DIAGEO PLC
Form 20-F
August 12, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

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

For the fiscal year ended: 30 June 2013

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)

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

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

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

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

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 2,754,166,581 ordinary shares of $28^{101}/_{108}$ pence each.

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

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

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

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

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

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

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

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

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

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2013 of Diageo plc (the 2013 Form 20-F).

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Contents (continued)

This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2013. 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 2013, 2012 or 2011. KPMG Audit Plc has reported on those accounts; their audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the years ended 30 June 2013, 2012 or 2011. The accounts for 2012 and 2011 have been delivered to the registrar of companies and those for 2013 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 32 to 33.

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

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

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

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Historical information

The following table presents selected consolidated financial data for Diageo prepared under International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU) and IFRS as issued by the International Accounting Standards Board (IASB) for the five years ended 30 June 2013 and as at the respective year ends. References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB, unless otherwise indicated. The data presented below has been derived from Diageo's audited consolidated financial statements.

						Year ended 30 June
	Notes	**2013**	**2012**	**2011**	**2010**	**2009**
		£ million	**£ million**	**£ million**	**£ million**	**£ million**
Income statement data						
Sales		**15,487**	14,594	13,232	12,958	12,283
Operating profit	1,2	**3,431**	3,158	2,595	2,574	2,418
Profit for the year						
Continuing operations	1,2	**2,594**	2,083	2,017	1,762	1,704
Discontinued operations	3		(11)		(19)	2
Total profit for the year	1,2	**2,594**	2,072	2,017	1,743	1,706
		pence	**pence**	**pence**	**pence**	**pence**
Per share data						
Dividend per share	4	**47.40**	43.50	40.40	38.10	36.10
Earnings per share						
Basic						
Continuing operations	1	**99.3**	78.2	76.2	66.3	64.5
Discontinued operations			(0.4)		(0.8)	0.1
Basic earnings per share	1	**99.3**	77.8	76.2	65.5	64.6
Diluted						
Continuing operations	1	**98.7**	77.8	76.0	66.2	64.3
Discontinued operations			(0.4)		(0.8)	0.1
Diluted earnings per share	1	**98.7**	77.4	76.0	65.4	64.4
		million	**million**	**million**	**million**	**million**
Average shares		**2,502**	2,495	2,493	2,486	2,485

						As at 30 June
		Notes	**2013**	**2012**	**2011**	**2010 2009**
		£ million	**£ million**	**£ million**	**£ million**	**£ million**
Balance sheet data						
Total assets	1	**25,077**	22,350	19,777	19,454	18,018
Net assets		**8,107**	6,811	5,985	4,786	3,874
Net borrowings	5	**8,403**	7,570	6,450	6,954	7,419
Equity attributable to the parent company's equity shareholders		**7,036**	5,588	5,245	4,007	3,169
Share capital	6	**797**	797	797	797	797
	1					

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Historical information (continued)

Notes to the historical information

1. Accounting policies The consolidated financial statements for the five years ended 30 June 2013 were prepared in accordance with IFRS. The IFRS accounting policies applied by the group to the financial information in this document are presented in 'Accounting policies of the group' in the consolidated financial statements.

2. Exceptional items Exceptional items are charges or credits which, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information. Such items are included within the income statement caption to which they relate. An analysis of exceptional items is as follows:

	Year ended 30 June				
	2013	**2012**	**2011**	**2010**	**2009**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Items included in operating profit					
Restructuring programmes	**(69)**	(96)	(111)	(142)	(170)
Pension changes past service credits	**20**	115			
Brand impairment	**(50)**	(59)	(39)	(35)	
Duty settlements			(127)		
SEC settlement			(12)		
	(99)	(40)	(289)	(177)	(170)
Sale of businesses	**(83)**	147	(14)	(15)	
Items included in taxation					
Tax on exceptional operating items	**27**	19	51	39	37
Tax on sale of businesses	**28**		3	10	
Loss of future tax amortisation		(524)			
Settlements with tax authorities			66		155
	55	(505)	120	49	192
Exceptional items in continuing operations	**(127)**	(398)	(183)	(143)	22
Discontinued operations net of taxation (note 3)		(11)		(19)	2
Exceptional items	**(127)**	(409)	(183)	(162)	24

3. Discontinued operations In the year ended 30 June 2012 discontinued operations represented a charge after taxation of £11 million (2011 £nil; 2010 £19 million) in respect of the discounted value of anticipated future payments to additional thalidomide claimants. In the year ended 30 June 2009 discontinued operations are in respect of the packaged food business (Pillsbury sold 31 October 2001).

