for the quarter ended August 4, 2007, from \$13.2 million for the quarter ended July 29, 2006. Operating margin decreased 410 basis points to 88.7% in the quarter ended August 4, 2007 compared to 92.8% for the quarter ended July 29, 2006 due primarily to additional performance based compensation expense.

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Outside of the U.S. and Canada, during the quarter ended August 4, 2007, together with our partners we opened 38 new stores, including 15 in Europe, 22 in Asia and one store in Central America. We ended the quarter with 541 stores outside of the U.S. and Canada, of which 365 were GUESS? stores, 29 were GUESS by MARCIANO stores, 100 were GUESS? Accessories stores and 47 were concessions based in South Korea and China that are directly operated by the Company. Of the 541 stores, 87 were operated by the Company and 454 were operated by licensees or distributors.

Corporate Overhead

Corporate overhead increased by \$2.9 million, or 20.7%, to \$17.1 million for the quarter ended August 4, 2007, from \$14.1 million for the quarter ended July 29, 2006. This increase was primarily due to increased performance-based compensation costs.

Application of Critical Accounting Policies

Our critical accounting policies reflecting our estimates and judgments are described in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, in our Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC on March 1, 2007. With the exception of the adoption of FIN 48 in January 2007, the accounting for derivatives and the accounting for gift card breakage income discussed below, we have not changed those policies since such date.

The Company adopted FIN 48 in January 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 in the one month ended February 3, 2007. The adoption of FIN 48 did not have a material impact on the Company's financial position and results of operations. The Company's continuing practice is to recognize interest and penalties related to income tax matters in income tax expense. See Note 5 to the Condensed Consolidated Financial Statements for further information regarding the adoption of FIN 48.

The Company operates in foreign countries, which exposes us to market risk associated with foreign currency exchange rate fluctuations. The Company has entered into certain forward contracts and swaps to hedge the risk of foreign currency rate fluctuations. The Company has elected to apply the hedge accounting rules as required by SFAS No. 133 (SFAS 133), *Accounting for Derivative Instruments and Hedging Activities*, for certain of these hedges. The Company's objective is to hedge the variability in forecasted cash flow due to the foreign currency risk (USD/Canadian exchange rate) associated with certain anticipated inventory purchases on a first dollar basis for specific months. Changes in the fair value of forward contracts designated as cash-flow hedges are recorded as a component of accumulated other comprehensive earnings within stockholders' equity, and are recognized in cost of goods sold in the period which approximates the time the hedged merchandise inventory is sold.

The Company completed its analysis of unredeemed electronic gift card liabilities in the quarter ended August 4, 2007 for the U.S. retail business. Gift card breakage is income recognized due to the non-redemption of a portion of gift cards sold by the Company for which a liability was recorded in prior periods. Beginning with the quarter ended August 4, 2007, these amounts will be accounted for under the redemption recognition method and will be classified as additional net revenues as the gift cards are redeemed. The Company determined a gift card breakage rate of approximately 6.5% in the quarter ended August 4, 2007 based upon historical redemption patterns, which represented the cumulative estimated amount of gift card breakage from the inception of the electronic gift card program in late 2002. Based upon historical redemption trends, the Company recognized during the quarter a one-time cumulative increase to revenue of \$3.1 million or \$0.02 per diluted share. In future periods, the Company will recognize estimated gift card breakage as a component of net revenue in proportion to actual gift card redemptions, over the period that remaining gift card values are redeemed.

RESULTS OF OPERATIONS

Three months ended August 4, 2007 and July 29, 2006.

NET REVENUE. Net revenue for the quarter ended August 4, 2007 increased by \$126.4 million, or 48.2%, to \$388.3 million, from \$261.9 million for the quarter ended July 29, 2006. All segments contributed to this revenue growth with double-digit increases. Our European segment was the largest contributor to this revenue growth.

Net revenue from retail operations increased by \$35.5 million, or 21.4%, to \$201.6 million for the quarter ended August 4, 2007, from \$166.1 million for the quarter ended July 29, 2006. The increase was driven by a comparable store sales growth of 16.2% and an average of 22 net additional stores during the quarter ended August 4, 2007 resulting in a 3.9% increase in average square footage compared to the prior year period. Currency fluctuations accounted for \$2.1 million of the increase in net revenue relating to our Canadian retail stores.

Net revenue from wholesale operations increased \$24.5 million, or 74.5%, to \$57.3 million for the quarter ended August 4, 2007, from \$32.8 million for the quarter ended July 29, 2006. Approximately 85% of this revenue growth was generated outside of the U.S., primarily in Asia, including revenue from our new South Korean operation. Our North American wholesale net revenue growth was primarily attributable to strong product performance, which drove higher sales volume and higher margins. Our products were sold in the U.S. in approximately 954 doors at the end of the quarter, compared to 862 doors at the end of the prior year quarter. Currency fluctuations between the quarter ended August 4, 2007 and July 29, 2006 had a negligible impact on net revenue relating to our wholesale business.

Net revenue from European operations increased \$59.1 million, or 121.2%, to \$107.9 million for the quarter ended August 4, 2007, from \$48.8 million for the quarter ended July 29, 2006. The acquisition of a 75% equity interest in Focus contributed significantly to this revenue growth, combined with significant growth in our accessories and footwear businesses, growth in our core apparel business and new stores combined with positive same store sales growth in our existing retail stores. Currency fluctuations accounted for \$7.5 million of the increase in net revenue relating to our European operations.

