DIAGEO PLC
Form 20-F
August 08, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM 20-F

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE**

**SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended: 30 June 2017**

**Commission file number 1-10691**

**DIAGEO plc**

(Exact name of Registrant as specified in its charter)

**England and Wales**

(Jurisdiction of incorporation or organisation)

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

(Address of principal executive offices)

**David Harlock, Company Secretary**

**Tel: +44 20 8978 6000**

**E-mail: the.cosec@diageo.com**

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

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| American Depositary Shares | New York Stock Exchange |
| Ordinary shares of $28^{101}/_{108}$ pence each | New York Stock Exchange(i) |
| 2.875% Guaranteed Notes due 2022 | New York Stock Exchange |
| 8.000% Guaranteed Notes due 2022 | New York Stock Exchange |
| 7.450% Guaranteed Notes due 2035 | New York Stock Exchange |
| 4.250% Guaranteed Notes due 2042 | New York Stock Exchange |

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

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

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

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the Annual Report: 2,754,467,515 ordinary shares of $28^{101}/_{108}$ pence each.

Indicate by check mark if each registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

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

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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, and emerging growth company in Rule 12b-2 of the Exchange Act.Indicate by check mark whether each registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

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

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

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

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2017 of Diageo plc (the 2017 Form 20-F).

**Contents**

**Contents (continued)**

**Introduction**

Diageo is a global leader in the beverage alcohol industry. Its geographic breadth and range of industry leading brands across categories and price points is unparalleled.

Diageo plc is incorporated as a public limited company in England and Wales. Diageo was incorporated as Arthur Guinness Son and Company Limited on 21 October 1886. The group was formed by the merger of Grand Metropolitan Public Limited Company (GrandMet) and Guinness plc (the Guinness Group) in December 1997. Diageo plc s principal executive office is located at Lakeside Drive, Park Royal, London NW10 7HQ and its telephone number is +44 (0) 20 8978 6000. Diageo plc s agent for service of process in the United States is General Counsel, Diageo North America, Inc., 801 Main Avenue (6078-06), Norwalk, CT 06851.

This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2017. The information set out in this Form 20-F does not constitute Diageo plc s statutory accounts under the UK Companies Acts for the years ended 30 June 2017, 2016 or 2015. PricewaterhouseCoopers LLP has reported on the accounts for the years ended 30 June 2017 and 2016, and the group s former auditor, KPMG LLP has reported on the accounts for the year ended 30 June 2015; their respective audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the years ended 30 June 2017, 2016 or 2015. The accounts for 2016 and 2015 have been delivered to the registrar of companies for England and Wales and those for 2017 will be delivered in due course.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo s control. For more details, please refer to the cautionary statement concerning forward-looking statements on pages 46-48.

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

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

**Information presented**

Organic movements and organic operating margins are before exceptional items. Commentary, unless otherwise stated, refers to organic movements. Share, unless otherwise stated, refers to value share. For a definition of organic movement and reconciliations of non-GAAP measures to GAAP measures see page 141.

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

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**Introduction (continued)**

**Disclosures not incorporated by reference**

The following pages and sections of the Annual Report of Diageo plc for the year ended 30 June 2017 are not incorporated by reference into this report on Form 20-F and are furnished to the SEC for information only:

- Disclosures under the headings Values , Broad portfolio , Global reach , Our role in society , Financial strength , Efficient supply and procurement , Brilliant execution , Doing business the right way , We produc We innovate , We market , and We sell in the section Strategic report Our business model on pages 13 ar 14.
- Disclosures under the headings Creating a positive role for alcohol in society , Building thriving communities , Reducing our environmental impact , and Highest standards of governance and ethics in the section Strategic report Our strategy on page 16.
- Disclosures included under the titles Number of responsible drinking programs (%) , Water withdrawal (%) , Carbon emission (%) and Number of employees (%) in the section Strategic report Our global reach Diag reports as five regions on page 21.
- Disclosures on pages 25 and 27 in the section Strategic report How we measure performance: key performance indicators of non-financial key performance indicators.
- Disclosures under the heading Our role in society in the Chairman s statement on page 29.
- Disclosures under the heading Our role in society in the Chief Executive s statement on pages 32 and 33.
- Disclosures included under the titles Earning trust and respect as part of wider society , Creating a positive role for alcohol in society , Industry collaboration and partnership to reduce harmful drinking , Building thriving communities , Water and environment and Diageo sites located in water-stressed areas in the section Strategic report Market dynamics on pages 35 and 36.
- Disclosures included under the titles Sustainability and responsibility on pages 62, 65, 69, 73, and 77 in relation to each reporting segment in the Business Review.
- Disclosures in the section Strategic report Our role in society on pages 119 to 140.

**Recent trends**

The following comments were made by Ivan Menezes, Chief Executive of Diageo, in Diageo s preliminary results announcement on 27 July 2017:

We delivered a strong set of results including broad based improvement in organic net sales and operating profit. Our performance demonstrates the effective delivery of our strategy through disciplined execution of our six priorities put in place four years ago. We have delivered consistent strong performance improvement across all regions and I am pleased with progress in our focus areas of US Spirits, scotch and India.

Our productivity work is delivering ahead of expectations allowing us to reinvest in our brands, drive margin improvement and generate consistent strong cash flow. Through productivity we have embedded an everyday efficiency mind set in the business and with improved data and insight we are making faster, smarter decisions on investment choices.

Diageo is a strong company today and we are confident in our ability to deliver sustainable growth. We are raising our productivity goal to £700 million with two thirds being reinvested in the business. We continue to expect mid-single digit top line growth, and we are raising our operating margin expansion objective to 175bps over the three years ending 30 June 2019.

Following three years of consistently improving cash flow generation the Board has approved a share buyback programme of up to £1.5 billion in F18.

**Historical information**

The following tables present selected consolidated financial data for Diageo for the five years ended 30 June 2017 and as at the respective year ends. The data presented below for the five years ended 30 June 2017 and the respective year ends has been derived from Diageo s consolidated financial statements, audited by Diageo s independent auditor, PricewaterhouseCoopers LLP for the two years ended 30 June 2017. The group s former auditor, KPMG LLP (KPMG) reported on the financial statements for the three years ended 30 June 2015.

| **Income statement data** | | | | | **Year ended 30 June** |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| | **£ million** | **£ million** | **£ million** | **£ million** | **£ million** |
| **Sales** | **18,114** | 15,641 | 15,966 | 13,980 | 15,276 |
| Excise duties | **(6,064)** | (5,156) | (5,153) | (3,722) | (3,973) |
| **Net sales** | **12,050** | 10,485 | 10,813 | 10,258 | 11,303 |
| Cost of sales | **(4,680)** | (4,251) | (4,610) | (4,029) | (4,416) |
| **Gross profit** | **7,370** | 6,234 | 6,203 | 6,229 | 6,887 |
| Marketing | **(1,798)** | (1,562) | (1,629) | (1,620) | (1,769) |
| Other operating expenses | **(2,013)** | (1,831) | (1,777) | (1,902) | (1,738) |
| **Operating profit** | **3,559** | 2,841 | 2,797 | 2,707 | 3,380 |
| Non-operating items | **20** | 123 | 373 | 140 | (83) |
| Net interest and other financial charges | **(329)** | (327) | (412) | (388) | (457) |
| Share of after tax results of associates and joint ventures | **309** | 221 | 175 | 252 | 217 |
| **Profit before taxation** | **3,559** | 2,858 | 2,933 | 2,711 | 3,057 |
| Taxation | **(732)** | (496) | (466) | (447) | (507) |
| **Profit from continuing operations** | **2,827** | 2,362 | 2,467 | 2,264 | 2,550 |
| Discontinued operations | **(55)** | | | (83) | |
| **Profit for the year** | **2,772** | 2,362 | 2,467 | 2,181 | 2,550 |
| **Weighted average number of shares** | **million** | **million** | **million** | **million** | **million** |
| Shares in issue excluding own shares | **2,512** | 2,508 | 2,505 | 2,506 | 2,502 |
| Dilutive potential ordinary shares | **11** | 10 | 12 | 11 | 15 |
| | **2,523** | 2,518 | 2,517 | 2,517 | 2,517 |
| **Per share data** | **pence** | **pence** | **pence** | **pence** | **pence** |
| Dividend per share | **62.2** | 59.2 | 56.4 | 51.7 | 47.4 |
| Earnings per share | | | | | |
| Basic | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Continuing operations | **108.2** | 89.5 | 95.0 | 93.0 | 98.0 |
| Discontinued operations | **(2.2)** | | | (3.3) | |
| **Basic earnings per share** | **106.0** | 89.5 | 95.0 | 89.7 | 98.0 |
| Diluted | | | | | |
| Continuing operations | **107.7** | 89.1 | 94.6 | 92.6 | 97.4 |
| Discontinued operations | **(2.2)** | | | (3.3) | |
| **Diluted earnings per share** | **105.5** | 89.1 | 94.6 | 89.3 | 97.4 |