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

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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 noon buying rate on each of the respective dividend payment dates.

		Year ended 30 June				
		2013	**2012**	**2011**	**2010**	**2009**
		pence	**pence**	**pence**	**pence**	**pence**
Per ordinary share	Interim	**18.10**	16.60	15.50	14.60	13.90
	Final	**29.30**	26.90	24.90	23.50	22.20
	Total	**47.40**	43.50	40.40	38.10	36.10
		$	**$**	**$**	**$**	**$**
Per ADS	Interim	**1.10**	1.05	1.02	0.90	0.82
	Final	**1.79**	1.72	1.59	1.48	1.46
	Total	**2.89**	2.77	2.61	2.38	2.28

Note: Subject to shareholders' approval the final dividend for the year ended 30 June 2013 will be paid on 3 October 2013, and payment to US ADR holders will be made on 8 October 2013. In the table above, an exchange rate of £1 = $1.53 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 3 October 2013.

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

6. Share capital During the year ended 30 June 2009 the company purchased 38 million ordinary shares for cancellation or to be held as treasury shares at a cost of £354 million as part of a share buyback programme.

7. Exchange rates A substantial portion of the group's assets, liabilities, revenues and expenses are denominated in currencies other than pounds sterling. For a discussion of the impact of exchange rate fluctuations on the group's financial position and results of operations, see note 19 to the consolidated financial statements.

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

	Year ended 30 June				
	2013	**2012**	**2011**	**2010**	**2009**
	$	**$**	**$**	**$**	**$**
Year end	**1.52**	1.57	1.61	1.50	1.65
Average rate*	**1.57**	1.59	1.59	1.57	1.60

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

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Historical information (continued)

The following table shows period end, high, low and average US dollar/pound sterling noon buying exchange rates by month, for the six month period to 31 July 2013, expressed in US dollars per £1. The information in respect of the month of July is for the period up to and including 31 July 2013.

						2013
	July	June	May	April	March	February
	$	$	$	$	$	$
Month end	**1.52**	**1.52**	**1.52**	**1.55**	**1.52**	**1.52**
Month high	**1.54**	**1.57**	**1.56**	**1.55**	**1.52**	**1.58**
Month low	**1.48**	**1.52**	**1.50**	**1.51**	**1.49**	**1.51**
Average rate**	**1.52**	**1.55**	**1.53**	**1.53**	**1.51**	**1.55**

** The average of the noon buying rates on each business day of the month.

The average exchange rate for period 1 to 2 August 2013 was £1 = $1.52 and the noon buying exchange rate on 2 August 2013 was £1 = $1.53.

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

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Business description

Diageo is the world's leading premium drinks business. Its geographic breadth and range of industry leading brands across categories and price points is unparalleled.

The business is balanced having a strong presence in the world's largest and most profitable beverage alcohol market, the United States, an integrated Western European business and a large and increasing presence in the new high growth markets of Africa, Latin America, Asia Pacific, Central and Eastern Europe, Russia and Turkey. Diageo's strong financial position has been built through investing in the growth of its brands, through continuing to improve its routes to market and through expanding its presence in the new high growth markets both organically and through selective acquisitions. Diageo maintains the strength of its brands and enhances its position through world class marketing and industry leading innovation. Diageo has scale but acts with agility to deliver top line growth, margin improvement and improved shareholder return. Diageo is proud of the role its brands play in the social life and celebrations of consumers around the globe.

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.

Strategy

Diageo's strategy is to drive top line growth and margin expansion in a sustainable and responsible way and to deliver consistent value creation for its shareholders over the long term. To do this Diageo will use its broad brand range, category depth and geographic reach to deliver on consumer needs. Key to achieving its strategy is the expertise of its people who share the same values.

