DIAGEO PLC
Form 20-F
November 26, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

For the fiscal year ended:	**30 June 2003**
Commission file number:	**1-10691**

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England
(Jurisdiction of incorporation or organisation)

8 Henrietta Place, London W1G 0NB, England
(Address of principal executive offices)

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

Title of each class	Name of each exchange on which registered
American Depositary Shares	New York Stock Exchange
Ordinary shares of 28 $^{101/108}$ pence each	New York Stock Exchange*
9.42% Cumulative guaranteed preferred securities, series A**	New York Stock Exchange

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

** Issued by Grand Metropolitan Delaware, LP, of which the Registrant is the sole general partner, and guaranteed as to certain payments by the Registrant.

Securities registered or to be registered pursuant to Section 12(g)of the Act: None
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None
Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the Annual Report: 3,099,593,537 ordinary shares of 28 $^{101/108}$ pence each.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 [ ] Item 18 [X]

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2003 of Diageo plc (the 2003 Form 20-F). Reference is made to the cross reference to Form 20-F table on page 144 here of (the Form 20-F Cross reference table). Only (i) the information in this document that is referenced in the Form 20-F Cross reference table, (ii) the cautionary statement concerning forward-looking statements on page 18 and (iii) the Exhibits, shall be deemed to be filed with the Securities and Exchange Commission for any purpose, including incorporation by reference into the Registration Statements on Form F-3 (File Nos. 333-10410 and 333-14100) and Registration Statements on Form S-8 (File Nos. 333-08090, 333-08092, 333-08094, 333-08096, 333-08098, 333-08100, 333-08102, 333-08104, 333-08106, 333-09770, 333-11460 and 333-11462), and any other documents, including documents filed by Diageo plc pursuant to the Securities Act of 1933, as amended, which purport to incorporate by reference the 2003 Form 20-F. Any information herein which is not referenced in the Form 20-F Cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference.

TABLE OF CONTENTS

Table of Contents

Contents

This is the annual report on Form 20-F of Diageo plc for the year ended 30 June 2003.

The market data contained in this document is taken from independent industry sources in the markets in which Diageo operates.

The reporting format has been revised to separate goodwill amortisation from exceptional items. Goodwill amortisation is now included in the before exceptional items column of the profit and loss account.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo s control. For more details, please refer to the cautionary statement concerning forward-looking statements on page 18.

This report includes names of Diageo s products, which constitute trademarks or trade names which Diageo owns or which others own and licence to Diageo for use. In this report, the term company refers to Diageo plc and the terms group and Diageo refer to the company and its consolidated subsidiaries, except as the context otherwise requires. A glossary of terms used in this report is included at the end of the document.

Diageo s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP), which is the group s primary reporting framework. Unless otherwise indicated all other financial information contained in this document has been prepared in accordance with UK GAAP. The principal differences between UK and US GAAP are discussed in the operating and financial review and set out in the consolidated financial statements.

Table of Contents

Five year information

The following table presents selected consolidated financial data for Diageo for the five years ended 30 June 2003 and as at the respective year ends. The UK GAAP data for the five years ended 30 June 2003 and the US GAAP data for the three years ended 30 June 2003 have been derived from Diageo s consolidated financial statements, which have been audited by Diageo s independent auditor. The US GAAP data for the two years ended 30 June 2000 has been extracted from Diageo s US GAAP audited consolidated financial statements.

					Year ended 30 June
	2003	2002	2001	2000	1999
Profit and loss account data[1]	**£ million**	£ million	£ million	£ million	£ million
UK GAAP					
Turnover:					
Premium drinks	**8,961**	8,704	7,580	7,117	7,163
Discontinued operations[2]	**479**	2,578	5,241	4,753	4,632
Total turnover	**9,440**	11,282	12,821	11,870	11,795
Operating profit before exceptional items:[3][4]					
Premium drinks	**1,976**	1,766	1,430	1,285	1,240
Discontinued operations[2]	**53**	340	671	678	659
Total operating profit before exceptional items	**2,029**	2,106	2,101	1,963	1,899
Exceptional items charged to operating profit[4]	**(168)**	(453)	(228)	(181)	(382)
Operating profit	**1,861**	1,653	1,873	1,782	1,517
Other exceptional items[4]	**(1,334)**	758	(4)	(166)	86
Profit for the year	**76**	1,617	1,207	990	937
US GAAP[2]					
Sales	**9,153**	10,760	11,868	11,015	11,579
Gains/(losses) on disposals of businesses	**16**	1,843	(8)	75	(35)
Net income	**487**	2,554	758	798	392
Per share data	**pence**	pence	pence	pence	pence
UK GAAP					
Dividend per share[6]	**25.6**	23.8	22.3	21.0	19.5
Earnings per share:					
Basic	**2.4**	48.8	35.7	29.2	26.5
Diluted	**2.4**	48.7	35.7	29.1	26.4
Earnings before exceptional items per ordinary share:					
Basic	**49.0**	43.2	41.6	37.3	33.5
Diluted	**49.0**	43.1	41.6	37.3	33.3
US GAAP					
Basic earnings per ordinary share	**15.6**	77.0	22.4	23.5	11.1
Diluted earnings per ordinary share	**15.6**	77.0	22.4	23.5	11.0
Basic earnings per ADS	**62.4**	308.0	89.6	94.0	44.4
Diluted earnings per ADS	**62.4**	308.0	89.6	94.0	44.0

Table of Contents

Balance sheet data[1]	**2003** **£ million**	2002 £ million	2001 £ million	2000 £ million	As at 30 June 1999 £ million
UK GAAP					
Net current (liabilities)/assets[7]	**(392)**	(32)	226	(115)	(941)
Total assets	**16,197**	18,493	17,644	16,089	16,216
Net borrowings[7]	**4,870**	5,496	5,479	5,545	6,056
Shareholders equity	**4,954**	6,001	5,123	4,664	3,964
Called up share capital[8]	**897**	930	987	990	992
US GAAP					
Total assets[9]	**24,071**	26,153	25,955	24,868	25,586
Long term obligations[7]	**3,149**	3,892	4,029	3,753	3,431
Shareholders equity	**9,226**	11,316	11,880	11,802	11,690
	million	million	million	million	million
Number of ordinary shares[8]	**3,100**	3,215	3,411	3,422	3,428

Notes to the selected consolidated financial data

1 Seagram The results and balance sheets for the two years ended 30 June 2003 have been affected by the acquisition of the Seagram spirits and wine businesses on 21 December 2001. See Operating and financial review Operating results .

2 Discontinued operations Included within UK GAAP discontinued operations are the quick service restaurants business (Burger King sold 13 December 2002) and the packaged food businesses (Pillsbury sold 31 October 2001). The quick service restaurants and packaged food businesses have been included in continuing operations under US GAAP. There are no discontinued operations under US GAAP.

3 Brands and goodwill amortisation An analysis of goodwill amortisation charged to UK GAAP operating profit is as follows:

	2003 **£ million**	2002 £ million	2001 £ million	2000 £ million	Year ended 30 June 1999 £ million
Continuing operations premium drinks	**(2)**	(2)	(2)	(1)	
Discontinued operations	**(2)**	(10)	(24)	(16)	(4)
	(4)	(12)	(26)	(17)	(4)

An analysis of brands and goodwill amortisation charged to US GAAP operating income is as follows:

	2003 **£ million**	2002 £ million	2001 £ million	2000 £ million	Year ended 30 June 1999 £ million
Premium drinks			(220)	(222)	(230)
Quick service restaurants			(70)	(40)	(39)
Packaged food			(145)	(130)	(123)
			(435)	(392)	(392)

The group adopted the requirements of SFAS No. 141 and SFAS No. 142 for the first time on 1 July 2001. Accordingly amortisation of intangible assets with indefinite useful lives ceased from that date. In addition, in the year ended 30 June 2002 an impairment in the carrying value of goodwill attributable to the group s quick service restaurants business of £135 million was recognised.

Table of Contents

4 Exceptional items An analysis of exceptional items before taxation under UK GAAP is as follows:

				Year ended 30 June	
	2003	2002	2001	2000	1999
	£ million	£ million	£ million	£ million	£ million
Exceptional items charged to operating profit					
Continuing operations premium drinks:					
Seagram integration costs	**(177)**	(164)			
Guinness/UDV integration costs	**(48)**	(48)	(74)		
GrandMet/Guinness merger integration costs				(83)	(262)
Other integration and restructuring costs			(79)		
Bass distribution rights	**57**				
José Cuervo settlement		(220)			
Share option funding costs					(43)
	(168)	(432)	(153)	(83)	(305)
Discontinued operations:					
Restructuring, reorganisation and other net costs		(21)	(75)	(98)	(77)
	(168)	(453)	(228)	(181)	(382)
Other exceptional items					
Charged to associates	**(21)**	(41)		(3)	(8)
(Losses)/gains on disposal of fixed assets	**(43)**	(22)	19	5	(10)
(Losses)/gains on disposal and termination of businesses	**(1,270)**	821	(23)	(168)	104
	(1,334)	758	(4)	(166)	86

Exceptional items under UK GAAP do not represent extraordinary items under US GAAP.

5 Unusual items An analysis of unusual (charges)/income, excluding gains/(losses) on disposal of businesses and (losses)/gains on disposal of fixed assets, included in, and affecting the comparability of, US GAAP operating income, is as follows:

				Year ended 30 June	
	2003	2002	2001	2000	1999
	£ million	£ million	£ million	£ million	£ million
Seagram integration costs	**(154)**	(82)			
Other integration and restructuring costs	**(48)**	(48)	(169)	(115)	(272)
Bass distribution rights	**57**				
José Cuervo settlement		(194)			
Derivative instruments in respect of General Mills shares	**(4)**	166			
Burger King impairment charges and transaction costs	**(750)**	(135)			
Other impairment charges					(74)
	(899)	(293)	(169)	(115)	(346)

6 Dividends The Diageo plc board expects that Diageo will pay an interim dividend in April and a final dividend in October of each year. Approximately 40% of the total dividend in respect of any financial year is expected to be paid as an interim dividend and approximately 60% as a final dividend. The payment of any future dividends, subject to shareholder approval, will depend upon Diageo s earnings, financial condition and such other factors as the Diageo plc board deems relevant.

The table below sets out the amounts of interim, final and total cash dividends paid by Diageo plc on each ordinary share. The dividends are translated into US dollars per ADS (each ADS representing four ordinary shares) at the noon buying rate on each of the respective dividend payment dates.

						Year ended 30 June
		2003	2002	2001	2000	1999
		pence	pence	pence	pence	pence
Per ordinary share	Interim	**9.9**	9.3	8.9	8.4	7.8
	Final	**15.7**	14.5	13.4	12.6	11.7
	Total	**25.6**	23.8	22.3	21.0	19.5
		$	$	$	$	$
Per ADS	Interim	**0.61**	0.54	0.51	0.53	0.50
	Final	**1.06**	0.90	0.78	0.72	0.76
	Total	**1.67**	1.44	1.29	1.25	1.26

7 Definitions Net current (liabilities)/assets is defined as current assets less current liabilities. Net borrowings is defined as total borrowings (i.e. short term borrowings and long term borrowings plus finance lease obligations) less cash at bank and liquid resources, interest rate and foreign currency swaps and current asset investments. Long term obligations is defined as long term borrowings and capital lease obligations which fall due after more than one year.

8 Share capital The called up share capital represents the number of ordinary shares in issue. During the year ended 30 June 2003 the group repurchased for cancellation 116 million ordinary shares at a cost of £852 million (2002 198 million ordinary shares, cost of £1,658 million; 2001 18 million ordinary shares, cost of £108 million; 2000 10 million ordinary shares, cost of £54 million; 1999 175 million shares, cost of £1,211 million (including £15 million for B shares)).