Net royalty revenue from licensing operations increased \$7.2 million, or 51.1%, to \$21.5 million for the quarter ended August 4, 2007, from \$14.3 million for the quarter ended July 29, 2006. The increase was the result of the strength of the accessories business, particularly handbags, watches and footwear, and the recognition of additional licensing revenues as a result of the amortization of fixed cash rights payments received from licensees relating to previously renegotiated contracts based on the periods these contracts represent. Licensing revenues were negatively impacted by the acquisition of the GUESS by MARCIANO licensee and the non-extension of the South Korean licensee, since both businesses are no longer included in the licensing segment and the underlying sales are reported as revenue in the European and wholesale segments, respectively.

GROSS PROFIT. Gross profit increased \$63.1 million, or 57.1%, to \$173.4 million for the quarter ended August 4, 2007, from \$110.3 million for the quarter ended July 29, 2006. The increase in gross profit primarily resulted from sales growth in all segments.

- Gross profit for the retail segment increased \$17.0 million, or 28.4%, to \$77.0 million for the quarter ended August 4, 2007, from \$60.0 million for the quarter ended July 29, 2006, primarily due to higher sales volume, higher average selling prices and gift card breakage, partially offset by higher occupancy costs.
- Gross profit for the wholesale segment increased \$9.3 million, or 77.1%, to \$21.4 million for the quarter ended August 4, 2007, from \$12.1 million in the prior year period, primarily due to the increase in international sales volume and higher mark-ups.
- Gross profit for the European operations increased \$29.4 million, or 122.5%, to \$53.4 million for the quarter ended August 4, 2007, from \$24.0 million in the prior year period. The increase in our European gross profit improvement was primarily attributable to higher sales volume in the existing European operations and the acquisition of a 75% equity interest in Focus at the end of 2006.
- Gross profit for the licensing segment increased \$7.2 million, or 51.1%, to \$21.5 million for the quarter ended August 4, 2007, from \$14.3 million in the prior year period. The licensing gross profit improvement was

primarily the result of the strong sales performance of accessories, especially handbags, watches and our footwear lines.

Gross margin (gross profit as a percentage of total net revenues) increased 250 basis points to 44.6% for the quarter ended August 4, 2007, from 42.1% for the quarter ended July 29, 2006. The gross margin improvement was driven by the relative growth of the Company's European business, which yields a higher gross margin than the retail and wholesale segments, occupancy leverage in our retail segment and the favorable impact arising from the one-time gift card breakage adjustment.

The Company's gross margin may not be comparable to other entities since some entities include all of the costs related to their distribution in cost of product sales and others, like the Company, exclude the wholesale related distribution costs from gross margin, including them instead in selling, general and administrative expenses.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. SG&A expenses increased by \$37.3 million, or 48.7%, to \$114.0 million for the quarter ended August 4, 2007, from \$76.7 million for the quarter ended July 29, 2006. The increase was primarily attributable to an incremental \$13.5 million in spending required to support new businesses including Focus, the South Korea operation, additional infrastructure needed for the new G by GUESS brand initiative and expansion in Greater China and Mexico. In addition, the increase was also attributable to increased store selling, merchandising and distribution costs of \$11.7 million as a result of increased sales, incremental compensation expenses (primarily performance-based) of \$3.3 million, additional advertising and marketing spending of \$1.5 million and increased spending of \$3.3 million on European infrastructure costs. As a percentage of net revenue, SG&A expense was flat at 29.3% for both the quarter ended August 4, 2007 and the quarter ended July 29, 2006.

EARNINGS FROM OPERATIONS. Earnings from operations increased by \$25.7 million, or 76.4%, to \$59.4 million for the quarter ended August 4, 2007, compared with earnings from operations of \$33.6 million for the quarter ended July 29, 2006.

- The retail segment generated earnings from operations of \$27.8 million for the quarter ended August 4, 2007, versus earnings from operations of \$20.9 million for the quarter ended July 29, 2006. The increase was driven by the higher sales and improved gross margin discussed above, partially offset by an increase in SG&A expenses including store selling expenses and pre-opening costs to support the new G by GUESS brand initiative. Currency fluctuations accounted for \$0.5 million of the increase in earnings from operations for our Canadian retail stores.
- Earnings from operations for the wholesale segment were \$10.2 million for the quarter ended August 4, 2007, compared to earnings from operations of \$5.4 million for the quarter ended July 29, 2006. This increase was principally due to gross profit generated by incremental sales from our new South Korea operation and improved sales and gross margin in North America, partially offset by additional SG&A expenses in Asia, including South Korea, to build infrastructure in this region and support the increased sales.
- Earnings from operations for the European segment were \$19.4 million for the quarter ended August 4, 2007, compared to \$8.2 million for the quarter ended July 29, 2006. The increase was primarily due to higher sales in the existing accessories and apparel wholesale businesses combined with the sales resulting from our acquisition of a 75% equity interest in Focus in late 2006 and higher sales in our Company-owned retail business in Europe. Currency translation fluctuations accounted for \$1.5 million of the increase in earnings from operations for our European operations.
- Earnings from operations for the licensing segment increased to \$19.1 million for the quarter ended August 4, 2007, compared to \$13.2 million for the quarter ended July 29, 2006. The improvement was the result of higher revenues generated by our accessories product licensees and the recognition of additional licensing revenues relating to the amortization of fixed cash rights payments received from licensees relating to previously renegotiated contracts. These increases were partially offset by the loss of royalty revenue from the GUESS by MARCIANO and South Korean licensees in the period compared to the prior year period. The revenue growth was partially offset by an increase in performance-based compensation expense.
- Unallocated corporate overhead increased to \$17.1 million for the quarter ended August 4, 2007, compared to \$14.1 million for the quarter ended July 29, 2006, mainly due to higher performance-based compensation costs.