Diageo has a broad range of leading brands across categories and price points. It owns six of the world's top 20 spirit brands by retail sales, including Johnnie Walker, the number one spirit brand by value and Smirnoff, the number one premium spirit brand by volume, making Diageo the leading premium spirits business in the world by volume, net sales and operating profit. In beer, Diageo owns one of the truly global beer brands, Guinness, the number one stout in the world. Diageo's wine brands are sold predominantly in North America and Great Britain where they offer a route to market benefit. Diageo's global brands are complemented by strong local brands to broaden the category range and to create category depth providing access at affordable price points to the increasing number of middle class consumers aspiring to trade up in their drink of choice. Diageo's brands cover a range of price points, from Diageo's reserve brands, including Johnnie Walker Blue Label, Cîroc and Ketel One vodka to more affordable brands, such as VAT69 in India, White Horse in Russia and 20cl bottles of Johnnie Walker Red Label and local beers across Africa.

Diageo is a global company with products sold in more than 180 countries around the world. In the developed markets, primarily in North America and Western Europe, Diageo has built scale and strong routes to market. In the new high growth markets, Diageo is the number one international spirits company in Asia Pacific and Latin America and the leading beer and spirits company in Africa. These rapidly growing markets now contribute more than 40% of Diageo's net sales, up from a fifth in 2005. These markets are expected to contribute 50% of Diageo's net sales by the end of 2015 through double digit organic growth as international spirits penetration expands and with selective acquisitions.

In the new high growth markets Diageo expects to make acquisitions of companies with both strong local routes to market and with brands that can be premiumised and appeal to the growing

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Business description (continued)

number of middle class consumers. The acquisitions of Mey Içki in Turkey, Ypióca in Brazil, the Serengeti and Meta breweries in Africa, its major shareholding in Shuijingfang in China, its investment in Halico in Vietnam, and from July 2013 its major shareholding in United Spirits Limited (USL) in India, each demonstrate this strategy in action.

Diageo explores the potential to make acquisitions on an ongoing basis and is currently evaluating a number of such opportunities of which some could be significant although no agreements or commitments for any significant acquisitions currently exist. Funds for any such acquisitions would be drawn from internally generated cash, bank borrowings or the issuance of equity or debt securities (in an amount that cannot now be determined) and the proceeds of any disposals. Other than as described herein, no material disposals are currently contemplated.

Diageo believes it leads the industry in marketing, combining expertise and creative alliances to engage consumers through traditional and digital media channels. This expertise and collaboration, combined with the benefits of global scale and consumer insights, delivers world class marketing campaigns focusing on the range of price points from luxury to more affordable brands; on new consumer groups, such as the emerging middle class, multicultural and female consumers; and on marketing innovation. Marketing spend is focused on the strategic brands and the new high growth markets. Global campaigns are made locally relevant with the use of local agencies. For example, the global Johnnie Walker 'Keep Walking' campaign has been in place for over 10 years and while the campaign is based on the universal appeal of personal progress, each market has local creative executions which reflect local insights.

Diageo's industry leading innovation programme is making a significant contribution to Diageo's net sales and operating profit growth by focusing not only on building a pipeline for the future, but also on sustaining past launches to drive long term value across the brand portfolio. Recent launches have focused on the consumers' desire for luxury, the tastes and increasing affluence of the emerging middle class consumer and increasing the accessibility of spirits through flavour extensions and new packaging and drink formats.

Diageo has strong routes to market which leverage local expertise. In the United States, Diageo is required by law to operate through a three-tier distribution system which separates suppliers, distributors and retailers. Diageo works with distributors who provide a substantial dedicated sales team of nearly 3,000 people. Outside of the United States, Diageo owns and controls the route to market in many countries, and in others the route to market is through joint ventures, associates and third party distributors. The recent acquisitions in the new high growth markets have helped to enhance Diageo's routes to market with the addition of the leading spirits company in Turkey, Mey Içki; the second largest brewery in Ethiopia, Meta Abo; the leader in the premium cachaça segment in Brazil, Ypióca; and with investments in a premium local spirit company in China, Shuijingfang, the leading branded spirit company in Vietnam, Halico and the leading beverage alcohol producer in India, USL.

Diageo works in collaboration with its customers to drive profitable category growth, by building partnerships with retailers and on trade customers. The 'Diageo Way of Selling' or the 'Platform for Growth' programmes equip both Diageo and its customers with the tools to be the best sales force in the industry, provide education to its partners and create commercial and strategic value for all parties. The European Customer Collaboration Centre provides a state of the art facility to bring consumer, shopper, retailer and distributor insights together to facilitate integrated planning with customers. These tools enable Diageo to realise its ambition to become an indispensable business partner to its customers.