**Historical information (continued)**

**Balance sheet data**

| | | | | | **As at 30 June** |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| | **£ million** | **£ million** | **£ million** | **£ million** | **£ million** |
| Non-current assets | **20,196** | 19,639 | 18,134 | 15,495 | 16,481 |
| Current assets | **8,652** | 8,852 | 7,670 | 7,469 | 8,510 |
| **Total assets** | **28,848** | 28,491 | 25,804 | 22,964 | 24,991 |
| Current liabilities | **(6,660)** | (6,187) | (5,290) | (4,851) | (5,519) |
| Non-current liabilities | **(10,160)** | (12,124) | (11,258) | (10,523) | (11,384) |
| **Total liabilities** | **(16,820)** | (18,311) | (16,548) | (15,374) | (16,903) |
| **Net assets** | **12,028** | 10,180 | 9,256 | 7,590 | 8,088 |
| Share capital | **797** | 797 | 797 | 797 | 797 |
| Share premium | **1,348** | 1,347 | 1,346 | 1,345 | 1,344 |
| Other reserves | **2,693** | 2,625 | 1,994 | 2,243 | 3,154 |
| Retained earnings | **5,475** | 3,761 | 3,634 | 2,438 | 1,741 |
| **Equity attributable to equity shareholders of the parent company** | **10,313** | 8,530 | 7,771 | 6,823 | 7,036 |
| **Non-controlling interests** | **1,715** | 1,650 | 1,485 | 767 | 1,052 |
| **Total equity** | **12,028** | 10,180 | 9,256 | 7,590 | 8,088 |
| **Net borrowings** | **(7,892)** | (8,635) | (9,527) | (8,850) | (8,403) |

**Notes to the historical information**

**1. Accounting policies** The consolidated financial statements for the five years ended 30 June 2017 have been prepared in accordance with IFRS. The IFRS accounting policies applied by the group to prepare the financial information in this document are disclosed in the notes to the consolidated financial statements.

**Historical information (continued)**

**2. Exceptional items** Exceptional items are those that in management s judgement need to be disclosed by virtue of their size or nature. Such items are included within the income statement caption to which they relate, and are separately disclosed in the notes to the consolidated financial statements. An analysis of exceptional items is as follows:

| | | | | | **Year ended 30 June** |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| | **£ million** | **£ million** | **£ million** | **£ million** | **£ million** |
| **Items included in operating profit** | | | | | |
| Competition authority investigation in Turkey | **(33)** | | | | |
| Customer claim in India | **(32)** | | | | |
| Disengagement agreements relating to United Spirits Limited | **23** | (49) | | | |
| Brand, goodwill and tangible asset impairment | | (118) | | (264) | (50) |
| Restructuring programmes | | | (82) | (163) | (69) |
| Korea settlement | | | (146) | | |
| Associate impairment | | | (41) | | |
| Pension changes past service credits | | | | | 20 |
| | **(42)** | (167) | (269) | (427) | (99) |
| **Non-operating items** | | | | | |
| Gains/(losses) on sale of businesses | **20** | 215 | 247 | | (83) |
| Step up gains | | | 156 | 140 | |
| Other non-operating items | | (92) | (30) | | |
| | **20** | 123 | 373 | 140 | (83) |
| **Items included in taxation** | | | | | |
| Tax credit on exceptional operating items | **11** | 7 | 51 | 99 | 27 |
| Tax on sale of businesses | **(7)** | 49 | | | 28 |
| | **4** | 56 | 51 | 99 | 55 |
| **Exceptional items in continuing operations** | **(18)** | 12 | 155 | (188) | (127) |

| | | | | | |
|---|---|---|---|---|---|
| Discontinued operations net of taxation (note 3) | **(55)** | | | (83) | |
| **Exceptional items** | **(73)** | 12 | 155 | (271) | (127) |

**3. Discontinued operations** In the year ended 30 June 2017 discontinued operations of £55 million, net of £9 million deferred tax comprise additional amounts payable to the UK Thalidomide Trust following an agreement reached in December 2016, updates to the discount and inflation rates applied to the existing thalidomide provision and legal costs. In the year ended 30 June 2014 discontinued operations comprised a charge after tax of £83 million, net of £8 million deferred tax, in respect of the settlement of thalidomide litigation in respect of claimants in Australia and New Zealand and anticipated future payments to the UK Thalidomide Trust.

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

**Historical information (continued)**

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

| | | | | | | Year ended 30 June |
|---|---|---|---|---|---|---|
| | | **2017** | **2016** | **2015** | **2014** | **2013** |
| | | **pence** | **pence** | **pence** | **pence** | **pence** |
| Per ordinary share | Interim | **23.70** | 22.60 | 21.50 | 19.70 | 18.10 |
| | Final | **38.50** | 36.60 | 34.90 | 32.00 | 29.30 |
| | Total | **62.20** | 59.20 | 56.40 | 51.70 | 47.40 |
| | | **$** | **$** | **$** | **$** | **$** |
| Per ADS | Interim | **1.18** | 1.27 | 1.28 | 1.31 | 1.10 |
| | Final | **2.02** | 1.85 | 2.14 | 2.06 | 1.89 |
| | Total | **3.20** | 3.12 | 3.42 | 3.37 | 2.99 |

Note: Subject to shareholders approval the final dividend for the year ended 30 June 2017 will be paid on 5 October 2017, and payment to US ADR holders will be made on 11 October 2017. In the table above, an exchange rate of £1 = $1.31 has been assumed for this dividend, but the exact amount of the payment to US ADR holders will be determined by the rate of exchange on 5 October 2017.

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

**6. Share capital** There were 2,754 million ordinary share of $28^{101}/_{108}$ pence each in issue with a nominal value of £797 million throughout the five year period ended 30 June 2017.

**7. Exchange rates** A substantial portion of the group s assets, liabilities, revenues and expenses are denominated in currencies other than sterling. For a discussion of the impact of exchange rate fluctuations on the group s financial position and results of operations, see note 15 to the consolidated financial statements.

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

| | Year ended 30 June | | | | |
|---|---|---|---|---|---|
| | **2017** | 2016 | 2015 | 2014 | 2013 |
| | **$** | $ | $ | $ | $ |
| Year end | **1.30** | 1.32 | 1.57 | 1.71 | 1.52 |
| Average rate[(i)] | **1.27** | 1.47 | 1.57 | 1.64 | 1.57 |

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

**Historical information (continued)**

The following table shows period end, high, low and average US dollar/pound sterling noon buying exchange rates by month, for the six month period to 28 July 2017, expressed in US dollars per £1. The information in respect of the month July is for the period up to and including 28 July 2017.

| | | | | | | **2017** |
|---|---|---|---|---|---|---|
| | **July** | **June** | **May** | **April** | **March** | **February** |
| | **$** | **$** | **$** | **$** | **$** | **$** |
| Month end | **1.31** | **1.30** | **1.29** | **1.29** | **1.25** | **1.24** |
| Month high | **1.31** | **1.30** | **1.30** | **1.29** | **1.26** | **1.26** |
| Month low | **1.29** | **1.26** | **1.28** | **1.24** | **1.22** | **1.24** |
| Average rate(i) | **1.31** | **1.28** | **1.29** | **1.26** | **1.23** | **1.25** |

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

The noon buying exchange rate as at 28 July 2017 was £1 = $1.31.
These rates have been provided for information only. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the consolidated financial statements. See note 1 to the consolidated financial statements for the actual rates used in the preparation of the consolidated financial statements.

**Strategic report**

***Business description***

**Our business model**

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

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

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

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

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

**Global leader**

**Values**

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

**Broad portfolio**

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

**Global reach**

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

**Our role in society**

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

**Financial strength**

Strong financial returns and consistent financial performance.

**Efficient supply and procurement**

High-quality manufacturing and environmental standards.

**Brilliant execution**

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

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*Business description (continued)*

**Strength through global reach and iconic brands**

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

**Doing business the right way**

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

| We produce | We innovate | We market | We sell |
|---|---|---|---|
| We are committed to efficient, sustainable production to the highest quality standards. | Led by consumer insights, we unlock new opportunities through our recruit, re-recruit, disrupt approach. | We invest in world-class marketing to build our brands, focused on programmes which recruit and re-recruit consumers responsibly. | We work to extend our sales reach by ensuring our products are available where people want them and by delivering memorable consumer experiences. |

**Key highlights**

| Brands | Employees |
|---|---|
| 200+ | 30,400 |

| Production sites | Countries |
|---|---|
| 143 | 180 |

**Agile business model**

**Market-based**

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

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

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

**Global functions**

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

**Our people**

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

*Business description (continued)*

**Our strategy**

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

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

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

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

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

**Our strategy is delivered through**

**Six executional priorities**

**Keep premium core vibrant**

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

**Increase participation in mainstream spirits**

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

**Continue to win in reserve**

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

**Drive innovation at scale**

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

**Build an advantaged route to consumer**

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

**Embed productivity to drive out costs and invest in growth**

We are focused on everyday efficiency, effectiveness and agility to reduce costs and create fuel for our growth.