Higher gross margin (including the effect of the gift card breakage income), and a flat SG&A spending as a percentage of net revenues, resulted in an increase in operating margin of 250 basis points to 15.3% for the quarter ended August 4, 2007 from 12.8% for the prior year quarter.

INTEREST EXPENSE AND INTEREST INCOME. Interest expense decreased to \$0.4 million for the quarter ended August 4, 2007, compared to \$1.8 million for the quarter ended July 29, 2006, primarily due to the early redemption of the Company's 6.75% secured notes of \$32.8 million at the end of 2006. Total debt at August 4, 2007 was \$21.2 million, and was comprised of \$1.4 million of short-term bank debt from our European operations and \$19.8 million of capital lease obligations relating to our Italian facilities. On a comparable basis, the average debt balance for the quarter ended August 4, 2007 was \$29.3 million, versus an average debt balance of \$80.5 million for the quarter ended July 29, 2006. Interest income increased to \$2.0 million for the quarter ended August 4, 2007, compared to \$1.5 million for the quarter ended July 29, 2006, due to higher average invested cash balances and higher interest rates on this invested cash.

OTHER INCOME, NET. Other income was \$0.5 million for the quarter ended August 4, 2007, compared to \$0.8 million for the quarter ended July 29, 2006. Other income in the quarter ended August 4, 2007 consisted of gains related to changes in foreign exchange rates on forward contracts and other foreign currency transactions, and favorable changes in value of insurance policy investments.

INCOME TAXES. Income tax expense for the quarter ended August 4, 2007 was \$24.0 million, or a 39.1% effective tax rate, compared to income tax expense of \$13.7 million, or a 39.9% effective tax rate, for the quarter ended July 29, 2006. Generally, income taxes for the interim periods are computed using the effective tax rate estimated to be applicable for the full fiscal year, which is subject to ongoing review and evaluation by management. The decrease in the effective tax rate for the quarter ended August 4, 2007 was due to the relatively lower impact of permanent differences on our tax rate as our overall taxable income has increased.

NET EARNINGS. Net earnings increased by \$16.8 million, or 81.5%, to \$37.5 million for the quarter ended August 4, 2007, from \$20.6 million for the quarter ended July 29, 2006.

Six months ended August 4, 2007 and July 29, 2006

NET REVENUE. Net revenue for the six months ended August 4, 2007 increased by \$238.6 million, or 45.2%, to \$766.2 million, from \$527.6 million for the six months ended July 29, 2006. All segments contributed to this revenue growth with double-digit increases. The largest contribution to this revenue growth was generated by our European segment.

Net revenue from retail operations increased by \$64.1 million, or 20.2%, to \$381.1 million for the six months ended August 4, 2007, from \$317.0 million for the six months ended July 29, 2006. The increase was driven by a comparable store sales growth of 15.0% and an average of 22 net additional stores during the six months ended August 4, 2007 resulting in a 4.0% increase in average square footage compared to the prior year period. Currency fluctuations accounted for \$2.0 million of the increase in net revenue relating to our Canadian retail stores.

Net revenue from wholesale operations increased \$50.3 million, or 76.0%, to \$116.5 million for the six months ended August 4, 2007, from \$66.2 million for the six months ended July 29, 2006. Approximately 80% of this revenue growth was generated outside of the U.S., primarily in Asia, including revenue from our new South Korean operation. Our North American wholesale net revenue growth was primarily attributable to strong product performance, which drove higher sales volume and higher margins. Currency fluctuations between the six months ended August 4, 2007 and July 29, 2006 had a negligible impact on net revenue relating to our wholesale business.

Net revenue from European operations increased \$110.9 million, or 95.7%, to \$226.8 million for the six months ended August 4, 2007, from \$115.9 million in the prior year period. The acquisition of a 75% equity interest in Focus contributed significantly to this revenue growth, combined with significant growth in our accessories and footwear businesses, growth in our core apparel business and new stores combined with positive same store sales growth in our existing retail stores. Currency fluctuations accounted for \$18.2 million of the increase in net revenue relating to our European operations.

Net royalty revenue from licensing operations increased \$13.3 million, or 46.3%, to \$41.9 million for the six months ended August 4, 2007, from \$28.6 million for the six months ended July 29, 2006. The increase was the result of the strength of the accessories business, particularly handbags, watches, and footwear, and the recognition of additional licensing revenues as a result of the amortization of fixed cash rights payments received from licensees relating to previously renegotiated contracts based on the periods these contracts represent. Licensing revenues were negatively impacted by the acquisition of the Focus licensee and the non-extension of the South Korean licensee, since both businesses are no longer included in the licensing segment and the underlying sales are reported as revenue in the European and wholesale segments, respectively.

GROSS PROFIT. Gross profit increased \$119.9 million, or 54.2%, to \$340.8 million for the six months ended August 4, 2007, from \$220.9 million for the six months ended July 29, 2006. The increase in gross profit primarily resulted from sales growth in all segments.

- Gross profit for the retail segment increased \$31.5 million, or 28.5%, to \$141.8 million for the six months ended August 4, 2007, from \$110.3 million for the six months ended July 29, 2006, primarily due to higher sales

volume and higher average selling prices, partially offset by higher occupancy costs.