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Business description (continued)

Diageo has a history of being a sustainable and responsible company dating from Arthur Guinness who undertook philanthropic community programmes and through the 1930s when its predecessor companies marketed their brands in a responsible manner. Diageo understands the social, environmental and economic impact of its activities and has adopted a structured approach to manage these impacts, to build engagement across stakeholders, to create value, especially in the new high growth markets, and to protect Diageo's licence to operate.

Diageo and its employees are proud of the responsible manner in which its brands are marketed and the role that moderate consumption of its brands can play as part of a balanced lifestyle for millions of people. Diageo seeks to be at the forefront of industry efforts to promote responsible drinking and works with key stakeholders to address alcohol misuse.

Diageo's supply organisation is responsible for producing, distilling, brewing, bottling, packaging and distributing its brands. It is committed to efficient, sustainable production. Investment in production facilities is focused on building capacity for the production of spirits and beer, with both high speed and high volume, cost efficient production lines and with flexible production facilities to create an industry leading supply chain for innovation, especially in luxury products. Diageo deploys groundbreaking new technology in its production sites in an effort to deliver cost savings, security of supply and reduction of waste. Diageo is constantly looking at ways to improve water efficiency, reduce water wastage, increase the use of sustainable packaging and reduce pollution, carbon emissions and waste to landfill.

Diageo is committed to generating broad-based prosperity through the value chain and through direct investment in the communities in which it operates, especially in the new high growth markets, by integrating its supply chain into the local community and through direct initiatives such as the 'Learning for Life' and 'Water of Life' programmes in Latin America and Caribbean and Africa.

Diageo believes that industry leading performance will be delivered through a talented and diverse workforce and great leadership. The company has active programmes that ensure the development of its management and leaders. Great leadership combined with a culture of good governance and ethics protect Diageo's reputation and support the sustainable efficient growth of the business.

Business overview

Market participation In the year ended 30 June 2013, Diageo managed its business through five regions: North America; Western Europe; Africa, Eastern Europe and Turkey; Latin America and Caribbean and Asia Pacific. North America is the biggest region by net sales and operating profit and Diageo is the number one spirits company in the region. The main focus of the business in North America is to drive continued top line growth in the on trade, to deliver industry leading innovation and to broaden its reach to the multicultural consumer and to improve its operating margin through pricing, premiumisation and by using its scale to drive cost advantage. Diageo is the largest premium drinks company in Western Europe. Western Europe is managed as a single market with the country teams focusing on sales execution, while marketing and back office functions are integrated at a Western Europe level to drive flexibility and efficiency. In the new high growth markets Diageo's strategy is based on the increased spend by both affluent and middle class consumers on premium beverage alcohol. In Africa the strategy is to grow Diageo's leadership across beverage alcohol through focusing on the emerging middle class consumer and providing a brand choice for every motivation, occasion and stage of consumer evolution. Diageo is focused on increasing its presence in spirits through continued investments behind its brands and infrastructure, through access pricing of the premium international brands and through building on its existing beer route to market. Diageo is

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Business description (continued)

increasing its presence in beer in Africa through investments in capacity expansion and targeted acquisitions. In Eastern Europe Diageo is focused on the emerging middle class consumers and in Turkey the focus is on growing local spirits and international spirits. In Latin America and Caribbean the strategic priority is continued leadership in scotch, while broadening the category range to include vodka, rum, liqueurs and local spirits. Diageo continues to invest behind routes to market, the range and depth of its portfolio of leading brands and is enhancing its supply footprint to enable the business to provide the emerging middle class and an increasing number of wealthy consumers with the premium brands they aspire to. The strategy in Asia Pacific which encompasses both developed and new high growth markets is to operate across categories with participation in local spirits, international spirits and beer, focusing on the highest growth categories and consumer opportunities, driving continued development of super and ultra premium scotch and leveraging the emerging middle class consumer opportunity in the new high growth markets through a combination of organic growth and selective acquisitions.

Market leading brands In calendar year 2012, the Diageo brand range included six of the top 20 spirits brands worldwide by value as estimated by Impact Databank. Diageo classifies its brands as spirits, beer, wine and ready to drink. An analysis of the group's volume is as follows:

	2013 Volume units million	**2012 Volume units million**	**2011 Volume units million**
Spirits	**130**	121	113
Beer	**27**	27	26
Wine	**3**	3	3
Ready to drink	**5**	6	6
Total	**165**	157	148

Strategic brands In the year ended 30 June 2013, Diageo classified a group of brands as strategic brands worldwide. Diageo considers that these brands have the greatest current and future earnings potential. Figures for strategic brands exclude related ready to drink products. Strategic brands accounted for 57% of volume and net sales. 71% of the group's marketing spend supported these brands.