*Business description (continued)*

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

**Creating a positive role for alcohol in society**

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

**Building thriving communities**

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

**Reducing our environmental impact**

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

**Highest standards of governance and ethics**

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

**Outcomes of our strategy**

| | |
|---|---|
| Efficient growth | Credibility and trust |
| Consistent value creation | Motivated people |

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

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

See our key performance indicators (KPIs) on **pages 23-27**

***Business description (continued)***

**Production**

Diageo owns manufacturing production facilities across the globe, including maltings, distilleries, breweries, packaging plants, maturation warehouses, cooperages and distribution warehouses. Diageo s brands are also produced at plants owned and operated by third parties and joint ventures at a number of locations throughout the world.

Diageo has been investing over the last few years in a number of restructuring programmes to increase the efficiency of its supply operations. This has resulted in improvements and changes in the group s supply operations principally in North America, Scotland and Ireland.

**Capacity**

The locations, principal activities, products, packaging production capacity and packaging production volume of Diageo owned principal production centres in the year ended 30 June 2017 are as follows:

| **Location** | **Principal products** | **Production capacity in millions of equivalent units (i)** | **Production volume in 2017 in millions of equivalent units** |
|---|---|---|---|
| United Kingdom (Spirits) | Scotch whisky, gin, vodka, rum, ready to drink | 96 | 52 |
| UK, Ireland (Guinness) | Beer | 8 | 7 |
| Ireland (Baileys) | Irish cream liqueur | 12 | 7 |
| Italy (Santa Vittoria) | Vodka, rum, ready to drink | 11 | 4 |
| Turkey | Raki, vodka, gin, liqueur, wine | 8 | 5 |
| United States, Canada, US Virgin Islands | Vodka, gin, tequila, rum, Canadian whisky, American whiskey, progressive adult beverages, ready to drink | 50 | 35 |
| Brazil | Cachaça, vodka | 10 | 7 |
| Mexico | Tequila | 1 | 1 |
| Australia | Rum, vodka, ready to drink | 4 | 2 |
| Singapore | Finishing centre | 7 | 1 |
| India | Rum, vodka, whisky, scotch, brandy, gin, wine | 60 | 42 |
| Nigeria | Beer | 7 | 6 |
| South Africa | Spirits and ready to drink | 4 | 4 |
| East Africa (Uganda, Kenya, Tanzania) | Beer and spirits | 13 | 11 |
| Africa Regional Markets (Ethiopia, Cameroon, Ghana, Seychelles) | Beer | 8 | 4 |

(i) Capacity represents ongoing production capacity. The production capacities quoted in the table are based on Diageo owned actual production levels for the year ended 30 June 2017 adjusted for the elimination of unplanned losses and inefficiencies. In addition, Diageo has third-party production arrangements with manufacturing facilities including brewers and co-packing partners licensed to produce Diageo brands

***Spirits***

Spirits are produced in distilleries located worldwide. The group owns 29 Scotch whisky distilleries in Scotland, two whisk(e)y distilleries in Canada and two in the United States. Diageo produces Smirnoff internationally. Ketel One and Cîroc vodkas are purchased as finished product from The Nolet Group and Eurowinegate, respectively. Gin distilleries are located in both the United Kingdom and the United States. Baileys is produced in the Republic of Ireland and Northern Ireland. Rum is blended and bottled in the United States, Canada, Italy and the United Kingdom, and is distilled and blended in the US Virgin Islands and in Australia, Venezuela and Guatemala. Raki is produced in Turkey, Chinese white spirits are produced in Chengdu, in the Sichuan province of China, cachaça is produced in Ceará State in Brazil and Don Julio tequila is produced in Mexico.

*Business description (continued)*

Diageo s maturing Scotch whisky is located in warehouses in Scotland (the largest at Blackgrange holding approximately 50% of the group s maturing Scotch whisky), its maturing Canadian whisky in La Salle and Gimli in Canada and its maturing American whiskey in Kentucky and Tennessee in the United States. In May 2014 the company announced its intention to invest approximately $115 million (£73 million) over three years to build a distillery and six barrel storage warehouses in Shelby County, Kentucky. The new distillery commenced operations at the end of calendar year 2016.

Diageo owns a controlling equity stake in United Spirits Limited (USL) which is the leading alcoholic beverage company in India selling 82 million equivalent cases of Indian Made Foreign Liquor (IMFL). USL operates 23 owned manufacturing units in India and Nepal and leases one manufacturing facility in India. USL and Diageo brands are also produced under licence by third-parties in 36 manufacturing units in India. USL also operates spirit distillation plants for neutral alcohol, malt spirit, grape spirit and rum spirit with accompanying maturation facilities. USL has many leading Indian brands such as McDowell s (Indian whisky, rum and brandy), Black Dog (scotch), Signature (Indian whisky), Royal Challenge (Indian whisky) Antiquity (Indian whisky) and Bagpiper (Indian whisky).

***Beer***

Diageo s principal brewing facility is at the St James s Gate brewery in Dublin where the capacity was recently expanded to brew all beers sold in Europe and for global exports. In addition, Diageo has breweries in a number of African countries; Nigeria, Kenya, Ghana, Cameroon, Ethiopia, Tanzania, Uganda and the Seychelles.

Guinness, Guinness Blonde, Kilkenny and Harp are brewed, under licence arrangements, by over 40 third parties across six continents with total volume over 2 million hectolitres supplying some 70 countries worldwide.

Guinness flavour extract is shipped from Ireland to all overseas Guinness brewing operations which use the flavour extract to brew Guinness locally. Guinness is transported to Great Britain in bulk to the Runcorn facility which carries out the kegging of Guinness Draught.

In January 2017, the company announced its intention to construct a brewing site for Guinness in the United States. It will be a working brewery, open to the public, in Relay, Maryland. The project adds brewing and packaging capacity to reduce costs, mitigate risks and add format flexibility with a consumer interface via an on-site brew pub, tap room and retail store. The project is expected to be completed by March 2018, with a temporary consumer experience in place for the 200$^{th}$ anniversary of the first Guinness export to the United States in October 2017.

***Ready to drink***

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

**Property, plant and equipment**

Diageo owns approximately 96% of the manufacturing, distilling, brewing, bottling and administration facilities it uses across the group s worldwide operations. It holds approximately 3% of properties on leases in excess of 50 years. The principal production facilities are described above. As at 30 June 2017, Diageo s land and buildings are included in the group s consolidated balance sheet at a net book value of £1,180 million. Diageo s two largest individual facilities, in terms of book value, are the Leven bottling, blending and warehousing facility in Scotland and St James s

Gate brewery in Dublin. Approximately 35% of the net book value of Diageo s land and buildings are properties located in Great Britain, 11% in Ireland, 15% in the United States and 12% in India.

**Raw materials and supply agreements**

The group has a number of long term contracts in place for the purchase of raw materials including glass, other packaging, spirit, cream, rum and grapes. Forward contracts are in place for the purchase of 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 raki and are sourced from suppliers in Turkey. Other raw materials purchased in significant quantities for the production of spirits and beer are molasses, cereals, sugar and a number of flavours (such as juniper berries, agave, aniseed, chocolate and herbs). These are sourced from suppliers around the world.

*Business description (continued)*

The majority of products are supplied to customers in glass bottles. Glass is purchased from a variety of multinational and local suppliers; the largest suppliers are Ardagh Packaging in the United Kingdom and Owens Illinois in the United States.

**Competition**

Diageo s brands compete on the basis of consumer loyalty, quality and price.

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

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

**Research and development**

Innovation forms an important part of Diageo s growth strategy, playing a key role in positioning its brands for continued growth in both the developed and emerging markets. The strength and depth of Diageo s brand range provides a solid platform from which to drive innovation. Diageo continuously invests to deepen its understanding of shopper trends and changing consumer habits to inform product and packaging development. Supporting this, the group has ongoing programmes to develop new products across beverage alcohol categories which are managed internally by the innovation and research and development function, which also takes advantage of a substantial open innovation network.

In the year ended 30 June 2017, the group s research and development expenditure amounted to £33 million (2016 £28 million; 2015 £26 million), representing principally the cost of developing new products, from idea generation through to full product development. Research and development expenditure is generally written off in the year in which it is incurred.

**Trademarks**

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

**Regulations and taxes**

Diageo s worldwide operations are subject to extensive regulatory requirements regarding production, product liability, distribution, importation, marketing, promotion, sales, pricing, labelling, packaging, advertising, labour, pensions, compliance and control systems and environmental issues. In the United States, the beverage alcohol industry is subject to strict federal and state government regulations. At the federal level, the Alcohol and Tobacco Tax and Trade Bureau of the U.S. Treasury Department oversees the industry, and each state as well as some local authorities in jurisdictions in which Diageo sells or produces products, have regulations. Federal, state and local regulations cover virtually every aspect of its operations, including production, distribution, marketing, promotion, sales, pricing, labelling, packaging and advertising.

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

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

*Business description (continued)*

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 cultures and countries, such as in certain states in India, and through the prohibition of the import of spirits, wine and beer, to restrictions on the advertising style, media and messages used. In a number of countries, television is a prohibited medium for spirits brands and in other countries, television advertising, while permitted, is carefully regulated. Many countries also regulate the use of internet-based advertising and social media in connection with alcohol sales.