9 Burger King Under UK GAAP, the sale of Burger King has been accounted for as a disposal and the results prior to disposal are presented within discontinued operations. Under US GAAP, the transaction is not accounted for as a disposal due to the size of the investment made by the buyer and Diageo s continuing involvement through the guarantee provided by Diageo in respect of the acquisition finance. Under US GAAP, the results of Burger King prior to 13 December 2002 (the completion date) are presented as continuing operations in the income statement and, on the completion of the transaction, a charge for impairment has been recognised rather than a loss on disposal. Following the completion date, Diageo does not recognise profits of Burger King in its income statement but will, generally, reflect losses as an impairment charge against the assets retained on the balance sheet. In the US GAAP balance sheet, the total assets and total liabilities of Burger King at 30 June 2003 (including consideration deferred under US GAAP) classified within other long term assets and other long term liabilities were each £1.3 billion. The transaction will be accounted for as a disposal when the uncertainties related to the guarantee provided in respect of the acquisition finance have been substantially resolved and/or the buyer s cumulative investment meets or exceeds minimum levels.

Table of Contents

10 Exchange rates A substantial portion of the group s assets, liabilities, revenues and expenses is denominated in currencies other than pound sterling, principally US dollars. For a discussion of the impact of exchange rate fluctuations on the company s financial condition and results of operations, see Operating and financial review Risk management .

The following table shows, for the periods indicated, information regarding the US dollar/pound sterling exchange rate, based on the noon buying rate, expressed in US dollars per £1.

	Year ended 30 June				
	2003	2002	2001	2000	1999
Period end	**1.65**	1.52	1.41	1.51	1.58
Average rate (a)	**1.59**	1.45	1.45	1.59	1.64

(a) The average of the noon buying rates on the last business day of each month during the year. These rates have been provided for your convenience. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the financial statements. See note 2 (i)(c) to the consolidated financial statements for the actual rates used.

The following table shows period end and average US dollar/pound sterling noon buying exchange rates by month, for the period to 31 October 2003, expressed in US dollars per £1.

							2003
	October	**September**	**August**	**July**	**June**	**May**	**April**
Period end	**1.70**	**1.66**	**1.58**	**1.61**	**1.65**	**1.64**	**1.60**
Average rate	**1.68**	**1.62**	**1.59**	**1.62**	**1.66**	**1.62**	**1.57**

The average rate for the period 1 to 14 November 2003 was £1=$1.68 and the noon buying rate on 14 November 2003 was £1=$1.68.

Business description

Overview

Diageo is one of the world s leading beverage alcohol businesses with a portfolio of international brands. Diageo was the eleventh largest publicly quoted company in the United Kingdom in terms of market capitalisation on 14 November 2003, with a market capitalisation of approximately £22.6 billion.

Diageo was formed by the merger of Grand Metropolitan Public Limited Company and Guinness PLC that became effective on 17 December 1997. As a result of the merger, Grand Metropolitan Public Limited Company became a wholly owned subsidiary of Guinness PLC, and Guinness PLC was renamed Diageo plc. Diageo is incorporated as a public limited company in England and Wales. Diageo s principal executive office is located at 8 Henrietta Place, London W1G 0NB and its telephone number is +44 (0) 20 7927 5200.

Diageo is a major participant in the branded beverage alcohol industry and operates on an international scale. It brings together world-class drinks brands and a management team committed to the maximisation of shareholder value. The management team expects to invest in global brands, expand internationally and launch innovative new products and brands.

Diageo s premium drinks business is the world s leading branded premium spirits business by volume, sales revenue and operating profit. Diageo also brews and markets beer and produces and sells wine. It produces and distributes a wide range of premium brands, including Smirnoff vodka, Johnnie Walker Scotch whiskies, Guinness stout, Baileys Original Irish Cream liqueur, J B Scotch whisky, Captain Morgan rum and Tanqueray gin.

Strategy

Diageo has now completed the strategic transition to a focused premium drinks company. Since announcing the planned realignment of its business focus in 2000, Diageo has exited the food business, selling Pillsbury to General Mills in October 2001 and divesting of Burger King in December 2002. Over the same period, it enhanced its premium drinks business with the purchase of parts of the Seagram spirits and wine businesses in December 2001. The completion of these transactions and the integration of the Seagram brands has strongly enhanced Diageo s position in the premium drinks industry, and furthered its strategic objectives of building strength and focus in its core business.

Diageo s brand portfolio is essential to its strategy. The company owns eight of the top 20 brands in the top 100 premium distilled spirits brands worldwide as defined by Impact. The international nature of these brands enables Diageo to operate as a global business, with local sensitivity in its markets, while remaining focused on its target of being the number one premium drinks player in every market.

Diageo s position in premium drinks enables the company to attract and develop talented people with the capabilities to achieve Diageo s performance goals. Key to this success is promoting diversity and ensuring Diageo is regarded as the best place to work.

Diageo s strategy is executed at three levels, market participation, product offering, and business effectiveness. The common themes which run through each of these levels, serve as crucial drivers of Diageo s current and future success.

Market participation Diageo targets its geographical priorities in terms of major, key and venture markets. The major markets are amongst the biggest premium drinks markets in the world. They account for the majority of operating profit, and serve as the primary drivers for Diageo s business. Key markets are those where Diageo has a high relative market share and they further enhance growth, while the innovative and entrepreneurial venture markets support the long term reach of Diageo s business.

Product offering At the brand level, Diageo manages its brands in terms of global priority brands, local priority brands, and category brands. Acting as the main focus for the business, global priority brands are Diageo s primary growth drivers across markets. At the individual market level, local priority brands are those which drive growth on a significant, yet more limited geographic scale. Category brands comprise the smaller scale brands in Diageo s portfolio.

Business effectiveness Diageo s size provides an opportunity for significant scale efficiencies in operations and marketing effectiveness. Strategically, Diageo is focused on using this scale to maximise cost efficiencies, and to enable the dissemination of consumer insight across its portfolio.

Over the long term, Diageo s strategy will be continually focused on driving growth and increasing shareholder value.

Diageo has completed a number of acquisitions and disposals consistent with its strategy of focusing on its premium drinks business. Between the merger in December 1997 and 30 June 2003 the group has received approximately £8.5 billion from disposals (including £4.3 billion from the sale of Pillsbury and £0.6 billion from the sale of Burger King) and spent approximately £4.4 billion on acquisitions. On 21 December 2001, Diageo and Pernod Ricard S.A. (Pernod Ricard) completed the acquisition of the spirits and wine businesses of The Seagram Company Ltd (Seagram) from Vivendi Universal SA (Vivendi) for $8.15 billion (£5.62 billion) in cash subject to certain debt, working capital and other adjustments. Diageo s share of the purchase price after adjustment was £3.7 billion.

Premium drinks

Diageo is engaged in a broad range of activities within the beverage alcohol business. Its operations include producing, distilling, brewing, bottling, packaging, distributing, developing and marketing a range of brands in approximately 180 territories around the world. Diageo markets a portfolio of widely recognised beverage alcohol brands including a number of the world s leading spirits and beer brands. The brand ranking information below, when comparing volume information with competitors, has been sourced from data published during 2003 by Impact, a publication which compiles volume statistics for the international drinks industry. Market data information is taken from industry sources in the markets in which Diageo operates. Seventeen of the group s owned brands were among the top 100 premium distilled spirits brands worldwide in calendar year 2002.

References to ready to drink products below include flavored malt beverages. Ready to drink products are sold throughout the world, but flavored malt beverages are currently only sold in the United States. References to Smirnoff ready to drink include Smirnoff Ice, Smirnoff Black Ice, Smirnoff Twisted V, Smirnoff Mule, Smirnoff Spin and Smirnoff Caesar. References to Smirnoff Black Ice include Smirnoff Ice Triple Black in the United States.

In the year ended 30 June 2003, Diageo sold 95 million equivalent units of spirits (including ready to drink), 2 million equivalent units of wine and 22 million equivalent units of beer. In the year ended 30 June 2003, ready to drink products contributed 6.7 million equivalent units of total premium drinks volume of which Smirnoff Ice accounted for 5.0 million equivalent units. Volume is measured on an equivalent units basis to nine litre cases of spirits. Equivalent units are measured as follows wine in nine litre cases is divided by five, ready to drink in nine litre cases is divided by 10, beer in hectolitres is divided by 0.9. An equivalent unit represents approximately 272 servings. A serving comprises 33ml of spirits; 165ml of wine; or 330ml of ready to drink or beer.

Turnover of premium drinks for the year ended 30 June 2003 was £8,961 million and operating profit before exceptional items was £1,976 million.

The premium drinks portfolio comprises brands owned by the company as a principal, and brands the company holds under agency agreements. The portfolio includes:

Global priority brands

Smirnoff vodka and Smirnoff ready to drink products
Johnnie Walker Scotch whiskies
Guinness stout
Baileys Original Irish Cream liqueur
J B Scotch whisky
Captain Morgan rum
José Cuervo tequila (agency brand in North America and many European and international markets)
Tanqueray gin

Other spirits brands include:
Crown Royal Canadian whisky
Buchanan s De Luxe whisky
Gordon s gin and vodka
Windsor Premier whisky
Bell s Extra Special whisky
Dimple/Pinch whisky
Seagram s 7 American whiskey
Old Parr whisky
Seagram s VO Canadian whisky
Bundaberg rum

Wine brands include:
Beaulieu Vineyard wine
Sterling Vineyards wine
Blossom Hill wine
Piat D Or wine

Other beer brands include:
Harp Irish lager
Smithwick s ale
Malta non-alcoholic stout
Red Stripe lager

Diageo s agency agreements vary depending on the particular brand, but tend to be for a fixed number of years. There can be no assurances that Diageo will be able to prevent termination of distribution rights or rights to manufacture under licence, or renegotiate distribution rights or rights to manufacture under licence on favourable terms when they expire. See Acquisitions and disposals/ termination of businesses and distribution rights for information in respect of José Cuervo and Bass Ale in the United States and Brown-Forman brands in the United Kingdom. Diageo s principal agency brands are José Cuervo in North America and many European and international markets and Grand Marnier liqueur in the United States.

Diageo also brews and sells other companies beer brands under licence, including principally Budweiser and Carlsberg lagers in Ireland, Heineken lager in Jamaica and Tiger beer in Malaysia. In addition, Diageo held distribution rights to Bass Ale in the United States but these rights were relinquished as of 30 June 2003.

Global priority brands Diageo has eight global priority brands that it markets worldwide. Diageo considers these brands to have the greatest current and future earnings potential. Each global priority brand is marketed consistently around the world, and therefore can achieve scale benefits such as global media campaigns. The group manages and invests in these brands on a global basis. In the year ended 30 June 2003, global priority brands contributed 58% of premium drinks total volume and achieved turnover of £5,121 million.

Figures for global priority brands include related ready to drink products, unless otherwise indicated.

Smirnoff is Diageo s highest volume brand and achieved sales of 23.0 million equivalent units in the year ended 30 June 2003. Smirnoff is ranked, by volume, as the number one premium vodka and the number two premium spirit brand in the world.

Johnnie Walker Scotch whiskies comprise Johnnie Walker Red Label, Johnnie Walker Black Label and several other brand variants. During the year ended 30 June 2003, Johnnie Walker Red Label sold 6.9 million equivalent units and was ranked, by volume, as the number one premium Scotch whisky and the number four premium spirit brand in the world. Johnnie Walker Black Label sold 3.6 million equivalent units and the remaining variants sold 0.3 million equivalent units in the year ended 30 June 2003.

Guinness is the company s only global priority beer brand, and for the year ended 30 June 2003 achieved volume of 11.4 million equivalent units.

Captain Morgan was acquired as part of the Seagram acquisition on 21 December 2001. Captain Morgan is ranked as the number two premium rum brand in the world and contributed 5.3 million equivalent units in the year ended 30 June 2003.

Other global priority brands were also ranked, by volume, among the leading premium distilled spirits brands by Impact. These include Baileys, ranked the number one liqueur in the world;J B Scotch whisky (comprising J B Rare, J B Select, J B Reserve and J B Jet), ranked the number two premium Scotch whisky in the world; José Cuervo, ranked the number one premium tequila in the world; and Tanqueray, ranked the number four premium gin brand in the world. During the year ended 30 June 2003, Baileys, J B, José Cuervo and Tanqueray sold 6.2 million, 6.0 million, 4.2 million and 1.9 million equivalent units, respectively.

Other brands Diageo manages its other brands by category, analysing them between local priority brands and category brands.