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Business description (continued)

Brand[#]	2013 Volume units million	
Johnnie Walker Scotch whisky	20	The number one Scotch whisky in the world*
Crown Royal Canadian whisky	6	The number one Canadian whisky in the world**
J&B Scotch whisky	4	The number five Scotch whisky in the world*
Buchanan's Scotch whisky	2	The number two premium Scotch whisky in Latin America and Caribbean*
Windsor Premier Scotch whisky	1	The number one super premium Scotch whisky in Asia Pacific*
Bushmills Irish whiskey	1	Distilled at Ireland's oldest working distillery
Smirnoff vodka	26	The number one premium vodka in the world**
Ketel One vodka (exclusive worldwide distribution rights)	2	The number two super premium vodka in the United States
Cîroc vodka	2	The number two ultra premium vodka in the United States
Captain Morgan rum and rum based products	10	The number two brand in the rum category in the world**
Baileys Irish Cream liqueur	7	The number one liqueur in the world**
Tanqueray gin	2	The number one imported gin in the United States [nc_cad,217]
Guinness stout	11	The number one stout in the world

* Source: IWSR 2012;

** Source: Impact Databank 2012;

Source: IRI;

[nc_cad,217] Source: Beverage Information Group;

Source: Plato Logic;

[#] Portfolio of premium drinks comprises brands owned by the company as a principal and some brands held by the company under agency or distribution agreements.

The distribution agreements entered into among Diageo and certain affiliates of Casa Cuervo SA de C.V (collectively Cuervo) for the distribution of Cuervo products in the United States and other territories around the world, expired on 30 June 2013. Except in those territories, such as the United States, where Cuervo opted to buy the inventory held by Diageo at the time of the expiration of the corresponding distribution agreements, Diageo is able to continue selling such inventory until early November 2013. The distribution of Cuervo products contributed net sales of £308 million and operating profit of £76 million in the year ended 30 June 2013 (2012 £304 million and £67 million, respectively).

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Business description (continued)

Other brands

Other spirits brands include	**Other beer brands include***	**Wine brands include**	**Ready to drink brands include**
Gordon's gin and Gordon's vodka	Malta Guinness non-alcoholic malt	Blossom Hill	Smirnoff Ice
Old Parr Scotch whisky	Harp lager	Sterling Vineyards	Smirnoff cocktails
Bundaberg rum	Tusker lager	Beaulieu Vineyard	Bundaberg ready to drink
Seagram's 7 Crown whiskey	Senator lager		
Bell's Scotch whisky	Red Stripe lager		
The Classic Malts Scotch whiskies			
Yenì Raki			

* Diageo also brews and sells other companies' beer brands under licence, including Budweiser and Carlsberg lagers in Ireland, Heineken lager in Jamaica and Tiger beer in Malaysia. There can be no assurance that Diageo will be able to prevent termination of distribution, manufacturing or licence agreements or to renegotiate distribution, manufacturing or licence agreements on favourable terms when they expire.

Production Diageo owns manufacturing production facilities across the globe, including maltings, distilleries, breweries, packaging plants, maturation warehouses, cooperages, vineyards, wineries 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 internationally.

During the year ended 30 June 2013, approximately 77% of total manufacturing was undertaken by Global Supply organised into four production centres: Europe Supply, Americas Supply, Global Beer Supply and Asia Pacific Supply. The remaining production activities of the group are integrated into the distribution organisation of the group, principally in Africa. As of 1 July 2013, supply operations have been fully integrated into demand markets while the supply operations in the United Kingdom, Ireland and Italy, which supply multiple international markets, are operated as the International Supply Centre. The locations, principal activities, products, packaging production capacity and packaging production volume of Diageo's principal production centres in the year ended 30 June 2013 are set out in the table below.