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

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

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

**Acquisitions and disposals**

Diageo has made a number of acquisitions of brands, distribution rights and equity interests and disposals in premium drinks businesses. For a description of principal acquisitions and disposals since 1 July 2014, see note 9 to the consolidated financial statements.

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

**Seasonality**

Approximately 40% of Diageo s annual net sales occur in the last four months of each calendar year.

*Business description (continued)*

**Our global reach**

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

**Diageo reports as five regions**

| | North America | Europe, Russia and Turkey | Africa | Latin America and Caribbean | Asia Pacific |
|---|---|---|---|---|---|
| **% Share by region** | | | | | |
| **Volume (%)** | 19.6 | 18.3 | 13.3 | 8.7 | 40.1 |
| **Net sales[(i)] (%)** | 34.7 | 23.4 | 13.0 | 8.7 | 20.2 |
| **Operating profit before exceptional items[(ii)] (%)** | 50.1 | 24.7 | 5.8 | 6.6 | 12.8 |
| **Operating profit[(iii)] (%)** | 50.7 | 24.0 | 5.8 | 6.7 | 12.8 |
| | 26.9 | 34.8 | 7.2 | 12.2 | 18.9 |

| | | | | | |
|---|---|---|---|---|---|
| **Number of responsible drinking programmes (%)** | | | | | |
| **Water withdrawal (%)** | 11.1 | 39.4 | 37.7 | 1.4 | 10.4 |
| **Carbon emission (%)(iv)** | 7.9 | 42.3 | 37.7 | 2.6 | 9.5 |
| **Number of employees(v) (%)** | 9.2 | 36.5 | 16.3 | 9.1 | 28.9 |

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

***Business description (continued)***

## Our brands

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

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

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

**Global giants**(i)

Our business is built around our six biggest global brands.

| | | | | | |
|---|---|---|---|---|---|
| Johnnie Walker | Smirnoff | Baileys | Captain Morgan | Tanqueray | Guinness |

| **Local stars**(ii) | | | **Reserve**(iii) | | |
|---|---|---|---|---|---|
| Can be individual to any one market, and provide a platform for our business to grow. | | | Exceptional spirits brands at above-premium price points to capture the global luxury opportunity. | | |
| Crown Royal | Yenì Raki | JeB | Johnnie Walker Blue Label | Johnnie Walker Gold Label Reserve | Johnnie Walker King George V |
| Buchanan s | Windsor | Grand Old Parr | John Walker & Sons Private Collection | Lagavulin | The Singleton of Glen Ord |
| Bundaberg | McDowell s No. 1 | Ypióca | Cîroc | Ketel One vodka | Tanqueray No. TEN |
| Shui Jing Fang | Black & White | | Ron Zacapa Centenario XO | Don Julio | Bulleit Bourbon |

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

*Business description (continued)*

**How we measure performance: key performance indicators**

**GAAP measures** - Financial GAAP performance measures similar to the financial non-GAAP key performance indicators are presented below.

**NET SALES GROWTH (%)**

**Definition**
Sales growth after deducting excise duties.

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

**OPERATING MARGIN IMPROVEMENT (BPS)**

**Definition**
The percentage point movement in operating profit, divided by net sales.

**Performance**
Operating profit margin improved by 244 bps largely due to favorable exchange, organic growth, lower exceptional operating charges and the disposal of lower margin non-core assets.

**BASIC EARNINGS PER SHARE (PENCE)**

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

**Performance**
Basic eps of 106 pence increased by 16.5 pence primarily due to favourable exchange, organic operating profit growth and higher income from associates which more than offset the negative impact from a higher tax charge and the exchange impact on the reported tax.

**NET CASH FROM OPERATING ACTIVITIES (£ MILLION)**

**Definition**

Net cash from operating activities comprises the net cash flow from operating activities as disclosed on the face of the cash flow statement.

**Performance**

**RETURN ON CLOSING INVESTED CAPITAL (%)**

**Definition**

Profit for the year divided by net assets at the end of the financial year.

**Performance**

Net cash from operating activities increased by £584 million largely driven by favourable exchange, higher organic operating profit growth and favourable working capital movement, partially offset by higher tax payments.

Return on closing invested capital was flat. Favourable exchange and higher organic operating profit growth were offset by higher net assets mainly due to the decrease in post employment liabilities.

*Business description (continued)*

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

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

**Relevance to strategy**

#1 Efficient growth

#2 Consistent value creation

#3 Credibility and trust

#4 Motivated people

| | | |
|---|---|---|
| **Financial ®**<br>**Organic net sales growth (%) #1**<br><br>**4.3%** | **Financial ®**<br>**Organic operating margin improvement (bps) #1**<br><br>**37bps** | **Financial ®**<br>**Earnings per share before exceptional items (pence)(i) #1**<br><br>**108.5p** |
| **Definition**<br>Sales growth after deducting excise duties, excluding the impact of exchange rate movements, acquisitions and disposals. | **Definition**<br>The percentage point movement in operating profit before exceptional items, divided by net sales after excluding the impact of exchange rate movements and acquisitions and disposals. | **Definition**<br>Profit before exceptional items attributable to equity shareholders of the parent company, divided by the weighted average number of shares in issue. |
| **Why we measure**<br><br>This measure reflects our performance as the result of the choices made in terms of category and market participation, and Diageo s ability to build brand equity, increase prices and grow market share. | **Why we measure**<br><br>The movement in operating margin measures the efficiency of the business. Consistent operating margin improvement is a business imperative, driven by investment choices, our focus on driving out costs across the business and improving mix. | **Why we measure**<br><br>Earnings per share reflects the profitability of the business and how effectively we finance our balance sheet. It is a key measure for our shareholders. |
| **Performance**<br><br>Organic net sales growth was driven by 1.1% volume growth and 3.2% positive price/mix. Overall, pricing is muted | **Performance**<br><br>On an organic basis operating margin expanded 37bps driven by our productivity programme which | **Performance**<br><br>Eps before exceptional items increased 19.1 pence as favourable exchange, organic operating profit |

| | | |
|---|---|---|
| across many of our markets but mix remains strong. | enabled gross margin expansion, marketing efficiencies and overhead savings. | growth and higher income from associates more than offset the negative impact from higher tax charges and the exchange impact on reported tax. |
| More detail on page 51 | More detail on pages 52-53 | More detail on page 53 |

*Business description (continued)*

**Non-Financial**
**Alcohol in society (reach and impact of responsible drinking programmes) #3, #4**

**264 programmes**

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

**Why we measure**

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

**Performance**

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

More detail on page 120

**Non-Financial**
**Health and safety (lost-time accident frequency per 1,000 full-time employees) #3, #4**

**1.14**

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

**Why we measure**

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

**Performance**

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

More detail on pages 126-128

**Non-Financial**
**Water efficiency[iii]**

**(l/l) #1, #3**

**4.96l/l**

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

**Why we measure**

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

**Performance**

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

More detail on pages 133-135

*Business description (continued)*

**Financial ®**
**Free cash flow (£ million) #1**

**£2,663m**

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

**Why we measure**

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

**Performance**

Improvement was driven by favourable exchange, higher organic operating profit growth and favourable working capital movement, driven by improvement in debtor collection, partially offset by higher tax payments.
More detail on page 54

**Financial**
**Return on average invested capital (ROIC) (%) #2**

**13.8%**

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

**Why we measure**

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

**Performance**

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

More detail on page 55

**Financial ®**
**Total shareholder return (%) #2**

**12%**

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

**Why we measure**

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

**Performance**

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

*Business description (continued)*

**Non-Financial**
**Carbon emissions[iii]**

**(1,000 tonnes $CO_2$e) #1, #3**

**634**

**Definition**

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

**Why we measure**

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

**Performance**

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

More detail on pages 135-136

**Non-Financial**
**Employee engagement index (%) #3, #4**

**75%**

**Definition**

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

**Why we measure**

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

**Performance**

93% of our people participated in our Values Survey (23,043 of the 24,733 invited). 75% were identified as engaged, a drop of 2% as discussed on pages 127-128. 89% declared themselves proud to work for Diageo, up 1% on 2016.

More detail on pages 127-129

**Remuneration**

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

See our Directors remuneration report from page 172 for more detail.

(i) For reward purposes this measure is further adjusted for the impact of exchange rates and other factors not controlled by management, to ensure focus on our underlying performance drivers.
(ii) The top 19 countries are those with the highest net sales.
(iii) In accordance with Diageo s environmental reporting methodologies and WRI/WBCSD GHG Protocol, data for each of the four years in the period ended 30 June 2016 has been restated.

*Business description (continued)*

**Chairman s statement**

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

**Recommended final dividend per share**
2017: 38.5p h5%
2016: 36.6p
**Total dividend per share(i)**
2017: 62.2p h5%
2016: 59.2p
**Total shareholder return (%)**
2017: 12%
2016: 17%

(i) Includes recommended final dividend.