Local priority brands represent the brands, apart from the global priority brands, that make the greatest contribution to operating profit in an individual country, rather than worldwide. Diageo has identified 30 local priority brands. Diageo manages and invests in these brands on a market by market basis and, unlike the global priority brands, may not have a common marketing strategy around the world for such brands. For the year ended 30 June 2003, local priority brands contributed 19% of premium drinks total volume (in nine litre equivalent units) and turnover of £1,946 million. Examples of local priority brands include Bell s Extra Special whisky in Great Britain, Dimple/Pinch whiskies in South Korea, Beaulieu Vineyard wines in North America, Smithwick s ale in Ireland, Budweiser and Carlsberg lagers in Ireland, and Gordon s gin in Great Britain and North America. From 1 July 2002, Diageo has replaced seven local priority brands from the original list with seven brands acquired in the Seagram spirits and wine businesses. These include Crown Royal Canadian whisky in North America and Windsor Premier whisky in South Korea, Seagram s VO Canadian whisky and Seagram s 7 American whiskey in North America.

The remaining brands are grouped under category brands. Other spirits achieved volume of 21.4 million equivalent units and contributed £1,263 million to Diageo s turnover in the year ended 30 June 2003. Examples of category brands are Gordon s gin (all markets except Great Britain and North America in which it is reported as a local priority brand), Gordon s vodka, The Classic Malt whiskies and White Horse whisky.

In the year ended 30 June 2003, Diageo sold 4.6 million equivalent units of other beers, achieving turnover of £365 million. Approximately 30% of other beer volume was attributable to owned brands, such as Harp Irish lager (all markets except Ireland), Kilkenny Irish beer, Malta non-alcoholic stout (all markets except Africa) and Smithwick s ale (all markets except Ireland). The remainder was attributable to beers brewed and/or sold under licence, including Bass Ale in the United States (distribution rights for which expired in June 2003), Tiger beer in Malaysia and Heineken lager in Jamaica.

In addition, Diageo produces and markets a wide selection of wines. These include well known labels such as Blossom Hill in the United States, and Barton & Guestier and Piat D Or in Europe. For the year ended 30 June 2003, other wine volume was 1.8 million equivalent units, contributing turnover of £266 million.

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

Approximately 75% of total production (including third party production) is undertaken in five Diageo production centres, namely the United Kingdom, Baileys, Guinness, Santa Vittoria and North America centres. The majority of these production centres have several production facilities. The locations, principal activities, products, production capacity and production volume in 2003 of these principal production centres owned throughout 2003 are set out in the following table:

Production centre	Location	Principal products	Production capacity* million	Production volume in 2003* million
United Kingdom	United Kingdom	Scotch whisky, gin, vodka, rum, ready to drink	58	37
Baileys	Ireland	Irish cream liqueur, vodka	12	7
Guinness	Ireland, United Kingdom	Beers, ready to drink	13	10
Santa Vittoria	Italy	Vodka, ready to drink	8	5
North America	United States, Canada	Vodka, gin, tequila, rum, Canadian whisky, American whiskey, ready to drink	75	33

*In equivalent units.

Diageo has invested in additional capacity for Baileys and other cream liqueurs by building a new facility in Northern Ireland (capacity of 5 million equivalent units) costing £40 million in order to support future growth of this product category. Production at the new facility commenced in May 2003.

Diageo is currently restructuring its production operations in Canada to reduce excess capacity following the acquisition of the Seagram spirits and wine businesses, and the associated enforced sale of the Malibu brand. The facility in Toronto, Ontario (capacity 5 million equivalent units) was closed in March 2003. The facility in LaSalle, Quebec (capacity of 10 million equivalent units) is planned to close in the year ending 30 June 2004.

Spirits are produced in distilleries located worldwide. The principal owned distilleries are 29 whisky distilleries in Scotland, a whisky distillery in Canada and gin distilleries in the United Kingdom and the United States. Diageo produces Smirnoff vodka internationally, Popov vodka and Gordon s vodka in the United States and Baileys in the Republic of Ireland. Rum is blended and bottled in the United States, Canada and the United Kingdom and is distilled, blended and bottled in Australia and Venezuela. All of Diageo s maturing Scotch whisky is located in warehouses in Scotland.

Diageo s principal wineries are in the United States, France and Argentina. Wines are sold both in their local markets and overseas.

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

Diageo s principal brewing facilities are at the St James s Gate brewery in Dublin and in Kilkenny, Waterford and Dundalk in the Republic of Ireland, Park Royal in London, England and in Nigeria, Kenya, Malaysia, Jamaica and Cameroon. Ireland is the main export centre for the Guinness brand. In other countries, Guinness is brewed under licence arrangements. Guinness Draught in cans and bottles, which uses an in-container system to replicate the taste of Guinness Draught, is packaged at Runcorn in England.

Property, plant and equipment Diageo owns or leases land and buildings throughout the world. The production facilities are described above. As at 30 June 2003, Diageo s land and buildings were included in the group s consolidated balance sheet under UK GAAP at a net book value of £774 million. Diageo s largest individual facility, in terms of net book value of property, is St James s Gate brewery in Dublin. Approximately 97% by value of the group s properties were owned and approximately 3% are held under leases running for 50 years or longer. Diageo s properties primarily are a variety of manufacturing, distilling, brewing, bottling and administration facilities spread across the group s worldwide operations, as well as vineyards in the United States. Approximately 49% and 22% of the book value comprises properties located in the United Kingdom and the United States, respectively.

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

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

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

On 4 February 2002, Diageo entered into a supply agreement with Casa Cuervo S.A. de C.V., a Mexican company, for the supply of bulk tequila used to make the José Cuervo line of tequilas and tequila drinks in the United States. The supply agreement will expire on 30 June 2013.

On 22 May 2002, Diageo entered into a long term supply agreement with Destiléria Serrallés, Inc (Serrallés), a Puerto Rico corporation for the supply of rum that is used to make the Captain Morgan line of rums and rum drinks in the United States. The supply agreement will last for 10 years from the time of its signing in 2002, with a three year notice requirement coming into effect once the original 10 year term has expired.

Marketing and distribution Diageo is committed to investing in its brands. £1,185 million was spent worldwide on marketing on premium drinks brands in the year ended 30 June 2003. Marketing was focused on the eight global priority brands, which accounted for 68% of total marketing expenditure on premium drinks products.

Diageo has four major markets North America, Great Britain, Ireland and Spain. In the year ended 30 June 2003, these markets contributed 60% of premium drinks operating profit before exceptional items. In addition, there are 15 key markets which are considered to be individually important, and these contributed 26% of premium drinks operating profit before exceptional items. The remaining geographic markets are reported as venture markets and these accounted for 14% of premium drinks operating profit before exceptional items in the year ended 30 June 2003.

North America North America is the largest market for Diageo, and the largest premium drinks market in the world. Currently, in North America, Diageo markets its products through 14 business teams or clusters (previously five separate spirits in market companies (IMCs)), Diageo Chateau & Estates Wines (DC&E), DIAGEO Guinness USA (DG-USA), a Canadian IMC and a 50% distribution joint venture with Moët Hennessy Schieffelin & Somerset (S&S).

The 14 geographic business units or clusters are managed as three hubs: major states, key states and control states. National brand strategy and strategic accounts marketing are managed at the corporate North America level. The clusters market the majority of Diageo s spirits portfolio (including Smirnoff vodka, Baileys Irish Cream liqueur, José Cuervo tequila, Captain Morgan rum, Crown Royal Canadian whisky, Seagram s 7 American whiskey and Seagram s VO Canadian whisky) across the United States. DG-USA distributes Diageo s US beer portfolio (Guinness stout, Harp lager, Kaliber non-alcoholic lager, Red Stripe lager and formerly Bass Ale on an agency basis) as well as the group s flavored malt beverages (Smirnoff Ice and Smirnoff Ice Triple Black). DC&E markets all Diageo s wine brands (such as Beaulieu Vineyard and Sterling Vineyards) across the United States. The Canada IMC distributes the group s spirits, wine and beer portfolio across all Canadian territories. In the United States, S&S markets a number of Diageo s Scotch whisky brands, including Johnnie Walker Scotch whiskies, J B Scotch whisky, The Classic Malt whiskies and Buchanan s De Luxe whisky along with Cîroc vodka, Tanqueray gin and Tanqueray Sterling vodka, and Moët Hennessy s brands such as Moët & Chandon and Dom Pérignon champagnes and Hennessy cognac. S&S has an agreement with Marnier-Lapostolle, Inc and with Ruffino, which grants S&S the exclusive rights to market, distribute, and sell their products among which are Grand Marnier and certain Chilean wines, including Casa Lapostolle, in the United States.

Within the United States, there are two types of regulatory environments, open states and control states. In open states, spirits companies, are allowed to sell spirits, wine and beer directly to independent distributors. In the majority of the open states within the United States, Diageo trades through a three tier distribution system, where the product is initially sold to distributors, which then sell it to on and off premise retailers. In some states, such as Texas, Diageo sells its products on premise through a four tier system, whereby Diageo sells to large distributors, which then sell to off premise retailers, and off premise retailers with special Class B licenses sell to on premise retailers. In most control states, Diageo markets its spirits products to state liquor control boards through the bailment warehousing system, and from there to state liquor stores. There are variations, for example certain states control distribution but not retail sales. Generally, wines are treated in the same way as spirits, although some states that are control states for spirits are open states for wines. Beer distribution follows open states regulation across the entire United States. In Canada, spirits distribution laws are similar to those of control states in the United States. In Canada, beer distribution laws are generally similar to those for spirits. Diageo, however, has some licences to direct-deliver keg beer to licensed accounts, which account for approximately 52% of Diageo s beer business in Canada.

The completion of the Seagram acquisition provided Diageo with the scale to pursue consolidation of its distributors in a strategy called Next Generation Growth (NGG). Building on the Seagram integration, the strategy focuses on consolidating the distribution of Diageo s US spirits and wine, S&S and former Seagram brands into a single distributor in each state wherever possible. The strategy provided sufficient economies of scale to support the distributor changes, a consolidated network limiting duplication of activities between Diageo and the distributor, increased Diageo and distributor selling capabilities and employs a number of alternative approaches to optimise product distribution.

Diageo has made excellent progress with the NGG initiative. Since the beginning of this calendar year, Diageo has signed distributor or broker agreements in 14 more states, bringing the current total to 34 states. These 34 states, together with Washington DC, represent nearly 80% of Diageo s US spirits and wine volume. Across the United States, Diageo has nearly 2,000 dedicated sales people focused on selling Diageo s and S&S s spirits and wines brands. In future, Diageo s focus will be on helping build the capabilities and selling tools of the distributors dedicated sales force and creating a more efficient and effective value chain. When the distributors and brokers are resourced to the target level, Diageo expect to have nearly 3,000 people selling its brands.

It is expected that the implementation of the NGG strategy will be completed by December 2004. As part of the strategy, risk mitigation plans have been developed for each state. These plans identify the financial, sales, marketing and operations activities that must be implemented to move Diageo s business to a new distributor without significant loss of business. While sales disruptions may occur during the distributor move process, the risk mitigation plans are expected to minimise the sales risk. However, consolidation has given rise, and is likely to continue to give rise, to legal actions, none of which is currently expected to be material to the group.

Great Britain In the Great Britain market, Diageo has the largest brand, by volume, in a number of spirit categories including vodka with Smirnoff, whisky with Bell s and gin with Gordon s. Smirnoff and Bell s are also the top two distilled spirit brands, by volume, in the United Kingdom. Products are distributed both via wholesalers and directly to the major grocers, convenience and specialist stores. In the on trade (for example, licensed bars and restaurants), products are sold through the major brewers, multiple retail groups and smaller regional independent brewers and wholesalers.

Ireland Ireland comprises the Republic of Ireland and Northern Ireland, which together is an important market for Diageo. The Guinness, Smirnoff and Baileys brands are market leaders in their respective categories of long alcoholic drinks, vodka and cream liqueurs, respectively. Budweiser and Carlsberg lagers, also major products in the Diageo portfolio, are brewed and sold under licence in addition to the other local priority brands of Smithwick s ale and Harp lager. In both countries, Diageo distributes directly to both the on trade and the off trade (for example, retail shops and wholesalers). Diageo also brews and packages a range of beers in Ireland for export to the United Kingdom, the United States and other international markets.