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Business description (continued)

Production centre	Location	Principal products	Production capacity in millions of equivalent units*	Production volume in 2013 in millions of equivalent units
Europe Supply	United Kingdom	Scotch whisky, Irish whiskey, gin, vodka, rum, ready to drink	80	54
	Ireland (Baileys)	Irish cream liqueur	12	7
	Italy (Santa Vittoria)	Vodka, wine, rum, ready to drink	10	6
	Turkey	Raki, vodka, gin, liqueur, wine	8	6
Americas Supply	United States, Canada, US Virgin Islands	Vodka, gin, tequila, rum, wine, Canadian whisky, American whiskey, progressive adult beverages, ready to drink	44	38
	United States	Wine	2	1
	Brazil	Cachaça	7	5
Global Beer Supply	Ireland (Guinness)	Beer	9	8
	Jamaica	Beer	1	1
Asia Pacific Supply	Australia	Rum, vodka, ready to drink	4	3
	Singapore	Finishing centre	4	3
Africa Supply	Nigeria	Beer	6	5
	South Africa	Beer and spirits	3	3
	East Africa (Uganda, Kenya, Tanzania)	Beer and spirits	10	9
	Africa Regional Markets (Ethiopia, Cameroon, Ghana, Seychelles)	Beer	3	3

* Capacity represents ongoing production capacity at any production centre. The production capacities quoted in the table are based on actual production levels for the year ended 30 June 2013 adjusted for the elimination of unplanned losses and inefficiencies, and taking into account planned manning levels for the coming year.

Spirits Spirits are produced in distilleries located worldwide. The group owns 29 Scotch whisky distilleries in Scotland, an Irish whiskey distillery in Northern Ireland, two whisky distilleries in Canada and a whiskey distillery in the United States. Diageo produces Smirnoff internationally. Ketel One vodka is purchased as finished product from The Nolet Group. 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

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Business description (continued)

is distilled, blended and bottled in the US Virgin Islands, Australia, Venezuela and Guatemala. Raki is produced in Turkey, while Chinese white spirits are produced in Chengdu, in the Sichuan province of China. In August 2012, Diageo acquired 100% of Ypióca Bebidas S.A. which owns a farm and a distillery in Ceará State in Brazil and produces cachaça. The company also owns a packaging plant in Fortaleza in northern Brazil and a warehouse in São Paulo. Diageo's maturing Scotch whisky is located in warehouses in Scotland (primarily at Blackgrange), its maturing Canadian whisky in La Salle and Gimli in Canada and its maturing American whiskey in Kentucky and Tennessee in the United States.

In April 2013, it was announced that Teaninich in Scotland would be the location for a new malt whisky distillery and a new bioenergy plant that will power the distillery and the capacity of the existing Teaninich distillery will be increased. The construction of the new distillery is expected to commence in July 2014 and production is expected to start in January 2016. Diageo also announced a major expansion of its Scotch whisky production in the Speyside area, including a project to substantially increase the capacity of the Mortlach distillery at Dufftown and construction of a new plant at Glendullan to produce biogas which will be used to power the distillery. Elsewhere in Scotland, the company is progressing plans for a major expansion of the Glen Ord Distillery, near Muir of Ord and is progressing with construction of new warehousing at Cluny near Kirkcaldy. These activities are part of a five-year investment plan launched in June 2012 where the group plans to lay down maturing scotch inventory over five years at a cost of over £500 million in order to be able to meet future demand.

In May 2011, Diageo announced the closure of the Menlo Park bottling plant in California and the specialty product building at the Relay plant in Maryland, in the United States. New investment has been made in the North American spirits supply chain principally in the packaging plants at Plainfield in Illinois and Relay in Maryland. This investment has delivered cost savings, modernised the US bottling manufacturing footprint and created a platform for higher quality, more flexible, more productive and sustainable operations in both Plainfield and Relay.

A distillery was opened in November 2010 in St. Croix as a result of a public/private initiative formed by Diageo and the government of the US Virgin Islands. This new facility has the capacity to distil up to 13 million equivalent units annually and supplies all rum used to produce Captain Morgan and other branded products for the United States.

A restructuring of the group's supply operations in Scotland was announced in July 2009. This resulted in the consolidation of production activities into fewer sites. The Kilmarnock packaging plant ceased operations in March 2012 after production was moved to the newly expanded packaging facility at Leven in Fife.

Beer Diageo's principal brewing facilities are at the St James's Gate brewery in Dublin, Ireland and in Nigeria, Kenya, Ghana, Cameroon, Ethiopia, Tanzania, Uganda, Seychelles, Malaysia and Jamaica. In addition, Diageo also owns a 25% equity interest in Sedibeng brewery in South Africa. Additionally, Guinness is brewed by more than 35 third parties around the world under licence arrangements. Guinness flavour extract is shipped from Ireland to all overseas Guinness brewing operations.