- Gross profit for the wholesale segment increased \$22.3 million, or 99.4%, to \$44.8 million for the six months ended August 4, 2007, from \$22.5 million in the prior year period, primarily due to the increase in international sales volume, higher mark-ups and increased sales in North America.
- Gross profit for the European operations increased \$52.8 million, or 88.7%, to \$112.3 million for the six months ended August 4, 2007, from \$59.5 million in the prior year period. The European gross profit improvement was attributable to higher sales volumes in the existing European operations and the acquisition of a 75% equity interest in Focus at the end of 2006.
- Gross profit for the licensing segment increased \$13.3 million, or 46.3%, to \$41.9 million for the six months ended August 4, 2007, from \$28.6 million in the prior year period. The licensing gross profit improvement was primarily the result of the strong sales performance of accessories, especially handbags, watches and our footwear lines.

Gross margin (gross profit as a percentage of total net revenues) increased 260 basis points to 44.5% for the six months ended August 4, 2007, from 41.9% for the six months ended July 29, 2006. The improvement in the overall gross margin was attributable to higher product margins in our retail segment due to higher mark-ups and gift card breakage income, improved occupancy leverage, higher mark-ups in our wholesale businesses and a higher mix of European net revenues, which generated a higher gross margin than the wholesale and retail segments.

The Company's gross margin may not be comparable to other entities since some entities include all of the costs related to their distribution in cost of product sales and others, like the Company, exclude the wholesale related distribution costs from gross margin, including them instead in selling, general and administrative expenses.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. SG&A expenses increased by \$70.5 million, or 46.0%, to \$223.5 million for the six months ended August 4, 2007, from \$153.0 million for the six months ended July 29, 2006.

The increase was primarily attributable to an incremental \$26.8 million in spending required to support new businesses including Focus, the South Korea operation, additional infrastructure needed for the new G by GUESS brand initiative and expansion in Greater China and Mexico. In addition, the increase was also attributable to additional store selling, merchandising and distribution costs of \$21.6 million as a result of increased sales, incremental compensation expenses (primarily performance-based) of \$8.7 million, additional advertising and marketing spending of \$5.0 million and increased spending of \$3.3 million on European infrastructure costs. As a percentage of net revenue, SG&A expenses increased 20 basis points to 29.2% for the six months ended August 4, 2007, compared to 29.0% for the six months ended July 29, 2006.

EARNINGS FROM OPERATIONS. Earnings from operations increased by \$49.4 million, or 72.7%, to \$117.3 million for the six months ended August 4, 2007, compared with earnings from operations of \$67.9 million for the six months ended July 29, 2006.

- The retail segment generated earnings from operations of \$47.7 million for the six months ended August 4, 2007, versus earnings from operations of \$34.6 million for the six months ended July 29, 2006. The increase in earnings from operations for the retail segment was driven by the higher sales and improved gross profit discussed above. The increase was partially offset by an increase in store selling expenses and pre-opening costs to support the new G by GUESS store concept. Currency fluctuations accounted for \$0.5 million of the increase in earnings from operations for our Canadian retail stores.
- Earnings from operations for the wholesale segment were \$20.9 million for the six months ended August 4, 2007, compared to earnings from operations of \$8.5 million for the six months ended July 29, 2006. This increase was principally due to incremental sales from our new South Korea operation and improved sales and gross margin in North America, partially offset by additional SG&A expenses in Asia, including South Korea, to build infrastructure in this region and support the increased sales.

- Earnings from operations for the European segment were \$47.1 million for the six months ended August 4, 2007, compared to \$25.2 million for the six months ended July 29, 2006. The increase was primarily due to higher sales in the existing accessories and apparel wholesale businesses combined with the sales resulting from our acquisition of a 75% equity interest in Focus in late 2006. In addition, our Company-owned retail business in Europe continued to improve, showing strong sales growth and higher profitability. Currency translation fluctuations accounted for \$3.9 million of the increase in earnings from operations for our European operations.
- Earnings from operations for the licensing segment increased to \$36.5 million for the six months ended August 4, 2007, compared to \$25.1 million for the six months ended July 29, 2006. The improvement was the result of higher revenues generated by our accessories product licensees and the recognition of additional licensing revenues relating to the amortization of fixed cash rights payments received from licensees relating to renegotiated contracts.

These

increases were partially offset by the loss of royalty revenue from the GUESS by MARCIANO and South Korean licensees in the period compared to the prior year period.

- Unallocated corporate overhead increased to \$34.8 million for the six months ended August 4, 2007, compared to \$25.5 million for the six months ended July 29, 2006, mainly due to higher performance-based compensation costs.

The higher gross margin, partially offset by increased SG&A spending as a percentage of net revenues, resulted in an increase in operating margin of 240 basis points to 15.3% for the six months ended August 4, 2007 from 12.9% for the prior year period.

INTEREST EXPENSE AND INTEREST INCOME. Interest expense decreased to \$1.3 million for the six months ended August 4, 2007, compared to \$3.3 million for the six months ended July 29, 2006, primarily due to the early redemption of the Company's 6.75% secured notes of \$32.8 million at the end of 2006. On a comparable basis, the average debt balance for the six months ended August 4, 2007 was \$41.7 million, versus an average debt balance of \$83.2 million for the six months ended July 29, 2006. Interest income increased to \$3.7 million for the six months ended August 4, 2007, compared to \$2.7 million for the six months ended July 29, 2006, due to higher average invested cash balances and higher interest rates on this invested cash.

OTHER EXPENSE, NET. Other expense was \$0.4 million for the six months ended August 4, 2007, versus income of \$1.1 million for the six months ended July 29, 2006. Other expense in the six months ended August 4, 2007 consisted of net losses related to changes in foreign exchange rates on forward contracts and other foreign currency transactions, and favorable changes in value of insurance policy investments.