Spain Spain is an important Scotch whisky market for Diageo, and Diageo owns two of the top five Scotch whisky brands by volume in Spain, with J B at number one and Johnnie Walker Red Label at number five. This is Diageo s most important J B market, contributing 47% of Diageo s J B total volume. With the addition of Cacique, a former Seagram brand, to its existing brand Pampero, Diageo Spain is leading the dark rum segment, which is the fastest growing segment in Spain. Distribution in Spain is primarily through Diageo s own distribution company.

Key markets There are 15 key markets. These are markets which make a significant contribution in their own right, but still rely on Diageo s global functions to support their businesses. Key markets are: Africa (excluding North Africa), Australia/New Zealand, Brazil/Paraguay, Colombia, France, Germany (a key market from 1 July 2003), Greece/Turkey, Japan, South Korea, Mexico, Taiwan, Thailand, Uruguay, Venezuela and Global Duty Free. Portugal was a key market until 30 June 2003.

In Latin America, distribution is achieved through a mixture of Diageo companies and third party distributors.

Africa (excluding North Africa) is one of the longest established and largest markets for the Guinness brand, with the brewing of Guinness Foreign Extra Stout in a number of African countries either through subsidiaries or under licence. Diageo has a wholly owned subsidiary in South Africa and in Cameroon and also has majority owned subsidiaries in Nigeria, Ghana, Kenya, Uganda, Réunion and the Seychelles.

Global Duty Free is Diageo s sales and marketing organisation which targets the international duty free consumer in duty free outlets such as airport shops, airlines and ferries around the world. The global nature of this organisation allows a co-ordinated approach to brand building initiatives and builds on shopper insights in this trade channel where consumer behaviour tends to be different from domestic markets.

In European key markets, Diageo distributes its spirits brands primarily through its own distribution companies. However, in France, Diageo sells its spirits and wine products through a joint arrangement with Moët Hennessy, and its beer products through Interbrew.

In Thailand, Japan and Taiwan Diageo distributes its spirits and wine brands through joint arrangements with Moët Hennessy. In Australia, Diageo has its own distribution company and also has licensed brewing arrangements with Carlton-United Breweries, while in New Zealand it operates through third party distributors and has licensed brewing arrangements with Lion Nathan. In South Korea, Diageo s own distribution company distributes the majority of Diageo s brands. The remaining brands are distributed through third party distributors. In Japan, Guinness is distributed through an associated company of the group.

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

Venture markets This grouping comprises all other markets, with the largest being North Africa, the Middle East, Jamaica, Central America, the Caribbean, the Canary Islands, Malaysia, Italy, Belgium, Portugal (a venture market from 1 July 2003), Netherlands and the Nordics. In these markets there is a focus on fewer brands and lean but flexible organisation structures are deployed whilst global best practices in areas such as consumer marketing, customer management and people development are applied. Germany was a venture market until 30 June 2003.

In the European venture markets, Diageo distributes its brands primarily through its own distribution companies. In Asia Pacific, Diageo works with a number of joint venture partners. For Diageo s spirits and wine brands, the most significant of these is Moët Hennessy with operations in Malaysia, Singapore, China and Hong Kong. In Malaysia and Singapore, Diageo s own and third party beers are brewed and distributed through Diageo s business with Asia Pacific Breweries Limited. In addition, Diageo owns a controlling interest in Desnoes & Geddes Limited, the Jamaican local brewer of Red Stripe lager. In general, the remaining markets are served by third party distribution networks controlled by regional offices.

Seasonal impacts Christmas provides the peak period for premium drinks sales. Historically, approximately 30% of premium drinks sales volume occurs in the last three months of each calendar year.

Employees Diageo s goal is to be an Employer of Choice offering an energising work environment, personal growth, and recognition and attractive rewards for the performance contribution its people make to the group. Its employee policies are designed to support these goals and to do so in a manner that is fair and equitable to all employees. These policies take account of external legislation, internal codes of conduct, as well as Diageo s values as an organisation.

Diageo is a multi-cultural community operating in an increasingly diverse business world and is committed to active equality and diversity practices. The group offers people with disability the same opportunities for employment, training and career progression as other employees. It is also committed to attracting and retaining talented people. Diageo invests in the growth and development of its people, which contributes directly to the performance and results of the business. Where practical, Diageo encourages flexible ways of working to enable employees to take some control over the balance between work and home life. Diageo s reward systems recognise the contribution employees make to success and reflect the value of the role they are performing.

Diageo is committed to the safety and wellbeing of employees at work. It promotes responsible drinking behaviour among all its people. Diageo is committed to open and continuous dialogue with its employees as a way to inform and engage them in the company s strategy and business goals as well as harnessing the ideas employees will have on improving broad areas of business performance. Each senior manager is responsible for supporting the Diageo Executive and the senior leadership community in delivering against these communication and employee engagement goals. The group has an intranet web site from which employees with access to a computer can obtain timely and accurate news and information.

The group has entered into numerous collective bargaining agreements and believes that its employee relations are satisfactory. Diageo s average number of employees during each of the three years ended 30 June 2003 was as follows:

			2003			2002			2001
	Full time	**Part time**	**Total**	Full time	Part time	Total	Full time	Part time	Total
Premium drinks	**23,427**	**1,134**	**24,561**	22,841	1,078	23,919	21,363	628	21,991
Discontinued operations	**8,965**	**5,429**	**14,394**	25,734	12,471	38,205	37,747	11,785	49,532
	32,392	**6,563**	**38,955**	48,575	13,549	62,124	59,110	12,413	71,523

Premium drinks includes ex-Seagram employees from 21 December 2001. Discontinued operations include employees for the quick service restaurants business prior to 13 December 2002 and packaged food prior to 30 October 2001, reflecting the periods in which the group owned the businesses.

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

In spirits and wine, Diageo s major global competitors are Pernod Ricard, Allied Domecq, Bacardi-Martini Inc, and Brown-Forman, each of which has several brands that compete directly with Diageo brands. Diageo believes, based on its analysis of data compiled by Impact, that Diageo and these four other major international companies account for approximately 62% of the volume of the top 100 premium distilled spirits in the world. In addition, Diageo faces competition from local and regional companies in the countries in which it operates.

In beer, the Guinness brand competes in the overall beer market with its key competitors varying by market. These include Heineken in Ireland and several markets in Africa, Coors Brewing (Carling) in the United Kingdom and Carlsberg in Malaysia.

Diageo aims to maintain and improve its market position by enhancing the consumer appeal of its brands through consistent high investment in marketing support focused around the eight global priority brands. Diageo makes extensive use of magazine, newspaper, point of sale and poster and billboard advertising, and uses radio, cinema and television advertising where appropriate and permitted by law. Diageo also runs consumer promotional programmes in the on trade (for example, licensed bars and restaurants).

Research and development The overall nature of the group s business does not demand substantial expenditure on research and development. However, the group has ongoing programmes for developing new drinks products. In the year ended 30 June 2003, the group s research and development expenditure amounted to £15 million (2002 £28 million; 2001 £71 million). Research and development expenditure is written off in the year in which it is incurred.

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

Regulations and taxes In the United States, the beverage alcohol industry is subject to strict federal and state government regulations covering virtually every aspect of its operations, including production, marketing, sale, distribution, pricing, labelling, packaging and advertising.

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

Import and excise duties can have a significant impact on the final pricing of Diageo s products to consumers. These duties have an impact on the competitive position versus other brands. The group devotes resources to encouraging the equitable taxation treatment of all beverage alcohol categories and to reducing government-imposed barriers to fair trading.

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

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

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

In addition, indications that regulatory bodies in the United States may change standards regarding the alcohol content and proper categorisation of flavored malt beverages such as Smirnoff Ice could have an adverse impact on the sales of the group. Regulatory decisions and changes in the legal and regulatory environment could increase Diageo s costs and liabilities or impact its business activities.

Business services Diageo has committed to re-engineer its key business activities with customers, consumers, suppliers and the processes that summarise and report financial performance. In that regard, global processes are being designed, built and implemented in North America, Great Britain, Ireland and segments of global supply.

A new business service centre in Budapest, Hungary opened in April 2002 and now performs various process tasks for Great Britain, Ireland and global supply. Additional processes currently located in Great Britain and other European countries are scheduled to transfer to Budapest during the next few years.

Associates Diageo s principal associate in the premium drinks segment is Moët Hennessy. It also owns shares in a number of other associates. In the year ended 30 June 2003, premium drinks share of profit of associates before interest and exceptional items was £191 million, of which Moët Hennessy accounted for £177 million.

Moët Hennessy Diageo owns 34% of Moët Hennessy, the spirits and wine subsidiary of LVMH Moët Hennessy Louis Vuitton SA (LVMH). LVMH is based in France and is listed on the Paris Stock Exchange. Moët Hennessy is also based in France and is a producer and exporter of a number of brands in its main business areas of champagne and cognac. Its principal products include champagne brands, Moët & Chandon(including Dom Pérignon), Veuve Clicquot and Mercier, all of which are included in the top 10 champagne brands worldwide by volume, and Hennessy which is the top cognac brand worldwide by volume.

Since 1987, a number of joint distribution arrangements have been established with LVMH, principally covering distribution of Diageo s premium brands of Scotch whisky and gin and Moët Hennessy s premium champagne and cognac brands in the Asia Pacific region, the United States, and France. S&S was established as a joint venture in the United States and distributes a number of Diageo s Scotch whisky brands along with Cîroc vodka, Tanqueray gin and Tanqueray Sterling vodka as well as Moët Hennessy brands see Marketing and distribution North America . Diageo and LVMH have each undertaken not to engage in any champagne or cognac activities competing with those of Moët Hennessy. The arrangements also contain certain provisions for the protection of Diageo as a minority shareholder in Moët Hennessy.

Acquisitions and disposals/termination of businesses and distribution rights Diageo has made a number of strategic acquisitions and disposals of brands, equity interests in premium drinks businesses and distribution rights.

Seagram On 21 December 2001, Diageo and Pernod Ricard completed the acquisition of the Seagram spirits and wine businesses from Vivendi for $8.15 billion (£5.62 billion) in cash, subject to certain debt, working capital and other adjustments. Diageo s share of the purchase price after adjustments was £3.7 billion.

The transaction was structured such that each of Diageo and Pernod Ricard would acquire certain businesses and related assets for integration into their respective global premium drinks businesses, with other businesses and related assets being acquired and held jointly pending their disposal. The spirits and wine businesses comprised a number of separate legal entities and assets which were acquired by either Diageo, Pernod Ricard, or both parties jointly, but the effect was that the purchase consideration was funded in the overall proportions of 60.9% and 39.1% between Diageo and Pernod Ricard, respectively.

Diageo has accounted for the transaction as an acquisition, reflecting profits and losses arising from those businesses and related assets acquired for its own use, consolidated from the acquisition date. For those businesses and assets acquired and/or held jointly pending their disposal (disposal assets), Diageo and Pernod Ricard shared the net proceeds of disposal in the proportion 60.9% and 39.1% respectively. Accordingly the results of these brands have been excluded from the group consolidation. Diageo accounted for its share of the net disposal proceeds as businesses held for resale. The disposals of these businesses were substantially completed within 12 months of the original acquisition.

The sales of the largest disposal assets were achieved in the year ended 30 June 2002. These included the UK based off-licence chain Oddbins to the Castel Frères Group of France; the Four Roses bourbon business to Kirin Brewery Co, Ltd of Japan; the Mumm Sekt sparkling wine business to Rotkäppchen Sektkellerei GmbH & Co KG of Germany; the Seagram s Mixers business to The Coca-Cola Company; the Sandeman port and sherry business to Sograp Holding SGPS SA of Portugal; and the Mumm Cuvée Napa sparkling wine business to Allied Domecq. In the year ended 30 June 2003, a number of smaller disposals were made, including Maschio sparkling wines and OVD, Woods and VAT 19 rums. Diageo s share of net cash proceeds received totalled £268 million which have been accounted for in the two years ended 30 June 2003.

Other In September 2002, Diageo announced that it would relinquish its 1998 US Importation and Distribution Agreement rights for Bass Ale to Bass parent company, Interbrew, effective 30 June 2003 for a consideration of $105 million (£69 million). Under the 1998 agreement, Diageo had the right to continue selling and marketing the brand in the United States until July 2016. The consideration included $10 million as a contribution to inventory management costs during the year ended 30 June 2003, and this element of the consideration has been accounted for as operating income. The balance of the consideration, net of provisions and legal expenses, of £57 million has been accounted for as an exceptional operating item.