All Guinness Draught production in the Republic of Ireland is at the St James's Gate brewery in Dublin. Guinness Draught in cans and bottles is packaged at Runcorn and Belfast in the United Kingdom. The Runcorn facility performs the kegging of Guinness Draught, transported to Great Britain in bulk.

In January 2012, Diageo announced that its Irish breweries will be centralised in Dublin's St James's Gate site as part of an investment project at a cost of €153 million (£123 million). The

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Business description (continued)

brewing activities at Dundalk, Kilkenny and Waterford are expected to cease by the end of calendar year 2013.

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

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

Property, plant and equipment Diageo owns approximately 91% of the manufacturing, distilling, brewing, bottling and administration facilities it uses across the group's worldwide operations. It holds approximately 4% of properties on leases in excess of 50 years. The principal production facilities are described above. As at 30 June 2013, Diageo's land and buildings are included in the group's consolidated balance sheet at a net book value of £945 million. Diageo's two largest individual facilities, in terms of book value, are the Leven bottling and blending facility in Scotland and St James's Gate brewery in Dublin. Of the book value of Diageo's lands and buildings approximately 37% are properties located in Great Britain, 17% in Ireland and 14% in the United States.

During the years ended 30 June 2011 and 30 June 2010 a number of vineyards and facilities located in Napa Valley, California were sold and leased back to Diageo under a 20-year lease, with Diageo holding options to extend the lease at fair value for up to 80 years in total. Diageo remains the operator of the properties under the lease agreement and retains ownership of the brands, vines and grapes, which remain a strategic part of Diageo's wine business.

Raw materials and supply agreements The group has a number of long term contracts in place for the purchase of significant raw materials including glass, other packaging, spirit, cream, rum and grapes. Forward contracts are in place for the purchase of raw materials including cereals to minimise the effects of short term price fluctuations.

Cream is the principal raw material used in the production of Irish cream liqueur and is sourced from Ireland. Grapes are used in the production of wine and raki and are sourced from suppliers in the United States, Argentina and 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.

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

Marketing and innovation Diageo is committed to investing in its brands to drive growth and make its brands even stronger. In the year ended 30 June 2013, £1,787 million was spent globally on marketing with a focus on its strategic brands that accounted for 71% of total marketing spend.

Diageo's marketing strategy is to anticipate and respond to the rapidly changing dynamics across all the markets in which it operates, with particular focus on four key areas: price points, consumer groups, cutting edge marketing and geography (both developed and new high growth markets).

Diageo builds its brands through a combination of marketing programs and strategic innovation and views this as a continued source of competitive advantage.

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Business description (continued)

Diageo makes extensive use of a diverse range of new and traditional media from print, digital, mobile, point of sale and outdoor advertising, and uses radio, cinema, television advertising and other engagement platforms, where appropriate and permitted by law, to engage with consumers and customers. Sponsorship also plays an important role in Diageo's brand marketing and commercial profile.

Business analysis In the year ended 30 June 2013, North America; Western Europe; Africa, Eastern Europe and Turkey; Latin America and Caribbean and Asia Pacific contributed 40%, 18%, 18%, 13% and 11%, respectively, of the group's operating profit before exceptional items and corporate costs.

An analysis of net sales and operating profit by operating segment for the year ended 30 June 2013 is set out in the table below.

		2013			**2012 (restated)***	
	Net sales	**Operating profit/(loss) before exceptional items**	**Operating profit/(loss)**	**Net sales**	**Operating profit/(loss) before exceptional items**	**Operating profit/(loss)**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**	**£ million**
North America	**3,733**	**1,484**	**1,484**	3,556	1,360	1,349
Western Europe	**2,220**	**656**	**625**	2,345	717	760
Africa, Eastern Europe and Turkey	**2,280**	**654**	**649**	2,051	575	568
Latin America and Caribbean	**1,457**	**471**	**471**	1,239	369	367
Asia Pacific	**1,667**	**414**	**413**	1,501	342	332
Global Supply			**(62)**			(40)
Corporate	**76**	**(149)**	**(149)**	70	(165)	(178)
Total	**11,433**	**3,530**	**3,431**	10,762	3,198	3,158

* Restated for changes in reporting segments and allocation of specific Corporate and Global Supply items, see page 34.