**Consumer focus**

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

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

**Opportunity for growth**

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

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

**Value creation**

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

***Business description (continued)***

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

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

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

**Business environment**

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

**Our role in society**

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

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

Creating a positive role for alcohol in society

Building thriving communities

Reducing our environmental impact

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

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

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

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

*Business description (continued)*

**Diversity**

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

**Board changes**

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

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

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

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

**Looking ahead**

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

**Javier Ferrán**

Chairman

*Business description (continued)*

**Chief Executive s statement**

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

| **Volume movement** | **Organic volume movement** |
|---|---|
| 2017: i1.7%<br><br>2016: h0.1% | 2017: h1.1%<br><br>2016: h1.3% |
| **Net sales movement** | **Organic net sales movement** |
| 2017: h14.9%<br><br>2016: i3.0% | 2017: h4.3%<br><br>2016: h2.8% |
| **Operating profit movement** | **Organic operating profit movement** |
| 2017: h25.3%<br><br>2016: h1.6% | 2017: h5.6<br><br>2016: h3.5% |

**Performance review**

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

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

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

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

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

**A year of progress**

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

Court ruling, banning sales by outlets near highways.

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

- We are better equipped to win at the moment of choice with increased outlet coverage and better sales execution

- Our work on gathering improved insight and measurement is enabling us to make better, more informed decisions, and sets us up well for the future

- We are a more agile organisation simpler and quicker able to adapt more quickly to changing consumer trends

- We bring an efficiency mindset to everything we do

*Business description (continued)*

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

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

**Productivity programme on track**

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

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

**Our role in society**

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

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

*Business description (continued)*

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

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

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

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

**Our people**

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

**Outlook**

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

**Ivan Menezes**

Chief Executive

*Business description (continued)*

**Market dynamics**

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

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

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

- We currently expect 500 million new legal purchase age consumers to come to the market over the next decade India and Africa will account for half of this

- Around 730 million more consumers will be able to afford international style spirits, over the next decade, with 85% of this growth coming from emerging markets

- Spirits penetration in many emerging markets is still low when compared to developed markets

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

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

***Developed market opportunities***

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

***Emerging market opportunities***

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

**Operating in a volatile environment**

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

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

*Business description (continued)*

**Earning trust and respect as part of wider society**

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

***Creating a positive role for alcohol in society***

The beverage alcohol industry is one of the most highly regulated in the world, and that regulation varies widely between countries and jurisdictions. Diageo complies with all laws and regulations, wherever we operate, as a minimum requirement, and we advocate effective, evidence-based alcohol policies as described on page 120 of this report.

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

***Industry collaboration and partnerships to reduce harmful drinking***

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

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

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

***Building thriving communities***

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

***Water and the environment***

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

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

*Business description (continued)*

**Examples of our strategic responses**

**Reserve mass luxury**

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

**Innovation holistic lifestyle products**

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

**Mainstream spirits**

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

(iv) Euromonitor 2015, internal analysis.

*Business description (continued)*

## Risk factors

Diageo believes the following to be the principal risks and uncertainties facing the group. If any of these risks occur, Diageo s business, financial condition and performance could suffer and the trading price and liquidity of its securities could decline. Because any global business of the kind Diageo is engaged in is inherently exposed to risks that become apparent only with the benefit of hindsight, risks of which Diageo is not presently aware or which Diageo does not currently consider to be material could also adversely impact Diageo s business, financial condition and performance, including its ability to execute its strategy. The order of presentation of the risk factors below does not necessarily indicate the likelihood of their occurrence or the potential magnitude of their consequences.

***Risks related to the global economy***

**Diageo s business may be adversely impacted by unfavourable economic, political, social or other developments and risks in the countries in which it operates**

Diageo may be adversely affected by unfavourable economic developments in any of the countries where it has distribution networks, marketing companies or production facilities. In particular, Diageo s business is dependent on general economic conditions in its most important markets, including in the United States and in the United Kingdom and the other countries that form the European Union. A significant deterioration in economic conditions in any of Diageo s important markets, including economic slowdowns or recessions, inflationary pressures and/or disruptions to credit and capital markets, could lead to decreased consumer confidence and consumer spending more generally, thus reducing demand for Diageo s products. Unfavourable economic conditions could also negatively impact Diageo s customers, suppliers and financial counterparties, who may experience cash flow problems, increased credit defaults or other financial issues, which could lead to customer destocking as well as an increase in Diageo s bad debt expense. In addition, volatility in the credit and capital markets caused by unfavourable economic developments and uncertainties could result in a reduction in the availability of, or an increase in the cost of financing to, Diageo. Diageo s business could also be affected by other economic developments such as fluctuations in currency exchange rates, the imposition of any import, investment or currency restrictions, including tariffs and import quotas, or any restrictions on the repatriation of earnings and capital. Any of these developments may have a material adverse effect on Diageo s business and financial results.

Diageo s operations are also subject to a variety of other risks and uncertainties related to its global operations, including adverse political, social or other developments. Political and/or social unrest or uncertainties (including in relation to the United Kingdom s decision to withdraw from the European Union), potential health issues, natural disasters, politically-motivated violence and terrorist threats and/or acts, including those which are specifically directed at the alcohol industry, may also occur in countries where Diageo has operations. Any of the foregoing could have a material adverse effect on Diageo s business, financial condition and performance.

Many of the above risks are heightened, or occur more frequently, in emerging markets. A substantial portion of Diageo s operations is conducted in emerging markets, which represented approximately 42% of Diageo s net sales for the year ended 30 June 2017. In general, emerging markets are also exposed to relatively higher risks of liquidity constraints, inflation, devaluation, price volatility, currency convertibility, corruption, crime and lack of law enforcement, expropriation of assets, and sovereign default, as well as additional legal and regulatory risks and uncertainties. Developments in emerging markets can affect Diageo s ability to import or export products and to repatriate funds, as well as impact levels of consumer demand (for example, in duty free outlets at airports or in on trade premises in affected regions) and therefore Diageo s levels of sales or profitability. Any of these factors may affect Diageo disproportionately or in a different manner from its competitors, depending on Diageo s specific exposure to any particular emerging market, and could have a material adverse effect on Diageo s business and financial results.

**The United Kingdom s decision to withdraw from the European Union may result in a sustained period of economic and political uncertainty and complexity, and may have a negative impact on economic conditions in Europe and on Diageo s business and financial results**

***Business description (continued)***

Diageo is headquartered in the United Kingdom and has significant production and investment in Scotland. In June 2016, the United Kingdom voted by referendum to withdraw from membership in the European Union (commonly referred to as Brexit ). The prime minister of the United Kingdom formally invoked Article 50 of the Treaty of the European Union on 29 March 2017, thus officially initiating the process for the departure of the United Kingdom from the European Union. The terms of this withdrawal are subject to a formal negotiation period that could last at least two years from this notification date. Although it remains too early to fully assess the potential impact of Brexit on Diageo s business, it is anticipated that there will be a sustained period of economic and political uncertainty and complexity whilst the detailed terms of the United Kingdom s exit from the European Union are finalised and the United Kingdom negotiates, concludes and implements successor trading arrangements with other countries. The United Kingdom s withdrawal from the European Union could also negatively impact economic conditions in Europe more generally and have adverse effects on Diageo s business and financial results. For instance, the negotiating process surrounding the terms of the departure of the United Kingdom from the European Union may contribute to significant volatility in exchange rates and risks to supply chains across the European Union and ultimately lead to changes in market access or trading terms, including to customs duties, tariffs and/or industry-specific requirements and regulations, restrictions on the mobility of employees and generally increased legal and regulatory complexity and costs.

The withdrawal of the United Kingdom from the European Union could also have further implications for the constitutional makeup of the United Kingdom as a result of renewed discussions following the outcome of the referendum concerning independence for Scotland and/or further devolved governments in Scotland and Northern Ireland. This could result in a further period of political uncertainty in the United Kingdom and otherwise adversely affect Diageo s business and financial results, particularly since Diageo has substantial operations and inventory located in Scotland.

***Risks related to Diageo s industry***

**Demand for Diageo s products may be adversely affected by many factors, including changes in consumer preferences and tastes and adverse impacts of a declining economy**

Diageo s portfolio of brands includes some of the world s leading beverage alcohol brands, as well as a number of brands that are prominent in certain regional and/or local markets. Maintaining Diageo s competitive position depends on its continued ability to offer high-quality products that have a strong appeal to a wide range of consumers. Consumer preferences on a global and/or local scale may shift due to a variety of factors, including changes in demographics, evolving social trends (including potential shifts in consumer tastes towards locally produced small batch craft products), changes in travel, vacation or leisure activity patterns, weather conditions, public health regulations and/or a downturn in economic conditions, any or all of which may reduce consumers willingness to purchase luxury or premium branded products or to purchase products from large producers such as Diageo. Economic pressures could also cause consumers to choose products which have lower price points, whether Diageo s or those of its competitors, which may have an adverse effect on Diageo s business and financial results. The competitive position of Diageo s brands, as well as Diageo s reputation more generally, could also be adversely affected by any failure by Diageo to provide consistent, reliable quality in its products or in its service levels to customers.