INCOME TAXES. Income tax expense for the six months ended August 4, 2007 was \$46.4 million, or a 38.9% effective tax rate, compared to income tax expense of \$27.3 million, or a 39.9% effective tax rate, for the six months ended July 29, 2006. Generally, income taxes for the interim periods are computed using the effective tax rate estimated to be applicable for the full fiscal year, which is subject to ongoing review and evaluation by management. The decrease in the effective tax rate for the six months ended August 4, 2007 was due to the relatively lower impact of permanent differences on our tax rate as our overall taxable income has increased.

NET EARNINGS. Net earnings increased by \$31.7 million, or 76.7%, to \$73.0 million for the six months ended August 4, 2007, from \$41.3 million for the six months ended July 29, 2006.

LIQUIDITY

We need liquidity primarily to fund our working capital in Europe, the expansion and remodeling of our retail stores, shop-in-shop programs, systems, infrastructure, existing operations, international growth and payment of dividends to our shareholders. We have historically financed our operations primarily from internally generated funds and borrowings under our credit facilities and other bank facilities. Please see Important Notice Regarding Forward-Looking Statements for a discussion of risk factors which could reasonably be likely to result in a decrease of internally generated funds available to finance capital expenditures and working capital requirements.

OPERATING ACTIVITIES

Net cash provided by operating activities was \$61.8 million for the six months ended August 4, 2007, compared to \$63.1 million for the six months ended July 29, 2006, or a decrease of \$1.3 million. The \$31.7 million growth in net income for the six months ended August 4, 2007 versus the prior year period was offset primarily by investments in inventory and accounts receivable relating to our new businesses, our existing European operations and our North American retail operations, partially offset by corresponding growth in accounts payable.

At August 4, 2007, the Company had working capital (including cash and cash equivalents) of \$330.9 million compared to \$283.9 million at February 3, 2007 and \$221.4 million at July 29, 2006. The Company's primary working capital needs are for inventory and accounts receivable. Accounts receivable at August 4, 2007 amounted to \$186.9 million, up \$77.8 million, compared to \$109.1 million at July 29, 2006. Approximately \$43.6 million of the increase resulted from the growth in receivables related to our existing European



business, which totaled \$104.4 million at August 4, 2007, versus \$60.7 million at July 29, 2006. Approximately \$50.3 million of the \$104.4 million of receivables were insured for collection purposes. The acquisition of a 75% equity interest in Focus, and our new South Korea and Greater China operations, accounted for approximately \$28.7 million of the remaining growth in receivables, of which \$3.3 million was insured.

The Company's inventory levels increased \$93.9 million to \$226.4 million at August 4, 2007 from \$132.5 million at July 29, 2006. Approximately \$49.3 million of this increase was attributed to the Company's new businesses, including the acquisition of Focus, our new South Korea, Greater China, Hong Kong and Mexico operations, and our new G by GUESS store concept, with the remaining increase driven by our existing North American retail, European and other international operations to support anticipated sales growth in fiscal 2008.

INVESTING ACTIVITIES

Net cash used in investing activities increased to \$57.7 million for the six months ended August 4, 2007, compared to \$32.8 million for the six months ended July 29, 2006. The increase in net cash used in investing activities was driven by the opening of 20 new stores in North America during the first half of the fiscal year compared to 17 new stores that were opened in the comparable prior year period, and the conversion of 18 stores to the new G by GUESS concept during the first half of this fiscal year.

FINANCING ACTIVITIES

Net cash used in financing activities increased to \$13.6 million for the six months ended August 4, 2007, compared to \$2.1 million for the six months ended July 29, 2006. The increase in net cash used in financing activities was primarily due to payment of cash dividends of \$11.2 million during the six months ended August 4, 2007. No dividends were paid in the prior year period.

DIVIDEND POLICY

On February 12, 2007, the Board of Directors declared a quarterly cash dividend of \$0.06 per share on the Company's common stock. The cash dividend was paid on March 12, 2007 to shareholders of record as of the close of business on February 26, 2007.

On June 5, 2007, the Board of Directors declared a quarterly cash dividend of \$0.06 per share on the Company's common stock. The dividend was paid on July 6, 2007 to shareholders of record at the close of business on June 20, 2007.

On September 4, 2007, the Board of Directors declared a quarterly cash dividend of \$0.08 per share on the Company's common stock. The dividend will be payable on October 5, 2007 to shareholders of record at the close of business on September 19, 2007.

CAPITAL RESOURCES

During the six months ended August 4, 2007, the Company relied on trade credit, available cash, short-term borrowings from our European bank facilities, real estate leases, and internally generated funds to finance its operations and expansion. The Company anticipates that it will be able to satisfy its ongoing cash requirements during the next twelve months for working capital, capital expenditures, and interest and principal payments on its debt, and dividend payments to shareholders, primarily with cash flow from operations supplemented by borrowings, if necessary, under the Credit Facility and bank facilities in Europe.

Gross capital expenditures totaled \$44.1 million, before deducting lease incentives of \$6.0 million, for the six months ended August 4, 2007. This compares to gross capital expenditures of \$26.5 million, before deducting lease incentives of \$3.4 million, for the six months ended July 29, 2006. The Company's capital expenditures for the full fiscal year 2008 are planned at approximately \$99 million, before deducting estimated lease incentives of approximately \$10 million, primarily for retail store expansion of approximately 54 stores in the U.S. and Canada, store remodeling programs, investments in information systems and enhancements in other infrastructure.