In December 2002 East African Breweries Limited (EABL), a Diageo subsidiary, acquired 20% of the issued share capital of Tanzania Breweries Limited from SABMiller Africa in exchange for 20% of the issued share capital of Kenya Breweries Limited. EABL also disposed its entire holding of shares in Kibo Breweries Limited and acquired Castle Brewing Kenya Limited.

Diageo s distribution rights in relation to certain Brown-Forman brands, including Jack Daniels and Southern Comfort in the United Kingdom, terminated on 1 August 2002. In the year ended 30 June 2002, these brands contributed £14 million to operating profit.

On 15 August 2003 it was announced that Diageo and Brown-Forman had resolved their dispute over the termination of these rights and that Diageo would receive £9 million as settlement.

In May 2002, Diageo completed the disposal of the Malibu brand to Allied Domecq for a consideration of £554 million. The disposal of Malibu was a condition for obtaining regulatory clearance for the acquisition of the Seagram spirits and wine businesses.

In May 2002, Diageo disposed of the Glen Ellen and MG Vallejo wines to a company managed by The Wine Group, Inc. for a consideration of $83 million.

On 5 February 2002, Diageo and José Cuervo SA (José Cuervo) agreed to terminate their litigation in respect of a change of control issue which José Cuervo claimed arose as a result of the merger of GrandMet and Guinness, and new arrangements were formalised for the distribution rights for the José Cuervo brand in the United States. These arrangements now extend to 2013. The settlement in favour of José Cuervo included the return of Diageo s 45% equity stake it held in José Cuervo and a net cash payment of £85 million. Diageo and José Cuervo also agreed to terminate José Cuervo s distribution of certain Diageo brands in Mexico and for José Cuervo to transfer to Diageo its 49% interest in the Smirnoff trademark in Mexico. The settlement resulted in a charge before taxes of £220 million to exceptional items in the profit and loss account for the year ended 30 June 2002, and a reduction in operating profit of £8 million in the period ended 30 June 2002. Further, effective 1 October 2002, the distribution rights to José Cuervo 1800 were transferred to a third party. José Cuervo 1800 contributed £13 million to operating profit in the year ended 30 June 2002.

In September 2001, Diageo disposed of its Croft and Delaforce port and sherry businesses to a consortium of Gonzalez Byass S. A. and Taylor Fonseca S. A. for a consideration of 82 million (£50 million).

In July 2001, Diageo disposed of its Guinness World Records business to Gullane Entertainment plc for £50 million.

In January 2001, Diageo acquired additional shares in East African Breweries Limited which as a result became a subsidiary. In October 2000, Diageo acquired the remaining 50% share of Bundaberg rum, Australia s second largest spirit brand. The annualised turnover of these two acquisitions is approximately £320 million and their annualised contribution to operating profit is approximately £40 million.

In January 2001, Diageo disposed of UDV Indústria E Comércio Ltda, the Brazilian entity that produces and markets local brands Dreher, Old Eight and Drurys to Campari.

During the year ended 30 June 2001, the distribution rights for Stolichnaya vodka in the United States ended. In the year ended 30 June 2001, Stolichnaya in the United States contributed approximately £32 million to operating profit.

Other businesses

General Mills, Inc Following the disposal of Pillsbury and a subsequent sale of shares in General Mills, the group currently holds an equity stake of 79 million ordinary shares (21%) in General Mills. The following business description is based on publicly available information about General Mills filed with the SEC. General Mills is a global consumer foods company based in the United States. General Mills owns a number of brand names and its primary objective is to build the equity of these brands with strong consumer directed advertising and innovative merchandising. The principal businesses owned by General Mills are Big G ready-to-eat cereals, Betty Crocker dessert, baking, dinner mix and snack products, Yoplait and Colombo yoghurt and former Pillsbury brands such as Pillsbury s refrigerated dough and other dough based goods, Old El Paso Mexican foods, Progresso soup, Green Giant vegetables and a foodservice business.

During the year ended 30 June 2003, the equity stake contributed £287 million to share of profits of associates before exceptional items, £73 million to interest expense and £69 million to tax expense. The group s share of General Mills exceptional items before taxation amounted to a charge of £18 million. During the year ended 30 June 2003 the group received dividends of £54 million from General Mills.

General Mills has options to purchase 29 million of Diageo s holding of General Mills ordinary shares for $51.56 per share until 28 October 2005 subject to certain limitations.

Discontinued operations

Quick service restaurants Diageo completed the disposal of Burger King on 13 December 2002. See Operating and financial review Off-balance sheet arrangements . Burger King is a leading company in the worldwide quick service restaurant industry. In the year ended 30 June 2003, Burger King contributed turnover of £479 million and operating profit of £53 million to Diageo.

Packaged food Diageo completed the disposal of Pillsbury to General Mills on 31 October 2001. Pillsbury contributed turnover of £1,455 million and operating profit before exceptional items of £184 million in the year ended 30 June 2002. As a division of Diageo, Pillsbury produced and distributed leading food brands including Pillsbury s refrigerated dough and other dough based goods, Old El Paso Mexican foods, Progresso soups, Green Giant vegetables and Häagen-Dazs ice cream, and, in addition, operated a foodservice business.

In connection with the disposal of Pillsbury Diageo has guaranteed the debt of a third party up to an amount of $200 million (£121 million).

Risk factors

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

Diageo may not be able to derive the expected benefits from its strategy to focus on premium drinks or its change and cost-saving programmes designed to enhance earnings On 17 July 2000, Diageo announced the integration of its spirits, wine and beer businesses to create a premium drinks business as part of an integrated strategy to be a focused premium drinks company. In line with this strategy, Diageo acquired on 21 December 2001 certain of the Seagram spirits and wine businesses. There can be no assurance that Diageo s strategic focus on premium drinks will result in better opportunities for growth and improved margins.

Following the acquisition of the Seagram spirits and wine businesses, Diageo has been consolidating the Diageo and former Seagram brands into a single distributor in each US state. This consolidation has given rise and could continue to give rise to legal actions. See Business description Premium drinks Marketing and distribution North America .

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further acquisitions. There can be no guarantee that any such acquisition would deliver the benefits intended.

Certain change programmes have been initiated (especially in the United States, Ireland and Great Britain) designed to improve the effectiveness and efficiency of end-to-end operating, administrative and financial systems and processes. This includes moving transaction processing from a number of markets to shared service centres. There can be no certainty that these programmes will deliver the expected benefits. There is likely to be disruption caused to production processes and possibly to administrative and financial systems as these changes are effected. They could also lead to adverse customer or consumer reaction. Any failure of information systems could adversely impact Diageo s ability to operate.

Regulatory decisions and changes in the legal and regulatory environment could increase Diageo s costs and liabilities or limit its business activities Diageo s operations are subject to extensive regulatory requirements regarding production, product liability, distribution, marketing, labelling, advertising and labour and environmental issues. Changes in laws, regulations or governmental policy, could cause Diageo to incur material additional costs or liabilities that could adversely affect its business. In particular, governmental bodies in countries where Diageo operates may impose new labelling, product or production requirements, limitations on the advertising activities used to market beverage alcohol, restrictions on retail outlets or other restrictions on marketing and distribution. Regulatory authorities under whose laws Diageo operates may also have enforcement power that can subject the group to actions such as product recall, seizure of products or other sanctions, which could have an adverse effect on its sales or damage its reputation.

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

Companies in the beverage alcohol industry may also be exposed to class action or other litigation relating to alcohol abuse problems or health consequences from the misuse of alcohol. If the industry were to be involved in such litigation, Diageo s business could be materially adversely affected.

US regulatory authorities are considering possible changes to the regulation of flavored malt beverages. Discussions are taking place in respect of possible rule changes related to the alcohol content in flavored malt beverages. Revised rules could result in changes in the methods by which Diageo currently produces flavored malt beverages and therefore increase the costs of production and/or distribution of these products. In addition, possible regulatory changes could impose adverse federal tax consequences on the import and sale of flavored malt beverages. Flavored malt beverages form a component of Diageo s growth strategy within the United States and it is possible that the implementation of any regulatory changes by the US authorities could have an adverse effect on Diageo s future profitability.

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

Demand for Diageo s products may be adversely affected by changes in consumer preferences and tastes Diageo s portfolio includes certain of the world s leading beverage alcohol brands as well as brands of local prominence. Maintaining Diageo s competitive position depends on its continued ability to offer products that have a strong appeal to consumers. Consumer preferences may shift due to a variety of factors, including changes in demographic and social trends, changes in travel, vacation or leisure activity patterns and a downturn in economic conditions, which may reduce consumers willingness to purchase premium branded products. In addition, concerns about health effects due to negative publicity regarding alcohol consumption, negative dietary effects, regulatory action or any litigation or customer complaints against companies in the industry may have an adverse effect on Diageo s profitability.

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

In addition, both the launch and ongoing success of new products is inherently uncertain especially as to their appeal to consumers; the failure to launch a new product successfully can give rise to inventory write offs and other costs and can affect consumer perception of an existing brand. Growth in Diageo s business has been based on both the launch of new products and the growth of existing products. Product innovation remains a significant aspect of Diageo s plans for growth. There can be no assurance as to Diageo s continuing ability to develop and launch successful new products or variants of existing products or as to the profitable lifespan of newly or recently developed products.

Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for Diageo s products and erosion of its competitive and financial position.

If the social acceptability of Diageo s products declines, or if litigation is directed at the beverage alcohol industry, Diageo s sales volume could decrease and the business could be materially adversely affected In recent years, there has been increased social and political attention directed to the beverage alcohol industry. Diageo believes that this attention is the result of public concern over problems related to alcohol abuse, including drink driving, underage drinking and health consequences from the misuse of alcohol. If the social acceptability of beverage alcohol were to decline significantly, sales of Diageo s products could materially decrease. Similarly, recent litigation against the tobacco industry has directed increased attention to other industries, including the beverage alcohol industry. If the drinks industry were to become involved in litigation of the type brought against other industries, such as tobacco, Diageo s business could be materially adversely affected.

Diageo learned on 20 November 2003 that a purported class action lawsuit, Hakki v. Adolph Coors Company et al., was commenced against a number of alcohol beverage companies on 14 November 2003, including Diageo, in the Superior Court of Washington, D.C. Diageo has not been served with a lawsuit. The complaint asserts claims under the District of Columbia Consumer Protection Procedures Act (DCCPPA) and the common law of the District of Columbia that the defendants specifically targeted the US advertising and marketing of certain of their products to individuals below the 21 year-old legal purchase age. The complaint alleges that at least 15-20% of all alcoholic beverages sold in the United States are consumed by underage drinkers . The complaint further alleges that profits earned by the defendants from the alleged illegal sales to underaged drinkers greatly exceed $1 billion per year .

The lawsuit seeks certification as a class action on behalf of (a) parents and guardians whose funds were used by their children under 21 from 1982 to the present without their knowledge to purchase alcohol beverages marketed by the defendants, on whose behalf monetary recovery is sought and (b) the parents and guardians of all children under 21, on whose behalf the complaint requests that the Court enter an injunction prohibiting the defendants from marketing alcohol beverages to underage persons.

The prayer for relief in the complaint seeks, among other matters, (i) that defendants each disgorge to the purported class all amounts by which they have been allegedly unjustly enriched, plus costs and interest; (ii) rescission of the alleged transactions whereby defendants allegedly obtained revenues from the illegal sale of alcoholic beverages to underage consumers and ordered to pay such monies to the purported class; and (iii) to assess all defendants jointly and severally for all alleged actual damages sustained by the purported plaintiff class plus treble damages or $1,500 per violation, whichever is greater, punitive damages, attorneys fees, costs of suit, and interest.

Diageo intends to strenuously defend this purported action.

See Additional information for shareholders Legal proceedings for further detail.

Diageo s operating results may be adversely affected by increased costs or shortages of raw materials or labour or disruption to production facilities The raw materials which Diageo uses for the production of its food and beverage products are largely commodities that are subject to price volatility caused by changes in global supply and demand, weather conditions, agricultural uncertainty or governmental controls. If commodity price changes result in unexpected increases in raw materials cost or the cost of packaging materials, Diageo may not be able to increase its prices to offset these increased costs without suffering reduced volume, revenue and operating income. Diageo may be adversely affected by shortages of such raw materials or packaging materials.