In addition, the social acceptability of Diageo s products may decline due to negative publicity surrounding, and/or public concerns about, alcohol consumption. Such concerns could also result in regulatory action, litigation or customer complaints against companies in the industry and have an adverse effect on Diageo s business and financial results.

Diageo s business has historically benefited from the launch of new products or variants of existing brands, and continuing product innovation and the creation of extensions to existing brands remain significant elements of Diageo s growth plans. The launch and ongoing success of new products is inherently uncertain, especially with respect to such products initial and continuing appeal to consumers. The failure to successfully launch a new product or a variant of an existing brand can give rise to inventory write-offs and other costs, as well as negatively impact consumer perception and growth of an existing brand. There can be no assurance of Diageo s continuing ability to develop and launch successful new products or variants of existing products, or to ensure or extend the profitable lifespan of its existing products.

*Business description (continued)*

**Diageo is subject to litigation specifically directed at the beverage alcohol industry, as well as to other litigation**

Companies in the beverage alcohol industry are, from time to time, exposed to class action or other private or governmental litigation relating to alcohol advertising, product liability, alcohol abuse problems or other health consequences arising from the misuse of alcohol. Diageo may also be subject to litigation arising from legacy and discontinued activities, as well as other litigation in the ordinary course of its operations, including in connection with the acquisition or disposal of businesses or other assets. Diageo is further subject to the risk of litigation, enforcement or other regulatory actions by tax, customs, competition, environmental, anti-corruption and other relevant regulatory authorities, including with respect to the methodology for assessing importation value, transfer pricing or compliance matters. Diageo s listing in the United States may also expose it to a higher risk of securities-related class action suits, particularly following any significant decline in the price of Diageo s securities. Any such litigation or other actions may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and/or impact the ability of management to focus on business matters, thus adversely affecting Diageo s business and financial results. For additional information with respect to legal proceedings, including certain litigation in relation to Diageo s acquisition of USL, see Additional information for shareholders Legal proceedings and note 18 to the consolidated financial statements.

**Diageo is subject to tax uncertainties, including changes in tax obligations, tax laws, regulations and interpretations, as well as enforcement actions by tax authorities**

Changes in the political and economic climate have resulted in an increased focus on tax collection in recent years, and tax authorities are showing an increased appetite to challenge the methodology used by multinational enterprises, even where a company complies with international best practice guidelines. Changes in tax law (including tax rates), tax treaties, accounting policies and accounting standards, including as a result of the Organisation for Economic Co-Operation and Development s review of base erosion and profit shifting and the European Union s anti-tax abuse measures, could also result in litigation or other actions by relevant tax authorities. For example, as discussed in note 18 to the consolidated financial statements, Diageo has entered into a process of collaborative working with HM Revenue & Customs (HMRC) in relation to preliminary notice of assessments it has received with respect to the new Diverted Profits Tax regime in the United Kingdom. Any such litigation or other actions may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and as a result, Diageo s business and financial results could be materially adversely affected. For additional information with respect to legal proceedings, see Additional information for shareholders Legal proceedings and note 18 to the consolidated financial statements.

Beverage alcohol products are also subject to national excise, import duty and other types of taxes in most countries around the world, most of which are specific to each jurisdiction. Increases in any such taxes could have a material adverse effect on Diageo s revenue from sales or margin, either through reducing the level of overall beverage alcohol consumption and/or by encouraging consumers to switch to lower-taxed categories of beverage alcohol.

In addition to the above, other changes in tax law (including tax rates), tax treaties, related accounting policies and accounting standards could also increase Diageo s cost of doing business and lead to a rise in Diageo s effective tax rate, thus adversely affecting Diageo s business and financial results.

**Climate change, or legal, regulatory or market measures to address climate change, may negatively affect Diageo s business or operations, and water scarcity or poor water quality could negatively impact Diageo s production costs and capacity**

There is growing concern that carbon dioxide and other greenhouse gases in the atmosphere may have an adverse effect on global temperatures, weather patterns and the frequency and severity of extreme weather events and natural disasters. In the event that climate change, or legal, regulatory or market measures enacted to address climate change, has a negative effect on agricultural productivity in the various regions from which Diageo procures its raw materials, Diageo may be subject to decreased availability or increased prices for a number of raw materials that are necessary in the production of Diageo s products, including sugar, cereals, hops, agave and grapes.

Water, which is the main ingredient in substantially all of Diageo s products, is also a limited resource in many parts of the world. As demand for water continues to increase, and as water becomes scarcer and the quality of available water deteriorates, Diageo may be affected by increasing production costs (including those related to unfavourable changes to applicable water-related taxes and regulations) or capacity constraints, which in turn could adversely affect Diageo s business and financial results.

***Business description (continued)***

**Any increases in the cost of production could affect Diageo s profitability**

The components that Diageo uses for the production of its beverage alcohol products are largely commodities that are subject to price volatility caused by factors beyond Diageo s control, including changes in global supply and demand, weather and/or agricultural conditions, fluctuations in relevant exchange rates and/or governmental controls. Fluctuations in the prices of various commodities, including energy prices, may result in unexpected increases in the cost of the raw materials Diageo uses in the production of its products, including the prices of the agricultural commodities, flavourings and other ingredients necessary for Diageo to produce its various beverages, as well as glass bottles and other materials used as packaging, thus increasing Diageo s production costs. Diageo may also be adversely affected by shortages of any such materials, by increases in energy costs resulting in higher transportation, freight and other related operating costs or by inflation in any of the jurisdictions in which it produces its products. Diageo may not be able to increase its prices to offset these increased costs without suffering reduced volumes of products sold and/or decreased operating profit.

***Risks related to regulation***

**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 relating to production, distribution, importation, marketing, advertising, promotion, sales, pricing, labelling, packaging, product liability, labour, pensions, antitrust, compliance and control systems, and environmental issues. Changes in laws, regulations or governmental or regulatory policies and/or practices could cause Diageo to incur material additional costs or liabilities that could adversely affect its business. In particular, governmental bodies in countries where Diageo operates may impose new labelling, product or production requirements, limitations on the marketing, advertising and/or promotion activities used to market beverage alcohol, restrictions on retail outlets, restrictions on importation and distribution or other restrictions on the locations or occasions where beverage alcohol is sold which directly or indirectly limit the sales of Diageo products. For example, in 2015 two of the major states (in terms of population and per capita alcohol consumption) of the Republic of India, the State of Kerala and the State of Bihar, announced the imposition of a total ban on alcohol consumption, while, more recently, the Supreme Court of India issued a ruling prohibiting the sale of alcohol in certain outlets near highways. These regulatory measures have impacted, and are likely to continue to impact, the sale and distribution of Diageo s products in India, which in turn could adversely affect Diageo s business and financial results.

Regulatory authorities under whose laws Diageo operates may also have enforcement power that can subject the group to actions such as product recalls, seizure of products or other sanctions which could have an adverse effect on Diageo s sales or damage its reputation. Any changes to the regulatory environment in which Diageo operates could also cause Diageo to incur material additional costs or liabilities, which could adversely affect Diageo s performance.

Diageo is subject to data privacy regulations in many of the markets in which it operates, and laws and regulations in this area are developing and changing on a continual basis. For example, Diageo is subject to the General Data Protection Regulation adopted in the European Union in April 2016, which must be fully implemented in all member states by May 2018. Breach of any of these laws or regulations can lead to significant fines and/or damage to Diageo s reputation as well as significantly restricting its ability to deliver on its digital productivity and growth plans.

**Any failure by Diageo to comply with anti-corruption laws, sanctions, trade restrictions or similar laws or regulations, or any failure of Diageo s related internal policies and procedures to comply with applicable law, may have a material adverse effect on Diageo s business and financial results**

Diageo produces and markets its products in a global scale, including in certain countries that, as a result of political and economic instability, a lack of well-developed legal systems and/or potentially corrupt business environments, are reported to have high levels of corruption risk (i.e., countries in which the Transparency International index of perceived levels of public sector corruption is less than or equal to fifty). There is increasing scrutiny and enforcement by regulators in many jurisdictions of anti-corruption laws, including pursuant to the US Foreign Corrupt Practices Act and the UK Bribery Act. Such enforcement has been enhanced by applicable regulations in the United States, which offer substantial financial rewards to whistleblowers for reporting information that leads to monetary fines.

*Business description (continued)*

If Diageo or any of its associates fails to comply with anti-corruption laws, or with existing or new economic sanctions or trade restrictions imposed by the United States, the European Union or other national or international authorities that are applicable to Diageo or such associate, Diageo may be exposed to the costs associated with investigating potential misconduct as well as potential legal liability and/or reputational damage.

While Diageo has implemented and maintains internal practices, procedures and controls designed to ensure compliance with anti-corruption laws, sanctions, trade restrictions or similar laws and regulations, and routinely conducts investigations, either at its own initiative or in response to requests from regulators in connection with compliance with such internal controls, there is no guarantee that such procedures will be effective in preventing compliance failures at Diageo or at third parties with whom Diageo maintains business relationships.