The Company evaluates strategic acquisitions and alliances and pursues those that we believe will support and contribute to our overall growth initiatives. Effective December 31, 2006, the Company purchased for approximately \$24.3 million, 75% of the outstanding shares of Focus, the Company's licensee for GUESS by MARCIANO contemporary apparel for women and men in Europe, the Middle East and Asia. In 2006, the Company paid \$15.8 million of the purchase price (\$13.2 million in cash and \$2.6 million in Company common stock). During 2007, the Company paid to the seller approximately \$8.5 million.

CREDIT FACILITIES

On September 19, 2006, the Company and certain of its affiliates entered into a credit facility led by Bank of America, N.A., as administrative agent for the lenders (the Credit Facility). The Credit Facility provides for an \$85 million revolving multicurrency line of credit and is available for direct borrowings and the issuance of letters of credit, subject to certain letters of credit sublimits. The Credit Facility is scheduled to mature on September 30, 2011. The Credit Facility replaced the (a) Amended and Restated Loan and Security Agreement by and among Wachovia Capital Finance Corporation (Western) (formerly known as Congress Financial Corporation (Western)) and Guess, Guess? Retail, Inc. and Guess.com, Inc., dated as of December 20, 2002, as amended, and (b) Canadian Loan and Security Agreement by and among Wachovia Capital Finance Corporation (Canada) (formerly known as Congress Financial Corporation (Canada)) and Guess Canada, dated as of December 20, 2002, as amended (together, the Prior Credit Facility).

The obligations under the Credit Facility are guaranteed by certain of the Company's existing and future domestic subsidiaries, and such obligations, including the guarantees, are secured by (a) substantially all present and future property and assets of the Company and each guarantor and (b) the equity interests of certain of the Company's direct and indirect U.S. subsidiaries and 65% of the equity interests of the Company's first tier foreign subsidiaries.

Direct borrowings under the Credit Facility will be made, at the Company's option, as (a) Eurodollar Rate Loans, which shall bear interest at the published LIBOR rate for the respective interest period plus an applicable margin (which was 0.75% at August 4, 2007) based on the Company's leverage ratio at the time, or (b) Base Rate Loans, which shall bear interest at the higher of (i) for domestic loans, 0.50% in excess of the federal funds rate, and for Canadian loans, 0.50% in excess of the average rate for 30 day Canada dollar bankers' acceptances, or (ii) the rate of interest as announced by Bank of America as its prime rate, in each case as in effect from time to time, plus an applicable margin (which was 0.0% at August 4, 2007) based on the Company's leverage ratio at the time. The Company is also obligated to pay certain commitment, letter of credit and other fees customary for a credit facility of this size and type. At August 4, 2007, the Company had \$12.6 million in outstanding standby letters of credit, \$26.9 million in outstanding documentary letters of credit and no outstanding borrowings under the Credit Facility.

The Credit Facility requires the Company to comply with a leverage ratio and a fixed charge coverage ratio. In addition, the Credit Facility contains customary covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to: incur liens, incur indebtedness, make investments, dispose of assets, make certain restricted payments, merge or consolidate, and enter into certain transactions with affiliates. Upon the occurrence of an event of default under the Credit Facility, the lenders may cease making loans, terminate the Credit Facility and declare all amounts outstanding to be immediately due and payable. The Credit Facility specifies a number of events of default (some of which are subject to applicable grace or cure periods), including, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults.

The Company, through its European subsidiaries, maintains short-term borrowing agreements, primarily for working capital purposes, with various banks in Italy. Under these agreements, which are generally secured by certain European accounts receivable, the Company can borrow up to \$152.7 million, limited by accounts receivable balances at the time of borrowing. Based on the applicable accounts receivable balances at August 4, 2007, the Company could have borrowed up to approximately \$120.0 million under these agreements, plus an additional \$5.5 million under one of the agreements which is secured by a standby letter of credit issued under the Credit Facility. At August 4, 2007, the Company had \$1.1 million of outstanding borrowings and \$6.7 million in outstanding documentary letters of credit under these agreements. The agreements are denominated in Euros, have no financial ratio covenants or stated maturities and provide for annual interest rates ranging from 4.0% to 7.8%. In addition, as part of the acquisition of Focus Europe S.r.l., as described in Note 12 to the Condensed Consolidated Financial Statements, effective December 31, 2006, the Company acquired \$0.3 million of bank debt with an interest rate of Euribor six-month rate plus 1.0%. The Company has classified this debt as current as it intends to pay this debt down in the short-term.

The Company entered into a capital lease of approximately \$16.0 million in December 2005 for a new building in Florence, Italy, with subsequent build-outs which were completed in 2006. Key functions related to the Company's Italian operation are represented in this building, including design and merchandising. This transaction resulted in a capital lease obligation of \$19.8 million as of August 4, 2007. The Company entered into separate interest rate swap agreements designated as non-hedging instruments resulting in a fixed rate of 3.55%. These interest rate swap agreements mature through 2016 and convert the nature of the capital lease obligation from Euribor floating rate debt to fixed rate debt. The fair value of the interest rate swap asset as of August 4, 2007 was approximately \$0.9 million.

SEASONALITY

The Company's business is impacted by the general seasonal trends characteristic of the apparel and retail industries. U.S. retail operations are generally stronger from July through December, and U.S. wholesale operations generally experience stronger performance in July, August and September. The European operations are largely wholesale and operate with two primary selling seasons. Spring/Summer primarily ships in January, February and March and Fall/Winter primarily ships in July, August and September. The remaining months of the year are relatively small shipping months. As the timing of the shipment of products may vary from year to year, the results for any particular quarter may not be indicative of results for the full year.