Similarly, Diageo s operating results could be adversely affected by labour or skill shortages or increased labour costs due to increased competition for employees, higher employee turnover or increased employee benefit costs. Diageo s success is dependent on the capability of its employees. There is no guarantee that Diageo will continue to be able to recruit, retain and develop the capabilities that it requires to deliver its strategy, for example in relation to sales and marketing capability within markets or in its senior management.

Diageo would be affected if there were a catastrophic failure of its major production facilities. See Business description Premium drinks Production for a listing of Diageo s principal production sites. In addition, the maintenance and development of information systems may result in systems failures which may adversely affect business operations.

Diageo has a substantial inventory of aged product categories, principally Scotch whisky and Canadian whisky, which mature over periods of up to 30 years. As at 30 June 2003, the historical cost of Diageo s maturing inventory amounted to £1,409 million. The maturing inventory is stored primarily in Scotland, and the loss through contamination, fire or other natural disaster of all or a portion of the stock of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, Diageo would not be able to meet consumer demand for these products as it arises. In addition, there can be no assurance that insurance proceeds would cover the replacement value of Diageo s maturing inventory or other assets were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third parties.

Diageo s business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates Diageo s business is dependent on general economic conditions in the United States, Great Britain and other important markets. A significant deterioration in these conditions, including a reduction in consumer spending levels, could have a material adverse effect on Diageo s business and results of operations. In addition, Diageo may be adversely affected by political and economic developments in any of the countries where Diageo has distribution networks, production facilities or marketing companies. Diageo s operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Current examples of such potential upheaval are currency restrictions and potential further disruption to movement of goods into and out of Venezuela, affecting both imports of goods (principally Scotch whisky into Venezuela) and export of rum (Cacique, especially to Spain), unrest in the Middle East, and the impact on tourism and travel of both terrorist threats and ongoing fears of global pandemics, such as SARS. These disruptions can affect Diageo s ability to import or export products and ability to repatriate funds as well as the levels of consumer demand (for example in duty free outlets at airports or in on trade premises in affected regions) and therefore on Diageo s levels of sales or profitability.

Diageo may also be adversely affected by movements in the value of, and returns from, the investments held by its pension funds.

Diageo may be adversely affected by fluctuations in exchange rates. The results of operations of Diageo are accounted for in pounds sterling. Approximately 35% of sales in the year ended 30 June 2003 were in US dollars, approximately 21% were in sterling and approximately 22% were in euros. Movements in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo s reported results of operations from year to year.

Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense. To partly delay any adverse impact from interest rate movements, Diageo maintains approximately 50% of its debt at fixed interest rates. See Operating and financial review Risk management .

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

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

Diageo remains exposed to factors affecting the US food industry While Diageo s strategy is to focus on premium drinks, it remains exposed to factors affecting the US food industry through its equity interest in General Mills and its residual exposure to Burger King. Following the disposal of Pillsbury to General Mills, Diageo now holds approximately 21% of General Mills outstanding share capital. The market value of this interest may be affected adversely by a variety of factors, including the performance of General Mills and the extent to which that performance meets investors expectations, economic conditions in the United States, including the US financial markets, and the dilution of our holding as a result of future issues of shares by General Mills. On 15 October 2003, General Mills announced that it had received a formal request from the US Securities and Exchange Commission (the SEC) concerning its sales practices and related accounting. General Mills stated that the SEC had advised the company that it had not reached any conclusions related to the information request.

In connection with the disposal of Burger King, Diageo has retained $212 million (£129 million) of subordinated debt, with a 10 year maturity, from the entity owning Burger King. In addition, Diageo has guaranteed up to $850 million (£515 million) of borrowings of the Burger King company. These loans have a term of five years although Diageo and Burger King have structured their arrangements to encourage refinancing by Burger King on a non-guaranteed basis prior to the end of the five years. There are no assurances, however, that such refinancing will occur or that no liability will arise with respect to the financing of the Burger King disposal. Both General Mills and Burger King may also be subject to factors affecting the food industry generally, including increased competition, changes in consumer preferences and concerns over obesity and the potential for related litigation or regulation. These factors could also affect Diageo s ability over time to reduce its equity interest in, or affect the price it receives for, General Mills shares. They could also result in Diageo not fully recovering the book value of its subordinated debt due from Burger King and/or having to make payments under the guarantee of Burger King s debt.

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

Table of Contents

Cautionary statement concerning forward-looking statements

This document contains statements with respect to the financial condition, results of operations and business of Diageo and certain of the plans and objectives of Diageo with respect to these items. These forward-looking statements are made pursuant to the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to Diageo and parties or consortia who have purchased Diageo s assets, actions of parties or consortia who have purchased Diageo s assets, anticipated cost savings or synergy and the completion of Diageo s strategic transactions, are forward-looking statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo s control.

These factors include, but are not limited to:

- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo s market share, increase expenses and hinder growth potential;
- the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergy and/or costs savings;
- Diageo s ability to complete future acquisitions and disposals;
- legal and regulatory developments, including changes in regulations regarding consumption of, or advertising for, beverage alcohol, changes in accounting standards, taxation requirements, such as the impact of excise tax increases with respect to the premium drinks business and environmental laws;
- changes in the food industry in the United States, including increased competition and changes in consumer preferences;
- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues;
- changes in the cost of raw materials and labour costs;
- changes in economic conditions in countries in which Diageo operates, including changes in levels of consumer spending;
- levels of marketing and promotional expenditure by Diageo and its competitors;
- renewal of distribution rights on favourable terms when they expire;
- termination of existing distribution rights in respect of agency brands;
- technological, developments that may affect the distribution of products or impede Diageo s ability to protect its intellectual property rights; and
- changes in financial and equity markets, including significant interest rate and foreign currency rate fluctuations, which may affect Diageo s access to or increase the cost of financing.

All oral and written forward-looking statements made on or after the date of this document and attributable to Diageo are expressly qualified in their entirety by the above factors and the Risk factors contained in this document for the year ended 30 June 2003.

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

Operating and financial review

Introduction

Information presented Diageo s strategy is to focus on its branded drinks businesses with international potential. Diageo completed the disposal of its quick service restaurants business on 13 December 2002 and the combination of its packaged food business with General Mills on 31 October 2001.

The consolidated information for the year ended 30 June 2003 presented in this annual report includes the results of the quick service restaurants business for the five and a half months ended 13 December 2002. In accordance with UK GAAP, the results of the quick service restaurants and, in the comparative periods, the packaged food businesses have been included within discontinued operations.

The following discussion is based on Diageo s UK GAAP results for the year ended 30 June 2003 compared with the year ended 30 June 2002, and the year ended 30 June 2002 compared with the year ended 30 June 2001.

There are a number of accounting differences between UK and US GAAP. A reconciliation of net income from UK to US GAAP and an explanation of the differences between UK and US GAAP are set out in the US GAAP information in note 32 of the consolidated financial statements, with a further explanation of significant reconciling items between UK and US GAAP net income which is included in Discussion of US GAAP differences below.

Presentation of information in relation to the premium drinks business In addition to describing the significant factors impacting on the profit and loss account compared to the prior year for both of the years ended 30 June 2003 and 30 June 2002, additional information is also presented on the operating performance of the premium drinks segment.

Volume Volume has been measured on an equivalent units basis to nine litre cases of spirits. Equivalent units are calculated as follows: beer in hectolitres divide by 0.9, wine in nine litre cases divide by five, ready to drink in nine litre cases divide by 10. An equivalent unit represents approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer.

Reference is made to information regarding the premium distilled spirits market segments from Impact and other independent industry sources in the markets in which Diageo operates. Impact collects information on the premium distilled spirits market from a variety of sources, including brand owners, import and export enterprises, trade associations and government agencies such as the US Commerce Department. Impact is aware of, and has consented to, being named in this document. Market data information is taken from industry sources in the markets in which Diageo operates. Diageo believes that all of the information in this document that is based on statements from Impact and other industry sources is reliable.

Non-GAAP measures Organic movement in volume, net sales (after deducting excise duties) and operating profit before exceptional items are measures not specifically used in the consolidated financial statements themselves (non-GAAP measures). The performance of the premium drinks segment is discussed using these measures.

Since overall performance is the result of a number of factors, breaking these down into broad categories and discussing each of these categories assists management and the reader in understanding the overall picture. Once factors such as the effect of currency movements, excise duties and acquisitions and disposals have been discussed, the above measures enable the reader to focus on the performance of the premium drinks brand portfolio which is common to both periods. Organic movement measures also most closely reflect the way in which the business is managed, for the same reasons of achieving comparability between periods. Diageo s strategic planning and budgeting process is based on organic movement in volume, net sales (after deducting excise duties) and operating profit before exceptional items, and these measures closely reflect the way in which operating targets are defined and performance is monitored by the group s management. These measures are chosen for planning, budgeting and reporting purposes since, as explained further below, they represent those measures which local managers are most directly able to influence and they enable consideration of the underlying business performance without the distortion caused by fluctuating exchange rates, excise duties, acquisitions and disposals. In addition, management bonus targets are set based on the performance of the business as measured by organic operating profit growth before exceptional items.

The group s management believe these measures provide valuable additional information for users of the financial statements in understanding the group s performance since they provide information on those elements of performance which local managers are most directly able to influence and focus on that element of the core brand portfolio which is common to both periods. However, whilst these measures are important in the management of the business, they should not be viewed as replacements for, but rather as complementary to, the comparable GAAP measures such as turnover and reported (rather than organic) movements in individual profit and loss account captions. These GAAP measures reflect all of the factors which impact the business and the discussion in relation to premium drinks should be read in the context of the discussion of the overall group performance.

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

Also in the discussion of the performance of the premium drinks segment, certain information is presented using sterling amounts on a constant currency basis. This strips out the translation effect of foreign exchange and enables an understanding of the underlying performance of the market that is most closely influenced by the actions of the group s management. The risk from foreign exchange translation is managed centrally and is not a factor over which local managers have any control.

During the last two years the group has undergone a major restructuring which has resulted in the disposal of its food businesses (Pillsbury and Burger King) and its Malibu rum brand and the acquisition of the Seagram spirits and wine businesses. As a consequence results are not comparable from period to period and require additional explanation. For this reason it is necessary to separate the effects of acquisitions and disposals on the sales and profit of brands acquired or disposed of in order to provide information on the underlying performance of individual markets.

Adjusting for these items enables group management to monitor performance over factors which local managers are most directly able to influence in relation to the core ongoing brand portfolio. The underlying performance on a constant currency basis and excluding the impact of acquisitions and disposals is referred to as organic performance, and further information on the calculation of organic measures as used in the discussion of the premium drinks segment is included below.

In order to assist the reader of the financial statements, the comparisons of both 2003 with 2002 and 2002 with 2001 include tables which present the exchange, disposal, acquisition and organic components of the year on year movement for each of turnover, net sales (after deducting excise duties) and operating profit before exceptional items.

Calculation of organic movement Where a business, brand distribution right or agency agreement was disposed of, or terminated, in the current year, the group, under organic movement calculations, adjusts the results for the prior year to exclude the amount the group earned in that period that it could not have earned in the current period (i.e. the period between the date in the prior period, equivalent to the date of the disposal in the current period, and the end of the prior period). As a result, the organic movement numbers reflect only comparable performance. Similarly, if a business was disposed of part way through the equivalent prior period then its results would also be completely excluded from that prior period s performance in the organic movement calculation, since the group recognised no contribution from that business in the current year.

For acquisitions, a similar adjustment is made in the organic movement calculations. For acquisitions in the current period, the post acquisition results are excluded from the organic movement calculations. For acquisitions in the prior period, post acquisition results are included in the prior period but are only included from the anniversary of the acquisition date in the current period.

A further adjustment in organic movement is made to exclude the effect of exchange rate movements by recalculating the prior period s results as if they had been generated at the current period s exchange rates.

Organic movement percentages are calculated as the organic movement amount in £ million, expressed as the percentage of the prior period results at current year exchange rates and after adjusting for disposals. The basis of calculation means that the results used to measure organic growth for a given year will be adjusted when used to measure organic growth in the subsequent year.