Any investigations and lawsuits, regardless of the ultimate outcome of the proceeding, are time consuming and expensive and can divert the time and effort of Diageo s personnel, including senior management, from its business. Adverse publicity, governmental scrutiny and legal and enforcement proceedings can also have a negative impact on Diageo s reputation and on the morale and performance of its employees. To the extent that violations of anti-corruption, sanction and/or trade restriction laws and regulations, and/or Diageo s internal policies and procedures, are found, or if Diageo s internal policies and procedures are found not to comply with applicable law, possible regulatory sanctions, fines and other consequences may also be material.

**Defective internal controls could adversely affect Diageo s financial reporting and management processes, as well as the accuracy of public disclosures**

Diageo has in place internal control and risk management systems in relation to its financial reporting process and its process for the preparation of consolidated financial statements. In addition, management undertakes a review of the consolidated financial statements in order to ensure that the financial position and results of the group are appropriately reflected therein. Diageo is required by the laws of various jurisdictions to publicly disclose its financial results, as well as developments that could materially affect its financial results, and regulators routinely review the financial statements of listed companies such as Diageo for compliance with new, revised or existing accounting and regulatory requirements. Should Diageo be subject to an investigation into potential non-compliance with accounting and disclosure requirements or be found to have breached any such requirements, this may lead to restatements of previously reported results and significant penalties. In addition, the reliability of financial reporting is important in ensuring that the management of a business and its results are based on reliable data. Flaws in internal control systems could adversely affect Diageo s business and financial results, including Diageo s ability to execute its strategy.

Accurate disclosures also provide investors and other market professionals with information to understand Diageo s business. Defective internal controls could result in inaccuracies or lack of clarity in public disclosures that could create market uncertainty regarding the reliability of the data presented. As a result, defective internal controls could adversely affect Diageo s business and financial results and/or the price of Diageo s securities.

***Risks related to Diageo s business***

**The value of Diageo s brands and its net sales may be negatively affected by its failure to maintain its brand image and corporate reputation or adapt to a changing media environment**

The value of Diageo s brands and its profitability depends heavily on its ability to maintain its brand image and corporate reputation. Adverse publicity, whether or not justified, may tarnish Diageo s reputation and cause consumers to choose products offered by its competitors. Such adverse publicity could arise as a result of a perceived failure by Diageo to make adequate positive social contributions, including in relation to the level of taxes paid by Diageo, or by the failures of internal controls or compliance breaches leading to a breach of Diageo s Code of Business Conduct, its other key policies or of the laws or regulations of the jurisdictions in which it operates.

In addition, Diageo s ability to maintain, extend, and expand its brand image depends on its ability to adapt to a rapidly changing media environment. Diageo maintains an online presence as part of its business operations, and increasingly relies on social media and online dissemination of advertising campaigns. Diageo s reputation may suffer if it is perceived to fail to appropriately restrict access to its online content or if it breaches any marketing regulation, code or policy. In addition, the growing use of social and digital media increases the speed and extent that information or misinformation and opinions can be shared. Negative posts or comments about Diageo, its brands or its products on social or digital media, whether or not valid, could seriously damage Diageo s brands and reputation.

*Business description (continued)*

Any failure to maintain, extend, and expand Diageo s brand image or adapt to a changing media environment may have a material adverse effect on Diageo s business and financial results.

**Diageo faces competition that may reduce its market share and margins**

Diageo faces substantial competition from several international companies as well as regional and local companies (including craft breweries and distilleries) in the countries in which it operates and competes with drinks companies across a wide range of consumer drinking occasions. Within a number of categories, the beverage industry has been experiencing continuing consolidation among major global producers, as evidenced by several business combinations of substantial value carried out by significant competitors in recent years. Consolidation is also taking place among Diageo s customers in many countries. These trends may lead to stronger competitors, increased competitive pressure from customers, negative impacts on Diageo s distribution network, downward pressure on prices, predatory marketing tactics by Diageo s competitors and/or a decline in Diageo s market share in any of these categories. Adverse developments in economic conditions or declines in demand or consumer spending may also result in intensified competition for market share, with potentially adverse effects on sales volume and price. Any of these factors may adversely affect Diageo s results and potential for growth.

**Diageo may not be able to derive the expected benefits from its business strategies, including in relation to expansion in emerging markets, acquisitions, productivity initiatives or inventory forecasting**

There can be no assurance that Diageo s business strategies will result in opportunities for growth and improved margins. Part of Diageo s growth strategy includes expanding its business in certain emerging market countries where consumer spending in general, and spending on Diageo s products in particular, has not historically been significant, but where Diageo believes there are strong prospects for growth. There is no guarantee that this strategy will be successful, and some of these markets may represent a higher risk in terms of their changing regulatory environments and higher degrees of uncertainty over levels of consumer spending.

It is also possible that Diageo s business strategies could give rise to further business combinations, acquisitions, disposals, joint ventures and/or partnerships (including any associated financing or the assumption of actual or potential liabilities, depending on the transaction contemplated). There can be no assurance that any transaction, including the Casamigos transaction announced in June 2017 and described in further detail on page 20 and in note 19 to the consolidated financial statements, will be completed or that any such transaction would deliver the anticipated benefits, cost savings or synergies. The success of any transaction will depend in part on Diageo s ability to successfully integrate new businesses with Diageo s existing operations and realise the anticipated benefits of the transaction. Acquisitions may also expose Diageo to liabilities it may not be aware of at the time of the acquisition, for example if acquired companies and businesses do not act, or have not acted, in compliance with applicable laws and regulations. The current and ongoing issues in USL detailed in note 18 to the consolidated financial statements provide an example of integration and legal challenges.

Similarly, there can be no assurance that the global productivity programme implemented by Diageo in order to drive efficiencies and deliver cost savings will deliver the expected benefits, and such programmes may result in significant costs to Diageo or may have other adverse impacts on the business and operations of the Group. Diageo continues to undertake programmes designed to improve the effectiveness and efficiency of end-to-end operations, including changes to organisational structures, business processes and business systems. Disruption caused to business processes as a result of such change could impact Diageo s operations and lead to adverse customer or consumer reaction. There may also be a risk of impairment charges on goodwill or other intangible assets as well as failure to meet financial targets. Any of the foregoing could have an adverse effect on Diageo s business and financial results.

Certain of Diageo s aged product categories may mature over periods of up to 30 years, and forecasts of demand for such products in future periods are subject to significant uncertainty. There is an inherent risk of forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption as a result of changes in business strategy, market demand and preferences, macroeconomic conditions, introductions of competing products and other changes in market conditions. Any forecasting error could lead to Diageo being unable to meet the objectives of its business strategy, future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks. If Diageo is unable to accurately forecast demand for its products or efficiently manage its inventory, this may have a material adverse effect on Diageo s business and financial results.

*Business description (continued)*

**Contamination, counterfeiting or other events could harm the integrity of customer support for Diageo s brands and adversely affect the sales of those brands**

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

Additionally, third parties may sell products which are either counterfeit versions of Diageo brands or inferior brands that look like Diageo brands, and consumers of Diageo brands could confuse Diageo products with such counterfeit products. A negative consumer experience with such a product could cause them to refrain from purchasing Diageo brands in the future and in turn could impair Diageo s brand equity, adversely affecting Diageo s business.

**Diageo s business may be adversely affected by increased costs for, or shortages of, talent, or by labour strikes or disputes**

Diageo s business 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 personnel possessing the skill sets that it requires to deliver its strategy, for example in relation to sales, marketing and innovation capability within markets or in its senior management. The loss of senior management or other key personnel or the inability to identify, attract and retain qualified personnel in the future could make it difficult to manage Diageo s operations and could adversely affect Diageo s business and financial results. In addition, labour strikes, work stoppages or slowdowns within Diageo s operations or those of Diageo s suppliers could adversely impact Diageo.

**Diageo may be adversely affected by disruption to production facilities, business service centres or information systems, including via cyber-attacks**

Diageo operates production facilities around the world. If there was a technical failure or a fire or explosion at one or more of Diageo s production facilities, this could result in significant damage to the facilities, plant or equipment, their surroundings and/or the local environment and/or injury or loss of life. Such an event could also lead to a loss of production capacity, result in regulatory action or legal liability, or damage Diageo s reputation.

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

As with all large systems, Diageo s information systems could be subject to cyber-attacks by outside parties intent on extracting information, corrupting information and/or disrupting business processes. Such unauthorised access could disrupt Diageo s business and/or lead to loss of assets or to outside parties having access to confidential information, including privileged data or strategic information of Diageo and its employees, customers and consumers. Such information could also be made public in a manner that harms Diageo s reputation. The concentration of processes in business service centres also means that any sustained disruption to the facility or issue impacting the reliability of the information systems used could impact a large portion of Diageo s business operations and in some circumstances, could result in property damage, breaches of regulations, litigation, legal liabilities and reparation costs.