INFLATION

The Company does not believe that the relatively moderate rates of inflation experienced in the U.S. and Europe over the last three years have had a significant effect on net revenue or profitability. Although higher rates of inflation have been experienced in a number of foreign countries in which the Company's products are manufactured and sold, management does not believe that foreign rates of inflation have had a material adverse effect on its net revenue or profitability.

WHOLESALE BACKLOG

The backlog of wholesale orders at any given time is affected by various factors, including seasonality, cancellations, the scheduling of market weeks and manufacturing and shipment of products. Accordingly, a comparison of backlogs of wholesale orders from period to period is not necessarily meaningful and may not be indicative of eventual actual shipments.

U.S. Backlog

The Company maintains a model stock program in its basic denim products which generally allows replenishment of a customer's inventory within 48 hours. The Company generally receives orders for fashion apparel 90 to 120 days prior to the time the products are delivered to stores. Regarding our U.S. wholesale backlog, the scheduling of market weeks can affect the amount of orders booked in the backlog compared to the same date in the prior year. This year's backlog for product at August 25, 2007, as an example, reflected a longer shipping period of about two months for women's product and a shorter shipping period of one month for men's product compared to last year's backlog at August 26, 2006. We estimate that if we were to normalize the orders for this year's backlog to make the comparison consistent with the prior year, then the current backlog would be up about 24.6% from the prior year. Not taking into account the impact of this change, our U.S. wholesale backlog as of August 25, 2007, consisting primarily of orders for fashion apparel (including orders for the following fiscal year), was approximately \$66.1 million, compared to \$49.0 million for such orders at August 26, 2006, or up 34.9%.

Europe Backlog

Our European business operates with two primary wholesale selling seasons. The Spring/Summer season, which ships mostly in January, February and March and the Fall/Winter season, which ships mostly in July, August and September. Generally, the other months are relatively small shipping months. However, customers have the ability to request early shipment of backlog orders or delay shipment of orders depending on their needs. Accordingly, a certain amount of orders in the backlog may be shipped outside of the traditional shipping months. As of August 28, 2007, the European operations backlog was approximately \$204.6 million. The backlog comprises sales orders for the Fall/Winter 2007 and Spring/Summer 2008 seasons. As discussed above, these orders are subject to cancellation and may not be indicative of eventual actual shipments.

IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), Fair Value Measurement. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently assessing the impact of SFAS No. 157 on its financial statements.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), The Fair Value Option for Financial Assets and Financial Liabilities, which permits entities to voluntarily choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS 159 provides entities an opportunity to mitigate volatility in reported earnings that is caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting SFAS 159 on its financial position and results of operations.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

Exchange Rate Risk

Approximately 53.3% of product sales and licensing revenue recorded for the six months ended August 4, 2007 were denominated in United States dollars. The Company's primary exchange rate risk relates to operations in Canada and Europe. The Company enters into derivative financial instruments, including forward exchange contracts and currency swaps, to manage exchange risk on foreign currency transactions.

During the six months ended August 4, 2007, the Company purchased U.S. dollar forward contracts in Canada, totaling US\$25.0 million to hedge forecasted merchandise purchases that were designated as cash-flow hedges at August 4, 2007. As of August 4, 2007, approximately US\$20.5 million were outstanding. Our derivative financial instruments are recorded on the consolidated balance sheet at fair value based on quoted market rates. These forward contracts are used to hedge forecasted merchandise purchases over specific months. Changes in the fair value of forward contracts designated as cash-flow hedges are recorded as a component of accumulated other comprehensive earnings within stockholders' equity, and are recognized in cost of goods sold in the period which approximates the time the hedged merchandise inventory is sold. An unrealized loss of approximately US\$1.4 million, net of tax, has been recorded in accumulated other comprehensive income at August 4, 2007, and will be recognized as a charge to cost of goods sold over the next ten months at the then current values, which can be different than the current quarter-end values. At August 4, 2007, the unrealized loss of these forward contracts was approximately US\$1.8 million and was recorded in current liabilities on the consolidated balance sheet.

Also, the Company has foreign currency contracts that are not designated as hedges for accounting purposes. Changes in fair value of foreign currency contracts not qualifying as cash flow hedges are reported in net earnings as part of other income and expenses. At August 4, 2007, the Company had Canadian dollar foreign currency contracts to purchase US\$10.0 million and Euro foreign currency contracts to purchase US\$18.6 million. For the six months ended August 4, 2007, the Company recorded losses for the Canadian and Euro foreign currency contracts of US\$1.7 million and US\$1.6 million, respectively, which has been included in other income and expenses. At August 4, 2007, the unrealized losses of these Canadian and Euro forward contracts were approximately US\$0.9 million and US\$1.1 million, respectively, and were recorded in current liabilities on the consolidated balance sheet.

At December 31, 2006, the Company had Canadian dollar currency exchange contracts to purchase US\$3.0 million and Euro currency exchange contracts to purchase US\$50.0 million. The value of those contracts at December 31, 2006 were US\$2.9 million and US\$51.5 million, respectively.

Interest Rate Risk

At August 4, 2007, approximately 93.3% of the Company's indebtedness related to a capital lease obligation which is covered by interest rate swap agreements resulting in a fixed interest rate of 3.55% over the life of the lease obligation. Changes in the related interest rate that result in an unrealized gain or loss on the fair value of the swap are reported in other income or expenses. The change in the unrealized fair value of the interest swap had an immaterial impact during the six months ended August 4, 2007. Substantially all of the Company's remaining indebtedness, principally consisting of short-term borrowings under the short-term European borrowing agreements, is at variable rates of interest. Accordingly, changes in interest rates would impact the Company's results of operations in future periods. A 100 basis point increase in interest rates would have increased interest expense for the quarter ended August 4, 2007 by approximately \$0.1 million.