Operating results 2003 compared with 2002

Summary consolidated profit and loss account

	2003			2002		
	Before exceptional items £ million	**Exceptional items £ million**	**Total £ million**	Before exceptional items £ million	Exceptional items £ million	Total £ million
Turnover	**9,440**		**9,440**	11,282		11,282
Operating costs	**(7,411)**	**(168)**	**(7,579)**	(9,176)	(453)	(9,629)
Operating profit	**2,029**	**(168)**	**1,861**	2,106	(453)	1,653
Share of profits of associates	**478**	**(21)**	**457**	324	(41)	283
Disposal of fixed assets and businesses		**(1,313)**	**(1,313)**		799	799
Interest payable (net)	**(351)**		**(351)**	(399)		(399)
Profit/(loss) before taxation	**2,156**	**(1,502)**	**654**	2,031	305	2,336
Taxation	**(539)**	**52**	**(487)**	(511)	(121)	(632)
Profit/(loss) after taxation	**1,617**	**(1,450)**	**167**	1,520	184	1,704
Minority interests	**(91)**		**(91)**	(87)		(87)
Profit/(loss) for the year	**1,526**	**(1,450)**	**76**	1,433	184	1,617

Note: Exceptional items under UK GAAP represent items which, in management s judgement, are material items that arise from events or transactions that fall within the ordinary activities of the group and, by virtue of their size or incidence, should be separately disclosed if the financial statements are to properly reflect the results for the period. Exceptional items under UK GAAP do not represent extraordinary items under US GAAP.

Turnover

Overall Turnover decreased by £1,842 million (16%) from £11,282 million in the prior year to £9,440 million in the year ended 30 June 2003, following the disposals of Pillsbury in October 2001 and Burger King in December 2002, both of which are accounted for as discontinued operations and which contributed £479 million to turnover in the year ended 30 June 2003 compared with £2,578 million in the prior year.

Continuing operations premium drinks For continuing operations, which now represents Diageo s premium drinks business, turnover increased by £257 million (3%) from £8,704 million in the year ended 30 June 2002 to £8,961 million in the year ended 30 June 2003. The Seagram spirits and wine businesses, which were acquired on 21 December 2001, contributed £1,214 million to turnover during the year, compared with £573 million in the six month period ended 30 June 2002. This increase attributable to the acquired Seagram business was partly offset by the impact of brands which were disposed of during the two year period ended 30 June 2003 of £327 million, principally due to Malibu (impact of £107 million), North American wine brands (£42 million) which were sold in May and April 2002 respectively, and the loss of the distribution rights of Jack Daniels and Southern Comfort in Great Britain effective August 2002 (£108 million). Turnover was also adversely impacted by the effect of exchange rate movements, primarily the US dollar, which reduced turnover by an estimated £329 million. The remaining £272 million increase in turnover reflects the underlying performance of the ongoing brand portfolio which saw volume increase by 1%.

Discontinued operations Burger King contributed £479 million to turnover in the year ended 30 June 2003 compared with £1,123 million, in the year ended 30 June 2002 following the disposal of Burger King in December 2002. Turnover in the year ended 30 June 2002 also included £1,455 million from Pillsbury which was sold on 31 October 2001.

Operating costs

Overall Operating costs decreased by £2,050 million (21% on a reported basis) from £9,629 million in the year ended 30 June 2002 to £7,579 million in the year ended 30 June 2003. This decrease was caused by the disposals of Pillsbury in October 2001, which had £1,271 million operating costs in the prior year, and Burger King in December 2002, whose operating costs fell by £562 million reflecting the reduction in the period of ownership by the group. Operating costs of premium drinks decreased by £217 million.

Continuing operations premium drinks For continuing operations, which now represents Diageo s premium drinks business, operating costs decreased by £217 million (3% on a reported basis) from £7,370 million in the year ended 30 June 2002 to £7,153 million in the year ended 30 June 2003. Operating exceptional costs for continuing operations decreased by £264 million from £432 million in the prior year to £168 million (these are discussed under exceptional operating costs below).

Excluding the exceptional operating costs, continuing operating costs increased by £47 million (1%) from £6,938 million in the year ended 30 June 2002 to £6,985 million in the year ended 30 June 2003. There were increases in operating costs compared with the prior period arising from the acquisition of the Seagram spirits and wine businesses in December 2001 and from organic increases in marketing and other costs. These were almost fully offset by reductions in costs from the movements in exchange rates (£291 million), principally the US dollar, and from disposals (£254 million), principally the loss of the distribution rights for Jack Daniels and Southern Comfort in Great Britain (£99 million) and Malibu (£67 million).

Marketing investment for premium drinks increased by £58 million (5%) to £1,185 million. Marketing investment on the global priority brands grew 5%, to £803 million. The major drivers of the increase were higher spend on the Johnnie Walker, Baileys and Smirnoff brands and behind the launch of Smirnoff Ice in key and venture markets. Marketing spend on J B declined and spend on Guinness was down as a result of a reduction in spend in Great Britain and in Ireland.

Operating profit before exceptional items

Overall Operating profit before exceptional items decreased by £77 million from £2,106 million to £2,029 million. The decrease reflects an increase attributable to premium drinks of £210 million, offset by a reduced contribution of £287 million from discontinued operations.

Continuing operations premium drinks Operating profit before exceptional items for premium drinks increased by £210 million (12%) from £1,766 million to £1,976 million. The Seagram businesses, in the six months ended 31 December 2002, contributed £211 million, but this was offset by a £73 million impact of businesses disposed, primarily Malibu (impact of £40 million) and North American wine brands (£5 million) which were sold in May and April 2002 respectively, and the loss of the distribution rights of Jack Daniels and Southern Comfort in Great Britain effective August 2002 (£9 million). £110 million of the increase in operating profit before exceptional items is attributable to the organic performance of the brand portfolio, discussed in more detail below. Exchange rate movements, net of the effect of currency hedging, had an adverse impact on operating profit before exceptional items of £38 million.

Discontinued operations The results for the year included an operating profit contribution of £53 million from discontinued operations (Burger King only), compared with £340 million in the year ended 30 June 2002 (Burger King and Pillsbury).

Exceptional operating costs

Overall The operating profit for the year ended 30 June 2003 is after exceptional operating charges of £168 million compared to £453 million (including £21 million in respect of discontinued operations) for the year ended 30 June 2002. This comprised integration and restructuring costs of £225 million, offset by £57 million received on the termination of Bass distribution rights in the United States.

Continuing operations premium drinks In the year ended 30 June 2003, £177 million was incurred in respect of the integration of the Seagram spirits and wine businesses, acquired in December 2001 (year ended 30 June 2002 £164 million). Approximately £43 million of these costs were employee related, £7 million were in respect of write downs of tangible fixed assets, £57 million were incurred in putting in place new distributor and broker agreements as part of the Next Generation Growth programme in the United States, and the balance included consultancy and systems costs. The majority of these costs were incurred in North America and the United Kingdom. It is expected that the total programme cost of restructuring and integrating the business will be approximately $700 million (£460 million) of which $590 million (£390 million) is expected to be cash. The majority of the balance of the cost will be incurred in the year ending 30 June 2004 as an operating exceptional item. As a result of the amount charged to the profit and loss account in the two years ended 30 June 2003, it is anticipated that approximately 2,200 jobs will be lost of which some 1,800 had been terminated by 30 June 2003. On completion of the programme it is anticipated that some 2,500 jobs will be lost and that integration synergy will reduce Diageo s annual cost base by approximately £115 million in the year ending 30 June 2005. The above merger synergy represents the latest management estimate and, as a forward-looking statement, involves risk and uncertainty. The expected level of synergy is based on a number of assumptions, including certain expectations concerning: the integration of back offices and sales forces in subsidiary regional offices resulting in headcount reductions and rationalisation of facilities; headcount reductions in central and regional offices; and procurement savings through improvement of supplier terms.

£48 million (2002 £48 million; 2001 £74 million) was incurred in respect of the restructuring of the UDV (spirits and wine) and the Guinness (beer) businesses. Approximately £28 million of the costs were employee related and the balance included legal and professional costs. Total costs of this integration totalled £170 million charged to the profit and loss account over the three years ended 30 June 2003, and no further costs are expected. As a result of the restructuring charge in the three years ended 30 June 2003, it is anticipated that approximately 750 jobs will be lost, of which approximately 600 had been terminated at 30 June 2003.

Effective 30 June 2003, Diageo relinquished its distribution rights for Bass Ale in the United States. Under the distribution agreement, Diageo had the right to continue selling and marketing the brand in the United States until July 2016. Consideration of £57 million received has been accounted for as an exceptional operating item.

In the year ended 30 June 2002, exceptional operating costs in relation to the premium drinks business included £164 million in respect of the integration of the Seagram spirits and wine businesses, £48 million in respect of the restructuring of the UDV and Guinness businesses and £220 million in respect of a settlement with José Cuervo following the termination of litigation and the formalisation of new arrangements for the distribution by Diageo of José Cuervo brands in the United States.

Discontinued operations There were no exceptional operating costs in relation to discontinued operations in the year ended 30 June 2003. In the prior year, exceptional operating costs for discontinued operations comprised £21 million in relation to the restructuring of franchisee loan financing arrangements in anticipation of the disposal of the Burger King business.

Associates

The group s share of profits of associates before exceptional items was £478 million for the year compared with £324 million for last year. The 21% equity interest in General Mills contributed £287 million (£143 million in the eight months ended 30 June 2002). Exceptional items for associates comprise £18 million for Diageo s share of General Mills exceptional costs incurred on its restructuring of the acquired Pillsbury business, and £3 million in respect of restructuring within Moët Hennessy.

Interest

The net interest charge decreased by 12% from £399 million in the prior year to £351 million in the year ended 30 June 2003. The net benefits of £76 million in respect of the disposal of businesses, of £27 million from exchange rate related movements, and of £44 million from the reduction in interest rates were offset by other factors. These factors included an increase of £14 million in the amount relating to the share of General Mills interest charge, the effect of business acquisitions, principally the Seagram spirits and wine businesses, of £60 million and the funding of the share repurchases which increased the interest charge by £43 million.

Non operating exceptional items

Non operating exceptional items before taxation comprise losses of £43 million on disposal of fixed assets and losses of £1,270 million on disposal of businesses in the year ended 30 June 2003 compared with losses of £22 million and gains of £821 million respectively in the prior year.

Burger King was sold on 13 December 2002 for $1.5 billion (£0.9 billion).The sale resulted in a pre tax charge of £1,457 million, after writing back goodwill previously written off to reserves of £673 million. Diageo retained $212 million (£129 million) of subordinated debt, with a ten year maturity (2013), from the Burger King Company. In addition, Diageo has guaranteed up to $850 million (£515 million) of borrowings of the Burger King Company. These loans have a term of five years from December 2002, although Diageo and Burger King have structured their arrangements to encourage refinancing by Burger King on a non-guaranteed basis prior to December 2007. The loss on disposal of Burger King was partially offset by the receipt of £171 million additional consideration on the disposal of Pillsbury. Gains on disposals of businesses in the year ended 30 June 2002 principally related to the disposal of Malibu (£532 million) and Pillsbury (£322 million).

Taxation

The effective rate of taxation on profit before exceptional items for the year ended 30 June 2003 was 25.0% compared with 25.2% for the year ended 30 June 2002. After exceptional items the effective rate of taxation was 74.5% for the year ended 30 June 2003 compared with 27.1% for the year ended 30 June 2002. The effective rate of taxation for the year ended 30 June 2003 reflected the fact that the pre tax loss on the disposal of Burger King was £1,457 million reduced by tax relief of £80 million.

Premium drinks The following discussion provides additional commentary on the trading performance of the premium drinks business with the equivalent period in the prior year.

In the discussion movements are segregated between reported or organic performance. Reported means that the measure reflects movement in the number disclosed in the financial statements. Organic represents the movement excluding the impact of exchange, acquisitions and disposals. In the discussion under organic brand performance for each market, movements given for volume, turnover, net sales (after deducting excise duties) and marketing expenditure are organic movements. A further description of organic movement, how it is calculated and why it is considered useful for the reader is set out on pages 19 and 20.