*Business description (continued)*

**Diageo s operations and financial results may be adversely affected by fluctuations in exchange rates and fluctuations in interest rates**

Diageo is engaged in an international business that operates in, and makes sales into, countries with different currencies, while its financial results are presented in sterling. As a result, Diageo is subject to foreign currency risk due to exchange rate movements, which will affect the sterling value of its transactions, as well as the translation to sterling of the results and underlying net assets of its operations. In particular, approximately 32% of Diageo s net sales in the year ended 30 June 2017 were in US dollars, approximately 11% were in euros and approximately 13% were in sterling. Movements in exchange rates used to translate foreign currencies into sterling may have a significant impact on Diageo s reported results of operations from year to year. Exchange rate fluctuations may also expose Diageo to increased interest expense on borrowings denominated in currencies which appreciate against the sterling. As a result, Diageo s business and financial results may be adversely affected by fluctuations in exchange rates. Diageo may also be adversely impacted by fluctuations in interest rates, mainly through increased interest expense.

**Diageo s operations and financial results may be adversely affected by movements in the value of assets and liabilities related to its pension plans**

Diageo operates a number of pension plans throughout the world, which vary in accordance with local conditions and practices. The majority of these pension plans are defined benefit plans and are funded by payments to separately administered trusts or insurance companies. The ability of these pension plans to meet their pension obligations may be affected by, among other things, the performance of assets owned by these pension plans, the liabilities in connection with the pension plans, the underlying actuarial assumptions used to calculate the surplus or deficit in the plans, in particular the discount rate and long term inflation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. For example, Diageo s deficit in respect of post-employment plans before taxation increased by £934 million from £259 million at 30 June 2015 to £1,193 million at 30 June 2016, primarily as a result of a decrease in returns from corporate bonds used to calculate the discount rates on plan liabilities. This deficit subsequently decreased by £702 million to £491 million at 30 June 2017, primarily as a result of an increase in the market value of assets held by the plans. If there are significant declines in financial markets and/or deterioration in the value of fund assets or changes in discount rates or inflation rates, Diageo may need to make significant contributions to these pension funds in the future.

Furthermore, if the market values of the assets held by Diageo s pension funds decline, the valuations of assets by the pension trustees decline or the valuation of liabilities in connection with pension plans increase, pension expenses may increase which, as a result, could materially adversely affect Diageo s financial position. There is no assurance that interest rates or inflation rates will remain constant, that pension fund assets can earn the assumed rate of return annually or that the value of liabilities will not fluctuate; Diageo s actual experience may be significantly more negative than the assumptions used.

**Diageo s operations may be adversely affected by failure to maintain or renegotiate distribution, supply, manufacturing or licence agreements on favourable terms**

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

*Business description (continued)*

**Diageo may not be able to protect its intellectual property rights**

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

*Risks related to Diageo s securities*

**It may be difficult to effect service of US process and enforce US legal process against Diageo and its directors**

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 all or a substantial portion of 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 US federal securities laws. There is also 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. In addition, punitive damages in actions brought in the United States or elsewhere may be unenforceable in England and Wales.

*Business description (continued)*

**Cautionary statement concerning forward-looking statements**

This document contains forward-looking statements. These statements can be identified by the fact that they do not relate only to historical or current facts. In particular, forward-looking statements include all statements that express forecasts, expectations, plans, outlook and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of changes in interest or exchange rates, the availability or cost of financing to Diageo, anticipated cost savings or synergies, expected investments, the completion of Diageo s strategic transactions and restructuring programmes, anticipated tax rates, expected cash payments, outcomes of litigation, anticipated deficit reductions in relation to pension schemes and general economic conditions. By their nature, forward-looking statements involve risks and uncertainties 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:

economic, political, social or other developments in countries and markets in which Diageo operates, which may contribute to a reduction in demand for Diageo s products, decreased consumer spending, adverse impacts on Diageo s customer, supplier and/or financial counterparties, or the imposition of import, investment or currency restrictions;

the negotiating process surrounding, as well as the eventual terms of, the United Kingdom s exit from the European Union, which could lead to a sustained period of economic and political uncertainty and complexity while detailed withdrawal terms and any successor trading arrangements with other countries are negotiated, finalised and implemented, potentially adversely impacting economic conditions in the United Kingdom and Europe more generally as well as Diageo s business operations and financial performance;

*Business description (continued)*

changes in consumer preferences and tastes, including as a result of changes in demographics, evolving social trends (including potential shifts in consumer tastes towards locally produced small-batch products), changes in travel, vacation or leisure activity patterns, weather conditions, public health regulations and/or a downturn in economic conditions;

any litigation or other similar proceedings (including with customs, competition, environmental, anti-corruption and other regulatory authorities), including litigation directed at the beverage alcohol industry generally or at Diageo in particular;

changes in the domestic and international tax environment, including as a result of the OECD Base Erosion and Profit Shifting Initiative and EU anti-tax abuse measures, leading to uncertainty around the application of existing and new tax laws and unexpected tax exposures;

the effects of climate change, or legal, regulatory or market measures intended to address climate change, on Diageo s business or operations, including any impact on the cost and supply of water;

changes in the cost of production, including as a result of increases in the cost of commodities, labour and/or energy or as a result of inflation;

legal and regulatory developments, including changes in regulations relating to production, distribution, importation, marketing, advertising, sales, pricing, packaging and labelling, product liability, labour, compliance and control systems, environmental issues and/or data privacy;

the consequences of any failure by Diageo or its associates to comply with anti-corruption, sanctions, trade restrictions or similar laws and regulations, or any failure of Diageo s related internal policies and procedures to comply with applicable law;

the consequences of any failure of internal controls, including those affecting compliance with existing or new accounting and/or disclosure requirements;

Diageo s ability to maintain its brand image and corporate reputation or to adapt to a changing media environment;

increased competitive product and pricing pressures, including as a result of actions by increasingly consolidated competitors or increased competition from regional and local companies, that could negatively impact Diageo s market share, distribution network, costs and/or pricing;

Diageo s ability to derive the expected benefits from its business strategies, including in relation to expansion in emerging markets, acquisitions and/or disposals, cost saving and productivity initiatives or inventory forecasting;

contamination, counterfeiting or other circumstances which could harm the level of customer support for Diageo s brands and adversely impact its sales;

increased costs for, or shortages of, talent, as well as labour strikes or disputes;

any disruption to production facilities, business service centres or information systems, including as a result of cyber-attacks;

fluctuations in exchange rates and/or interest rates, which may impact the value of transactions and assets denominated in other currencies, increase Diageo s cost of financing or otherwise adversely affect Diageo s financial results;

movements in the value of the assets and liabilities related to Diageo s pension plans;

Diageo s ability to renew supply, distribution, manufacturing or licence agreements (or related rights) and licences on favourable terms, or at all, when they expire; or

any failure by Diageo to protect its intellectual property rights.

*Business description (continued)*

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 by the principal risks set out in the Risk factors section above. Any forward-looking statements made by or on behalf of Diageo speak only as of the date they are made. Diageo does not undertake to update forward-looking statements to reflect any changes in Diageo s expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that Diageo may make in any documents which it publishes and/or files with the US Securities and Exchange Commission (SEC). All readers, wherever located, should take note of these disclosures.



The information in this document does not constitute an offer to sell or an invitation to buy shares in Diageo plc or an invitation or inducement to engage in any other investment activities.

This document may include information about Diageo s target debt rating. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating organisation. Each rating should be evaluated independently of any other rating.

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

*Business review*

**Operating results 2017 compared with 2016**

**GROUP FINANCIAL REVIEW**

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

**Kathryn Mikells,**

Chief Financial Officer

| |
|---|
| Reported net sales were up 15% as favourable exchange and organic growth more than offset the adverse impact from prior year disposals |
| Reported operating profit was up 25% driven by favourable exchange, organic growth and lower exceptional operating charges |
| Organic results improved with volume growth of 1.1% |
| Organic net sales growth of 4.3% |
| Organic operating profit grew 5.6% |
| Net cash from operating activities was £3.1bn |
| Free cash flow continued to be strong at £2.7bn up £566 million on last year |
| Basic eps of 106.0 pence was up 18% |
| Eps before exceptional items increased 21% to 108.5 pence |

*Business review (continued)*

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

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

(i) For further details of exceptional items see pages 218-221 and discontinued operations see page 227.

| Growth by region | Volume<br>% | Net sales<br>% | Marketing<br>% | Operating profit<br>% | Operating profit before exceptional items<br>% |
|---|---|---|---|---|---|
| North America | **1** | **17** | **19** | **22** | **22** |
| Europe, Russia and Turkey | **1** | **11** | **10** | **13** | **17** |
| Africa | **3** | **11** | **16** | **3** | **3** |
| Latin America and Caribbean | **2** | **21** | **17** | **209** | **26** |
| Asia Pacific | **(6)** | **17** | **14** | **38** | **23** |
| **Diageo(ii)** | **(2)** | **15** | **15** | **25** | **20** |

| Organic growth by region | Volume<br>% | Net sales<br>% | Marketing<br>% | Operating profit(i)<br>% |
|---|---|---|---|---|
| North America | **2** | **3** | **4** | **4** |
| Europe, Russia and Turkey | **3** | **5** | **3** | **8** |
| Africa | **3** | **5** | **5** | **10** |
| Latin America and Caribbean | **2** | **9** | | |