The fair value of the Company's debt instruments are based on the amount of future cash flows associated with each instrument discounted using the Company's borrowing rate. At August 4, 2007, the carrying value of all financial instruments was not materially different from fair value, as the interest rate on the Company's debt approximates rates currently available to the Company.

ITEM 4. Controls and Procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the quarterly period covered by this report.

There was no change in our internal control over financial reporting during the second quarter of the fiscal year ending February 2, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings.

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On February 1, 2005, a complaint was filed by Michele Evets against the Company in the Superior Court of the State of California for the County of San Francisco. The complaint purported to be a class action filed on behalf of current and former GUESS? store managers in California. Plaintiffs seek overtime wages and a preliminary and permanent injunction. The Company answered the complaint on April 28, 2005. The parties participated in a voluntary mediation in August 2006 and in February 2007 executed a settlement agreement, which shall become effective upon final court approval. A hearing date for final court approval has been set for November 2007. During the third quarter of 2006, the Company accrued \$1.0 million related to net charges in connection with the proposed settlement arrangement.

In 2006, the Officers of the Florence Customs Authorities (Customs Authorities) began an import customs audit with respect to the Company's Italian subsidiary, Maco Apparel S.p.A. (Maco), in Florence, Italy, acquired on January 3, 2005. Maco was the Italian licensee of GUESS? jeanswear for men and women in Europe. As part of the audit, the Customs Authorities considered whether the Italian subsidiary should have included the royalty expense payable to Guess?, Inc., the parent company, as part of the cost of the product subject to customs duties. The Customs Authorities have subsequently reviewed specific transactions which occurred in 2003, 2004 and 2005 and provided a preliminary assessment that the royalty expenses are subject to customs duties and related penalties. The Company is disputing the Customs Authorities assessment and intends to vigorously defend its position. In addition, under the terms of the Maco purchase agreement, the seller is required to indemnify the Company for 90% of any loss with respect to Maco for periods prior to the acquisition. A hearing with the Florence Provincial Tax Commission has been set for October 29, 2007. The Company has concluded that the amount of any possible loss would not be material to the Company's consolidated financial statements and that the likelihood of incurring a loss is less than probable. Accordingly, no liability related to this matter has been accrued.

The Company is also involved in various other employment-related claims and other matters incidental to the Company's business, the resolution of which are not expected to have a material adverse effect on the Company's consolidated results of operations or financial position. With the exception of the class action accrual discussed above, no material amounts were accrued as of August 4, 2007 related to any of the Company's other legal proceedings.

ITEM 1A. Risk Factors.

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There have not been any material changes from the risk factors as previously disclosed in our annual report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 1, 2007.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

ITEM 3. Defaults Upon Senior Securities.

ITEM 4. Submission of Matters to a Vote of Security Holders.

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The Annual Meeting of Stockholders of the Company was held on June 18, 2007 (the Meeting). Proxies for the Meeting were solicited pursuant to Regulation 14A under the Exchange Act. There was no solicitation in opposition to management's nominees for director as listed in the Proxy Statement. At the Meeting, the stockholders elected three directors and ratified the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the 2008 fiscal year. There were no other proposals voted upon by the stockholders at the Meeting. The stockholders voted at the Meeting as follows:

Description	For	Against	Withheld	Abstain	Broker Non-Votes
Election of Paul Marciano	84,504,372	N/A	5,171,743	N/A	
Election of Anthony Chidoni	85,225,240	N/A	4,450,875	N/A	
Election of Judith Blumenthal	89,387,280	N/A	288,835	N/A	
Ratification of appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the year ending February 2, 2008	89,208,413	456,260	N/A	11,442	

ITEM 5. Other Information.

None.

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ITEM 6. Exhibits.

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Exhibit Number	Description
3.1	Restated Certificate of Incorporation of the Registrant (incorporated by reference from Amendment No. 3 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-4419) filed on July 30, 1996).
3.2	Amended and Restated Bylaws of the Registrant (incorporated by reference from the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 29, 2001).
4.1	Specimen stock certificate (incorporated by reference from Amendment No. 3 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-4419) filed on July 30, 1996).
*10.1	Amendment No. 2 to Credit Agreement dated as of September 19, 2006 by and among the Registrant and Guess? Canada Corporation, as Borrowers, lenders from time to time party thereto, Bank of America, N.A., as Domestic Administrative Agent and Domestic L/C Issuer, and Bank of America, N.A., acting through its Canada Branch, as Canadian Administrative Agent and Canadian L/C Issuer, dated as of July 5, 2007.
*10.2	Executive Employment Agreement dated August 6, 2007 between the Registrant and Carlos Alberini.
*10.3	Restricted Stock Agreement dated August 6, 2007 between the Registrant and Carlos Alberini.
*31.1	Certification of Chief Executive Officer and Vice Chairman of the Board pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.2	Certification of President and Chief Operating Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*31.3	Certification of Senior Vice President and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
*32.1	Certification of Chief Executive Officer and Vice Chairman of the Board pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.2	Certification of President and Chief Operating Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*32.3	Certification of Senior Vice President and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

SIGNATURES

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Guess?, Inc.

Date: September 10, 2007

By: /s/ CARLOS ALBERINI

Carlos Alberini
President and Chief Operating Officer

Date: September 10, 2007

By: /s/ DENNIS R. SECOR

Dennis R. Secor
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

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