The organic movement calculations for turnover, net sales (after deducting excise duties) and operating profit before exceptional items for the year ended 30 June 2003 were as follows:

	2002 Reported £ million	Exchange £ million	Disposals £ million	**Acquisitions £ million**	**Organic movement £ million**	**2003 Reported £ million**	**Organic movement %**
Turnover							
Major markets:							
North America	2,669	(238)	(105)	**444**	**25**	**2,795**	**1**
Great Britain	1,467		(135)	**17**	**80**	**1,429**	**6**
Ireland	937	40	(15)	**1**	**(10)**	**953**	**(1)**
Spain	380	15	(11)	**35**	**5**	**424**	**1**

	5,453	(183)	(266)	**497**	**100**	**5,601**	**2**
Key markets	2,078	(113)	(30)	**141**	**53**	**2,129**	**3**
Venture markets	1,173	(33)	(31)	**12**	**110**	**1,231**	**10**
Total premium drinks	8,704	(329)	(327)	**650**	**263**	**8,961**	**3**

Table of Contents

	2002 Reported £ million	Exchange £ million	Disposals £ million	**Acquisitions £ million**	**Organic movement £ million**	**2003 Reported £ million**	**Organic movement %**
Net sales(after deducting excise duties)							
Major markets:							
North America	2,230	(197)	(95)	**373**	**24**	**2,335**	**1**
Great Britain	896		(84)	**9**	**18**	**839**	**2**
Ireland	625	27	(13)	**1**	**(2)**	**638**	
Spain	298	12	(10)	**26**	**(4)**	**322**	**(1)**
	4,049	(158)	(202)	**409**	**36**	**4,134**	**1**
Key markets	1,631	(93)	(27)	**100**	**75**	**1,686**	**5**
Venture markets	905	(33)	(26)	**9**	**120**	**975**	**14**
Total premium drinks	6,585	(284)	(255)	**518**	**231**	**6,795**	**4**
Excise duties	2,119					**2,166**	
Turnover	8,704					**8,961**	
Operating profit before exceptional items							
Major markets:							
North America	550	(2)	(30)	**154**	**57**	**729**	**11**
Great Britain	204		(17)	**4**	**28**	**219**	**15**
Ireland	151	6	(2)		**(14)**	**141**	**(9)**
Spain	94	1	(2)	**11**	**(5)**	**99**	**(5)**
	999	5	(51)	**169**	**66**	**1,188**	**7**
Key markets	524	(41)	(12)	**39**	**12**	**522**	**3**
Venture markets	243	(2)	(10)	**3**	**32**	**266**	**14**
Total premium drinks	1,766	(38)	(73)	**211**	**110**	**1,976**	**7**

Notes

(1) The exchange adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items are principally in respect of the US dollar.

(2) Disposal adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in relation to the disposal of Malibu rum (£107 million, £93 million, £40 million); the termination of the distribution rights for Jack Daniels and Southern Comfort (£113 million, £70 million, £10 million) in the United Kingdom; the sale of Glen Ellen/MG Vallejo wines (£42 million, £38 million, £5 million); the transfer of distribution rights of Cuervo 1800 (£27 million, £22 million, £10 million); the sale of Croft Inns (£10 million, £10 million, nil); the sale of Gilbey s Green and White Label whiskies in India (£9 million, £8 million, £1 million); the termination of distribution rights for Drambuie (£7 million, £4 million, £1 million); the sale of Croft and Delaforce port and sherry brands (£5 million, £4 million, £2 million); and other disposals (£7 million, £6 million, £4 million).

(3) Acquisition adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in respect of the purchase of the Seagram spirits and wine businesses (£650 million, £518 million, £211 million).

(4) In the calculation of operating profit before exceptional items the overheads included in disposals and acquisitions were directly attributable to those businesses and do not result from subjective judgements of management.

(5) The organic movement percentage is the amount in the column headed organic movement in the table above expressed as a percentage of the aggregate of the first three columns. The basis of the calculation of the organic movement is explained on page 20.

Table of Contents

Organic brand performance

	Equivalent units million	Volume movement %	Net sales (after deducting excise duties) movement %
Smirnoff	**23.0**	**6**	**8**
Johnnie Walker	**10.8**	**2**	**2**
Guinness	**11.4**	**2**	**6**
Baileys	**6.2**	**10**	**13**
J B	**6.0**	**(5)**	**(6)**
Captain Morgan*	**2.5**	**(1)**	**(12)**
José Cuervo	**4.2**	**7**	**7**
Tanqueray	**1.9**	**3**	**7**
Total global priority brands	**66.0**	**3**	**5**
Local priority brands	**17.1**	**(1)**	**4**
Category brands	**26.8**	**(3)**	**1**
	109.9	**1**	**4**
Acquisitions	**9.4**		
Total in year ended 30 June 2003	**119.3**		

*Captain Morgan included for second half only with first half volume included in acquisitions.

Analysis by individual market

North America

Key measures:

	2003 £ million	2002 £ million	Reported movement %	Organic movement %
Volume			**15**	**1**
Turnover	**2,795**	2,669	**5**	**1**
Net sales (after deducting excise duties)	**2,335**	2,230	**5**	**1**
Marketing	**405**	408	**(1)**	**(3)**
Operating profit before exceptional items	**729**	550	**33**	**11**

Reported performance Turnover in North America increased 5% from £2,669 million in the year ended 30 June 2002 to £2,795 million in the year ended 30 June 2003. Operating profit before exceptional items increased 33% from £550 million in the year ended 30 June 2002 to £729 million in the year ended 30 June 2003.

Organic performance The increase in turnover was primarily due to the turnover derived from the Seagram brands, acquired in the joint acquisition of the Seagram spirits and wine businesses in December 2001, which contributed £444 million in the six months ended 31 December 2002. The effect of brand disposals and of exchange rate movements in the US dollar reduced turnover in the year ended 30 June 2003 by £105 million and £238 million, respectively. The disposal impact is primarily attributable to the disposal of Malibu in May 2002 (£37 million), the Glen Ellen wine business in May 2002 (£37 million) and Cuervo 1800 in September 2002 (£24 million).

The acquired Seagram brands were the main factor in growing operating profit before exceptional items in North America from £550 million last year to £729 million in the year ended 30 June 2003 contributing £154 million in the six months ended 31 December 2002.

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Organic brand performance:

	Volume movement %	Net sales (after deducting excise duties) movement %
Smirnoff	4	(2)
Johnnie Walker	2	7
José Cuervo	10	9
Baileys	14	17
Tanqueray	2	7
Guinness	1	1
Captain Morgan	(6)	(17)
J B	(6)	(6)
Total global priority brands	4	2
Local priority brands	1	4
Category brands	(7)	(3)
Total	1	1

Smirnoff volume excluding ready to drink was up 9% and net sales (after deducting excise duties) were up 11%

Excluding Captain Morgan Gold, volume of Captain Morgan was up 8% and net sales (after deducting excise duties) were up 10%

Excluding ready to drink, total volume was up 3% and net sales (after deducting excise duties) were up 5%

Volume growth in North America was driven by the strong performance of the priority spirits brands. Global priority brand volume excluding ready to drink grew 7%. Ready to drink volume, which includes flavored malt beverages and ready to drink in the United States and ready to drink in Canada, was down 17%, representing a decline in Smirnoff ready to drink of 11% and the withdrawal of Captain Morgan Gold.

Smirnoff had another strong year despite weakness in Smirnoff ready to drink. Excluding ready to drink, volume was up 9%, driven by strong growth in Smirnoff Red and the continued success of the Smirnoff Twist flavoured vodka range. Smirnoff Red increased its share to 23.1%. The brand s volume growth was driven by the success of the What s your mix advertising campaign. In addition, Smirnoff Red continues to benefit from spend behind Smirnoff ready to drink and Smirnoff Twist.

Smirnoff ready to drink volume was down 11%. The launch of Smirnoff Ice Triple Black in January 2003 partially offset softness in Smirnoff Ice.

Volume of Johnnie Walker Red Label improved in the second half of the year. Johnnie Walker Black Label also gained share although volume growth slowed from the first half. Net sales (after deducting excise duties) for the total brand were up 7% due to volume growth of 2% and favourable price/mix variances of 5%, driven by a 3% price increase in certain markets.

Baileys continued its impressive growth driven by national advertising around a very successful holiday programme, and the continued success of initiatives to broaden the appeal of the brand to new occasions. The launch of Baileys Minis in May also contributed incremental volume and revenue, as well as generating momentum for the brand.

The strategy for J B in North America is to maximise value and in the year operating profit from the brand increased as marketing expenditure was reduced.

José Cuervo continues to be the leader in US tequila sales. The key drivers of its growth were high consumer visibility, the success of national advertising and an increased trial programme.

The success of the Distinctive Since campaign was a key driver of the growth in Tanqueray. Both Tanqueray and Tanqueray No. TEN increased their share of the category.

Excluding Captain Morgan Gold ready to drink, Captain Morgan volume was up 8% and net sales (after deducting excise duties) were up 10% driven by increased advertising and media spending for Captain Morgan Original Spiced Rum.

Guinness volume grew slightly in the year driven by strong performance by bottled Guinness Extra Stout and Guinness Draught in Bottles.

Local priority brand volume was up 1% for the year, with net sales (after deducting excise duties) up 4%. Crown Royal showed strong gains, as did Sterling Vineyards, however these were partially offset by volume decline in Gordon s Gin, Beaulieu Vineyard, and other smaller brands. Volume of category brands was down 7% for the year, with net sales (after deducting excise duties) down 3%. The decrease in volume was due to declines in Gordon s vodka and other smaller category brands. Bass volume was down versus the prior year; distribution of the brand was returned to Interbrew as of 30 June 2003. There has been a mix improvement due to inclusion of the former Seagram brands and the launch of Cîroc.

Other business performance drivers:

Almost 80% of Diageo s volume now distributed through dedicated sales teams

Ready to drink segment under pressure

Efficiencies generated savings of over 10% in media planning and buying

Share of US spirits brands increased by 0.3 percentage points to 27.3%

Diageo North America continued to progress its strategic initiatives. In particular its Next Generation Growth programme has made excellent further progress. In the second half of the year, new distribution and brokerage agreements were reached in nine more states and additional distributors established dedicated sales forces. Distributors and brokers in 34 states and Washington DC, representing nearly 80% of Diageo s volume, are now supporting Diageo s brands with just under 2,000 sales personnel working in teams solely dedicated to Diageo and S&S brands.

Following two years of rapid growth, flavored malt beverages in the United States have slowed considerably and volume in the segment was broadly level for the year. Of the new launches this year, Smirnoff Ice Triple Black was the most successful and it is now the second best selling flavored malt beverage in the United States behind Smirnoff Ice. Flavored malt beverages currently represent 2% of the beer category, of which Smirnoff ready to drink is estimated to constitute about a third.

Diageo s share of US spirits increased in the year to 27.3% as a result of share gains in most priority brands.

Diageo has now consolidated to one media planning and buying agency resulting in a 10% reduction in media spend against prior year cost levels. In addition a 15% reduction versus prior year was achieved in media production costs. Marketing spend at £405 million was 3% below prior year while share of voice in the combined beer and spirits category increased.

Great Britain

Key measures:

	2003 £ million	2002 £ million	**Reported movement %**	**Organic movement %**
Volume			**(2)**	**5**
Turnover	**1,429**	1,467	**(3)**	**6**
Net sales (after deducting excise duties)	**839**	896	**(6)**	**2**
Marketing	**188**	188		**2**
Operating profit before exceptional items	**219**	204	**7**	**15**

Reported performance Turnover in Great Britain was down 3% on a reported basis from £1,467 million last year to £1,429 million in the year ended 30 June 2003. Operating profit before exceptional items was up £15 million from £204 million in the year ended 30 June 2002 to £219 million in the year ended 30 June 2003.

Organic performance The principal reason for the decrease in turnover was the termination of the distribution rights for Jack Daniels and Southern Comfort in Great Britain in August 2002 which reduced turnover by £108 million. The acquired Seagram brands contributed £17 million to turnover in the six months ended 31 December 2002. The organic increase in the year was £80 million (6%).

Increase in operating profit before exceptional items was due to organic growth of £28 million, partly offset by a net negative impact resulting from acquisitions and disposals of £13 million.

Organic brand performance:

	Net sales (after deducting