North America North America is the largest market for Diageo in terms of net sales and operating profit and the largest market for premium drinks in the world. Diageo sells and markets its products through five operating units: US Spirits and Wine, Diageo Guinness USA, Diageo Chateau & Estate Wines, Diageo Canada and the North American operations of Global Travel.

The US Spirits and Wine business, while managed as a single business unit, executes sales and marketing activities through seven divisions. Within the United States, there are generally two types of regulatory environments for spirits and wine: open states and control states. In open states, companies are permitted to sell spirits directly to independent distributors. In these open states, Diageo generally trades through a three-tier distribution system, where the product is initially sold to distributors, who then sell it to on and off trade retailers. In most control states, Diageo sells its spirits products to state liquor control boards through the bailment warehousing system, and from there to state or agency liquor stores. There are variations for example, certain states control distribution but not retail sales. Generally, wines are treated in the same way as spirits, although most states that are control states for spirits are open states for wines. Five of the US Spirits and Wine divisions conduct activities in open states and two conduct activities in control states.

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Business description (continued)

National brand strategy and strategic accounts marketing are managed at the North America level. The US Spirits and Wine divisions market Diageo's collection of spirits and wine brands across the United States.

Diageo Guinness USA markets Diageo's US beer brands nationally as well as the group's progressive adult beverages. Beer distribution generally follows the three-tier open state regulations across the United States.

Diageo Chateau & Estate Wines owns, leases and operates wineries in California. In the United States, the majority of the wine is sold through the US Spirits and Wine divisions with the remainder sold through the winery visitors centres and club sales.

The Canada business unit distributes the group's collection of spirits, beer and wine brands across all Canadian territories. In Canada, spirits and beer distribution laws are generally consistent and similar to those of control states in the United States. Diageo, however, has some licences to deliver keg beer directly to licensed accounts, which account for approximately 21% of Diageo's beer business in Canada.

Across the United States, Diageo's distributors and brokers have nearly 3,000 dedicated sales people focused on selling its spirits and wine brands. Diageo has pursued a distribution strategy centred on consolidating the distribution of its spirits and wine brands into a single distributor or broker in each state where possible. The strategy is designed to provide a consolidated distribution network, which will limit the duplication of activities between Diageo and the distributor, improve selling capabilities and enable a number of alternative approaches to optimise product distribution. To date, Diageo has consolidated its business in 41 markets (40 states plus Washington DC), representing over 80% of Diageo's US spirits and wine volume. The remaining markets will be consolidated as opportunities arise. Diageo continues to focus on building the capabilities and selling tools of the distributors' dedicated sales forces and creating a more efficient and effective value chain.

Western Europe Western Europe comprises Great Britain, Ireland, Iberia, France, Germany, Benelux, Italy, Nordics, Greece, Switzerland, Austria, the Western European reserve brands, Diageo Guinness Continental Europe, European wines and the Western European operations of Global Travel.

In Great Britain, Diageo sells and markets its products via three business units: Diageo GB (spirits, beer and ready to drink), Percy Fox & Co (wines) and Justerini & Brooks Retail (private client wines). Products are distributed both through independent wholesalers and directly to the major grocers, convenience and specialist stores. In the on trade (for example, licensed bars and restaurants), products are sold through the major brewers, multiple retail groups and smaller regional independent brewers and wholesalers.

Ireland comprises the Republic of Ireland and Northern Ireland. In both territories, Diageo sells and distributes directly to both the on trade and the off trade (for example, retail shops and wholesalers) through a telesales operation, extensive sales calls to outlets and third party logistics providers.

Across the remainder of Western Europe, Diageo distributes its spirits brands primarily through its own distribution companies, except for France where products are sold through a joint arrangement with Moët Hennessy. In the Nordic countries Diageo has sales offices in Sweden, Norway and Denmark. In these countries, except for Denmark, off trade sales are controlled by state monopolies, with alcohol tax rates among the highest in the world and border trade and duty free being important sources of sales. Smirnoff Ice is sold in Nordic countries through Carlsberg.

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Business description (continued)

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

Africa, Eastern Europe and Turkey Africa, Eastern Europe and Turkey comprises Nigeria, East Africa (Kenya, Tanzania, Uganda, Burundi, Rwanda and South Sudan), Africa Regional Markets (including Ghana, Cameroon, Ethiopia, Angola, Mozambique and Democratic Republic of Congo), South Africa, Russia, Central and Eastern Europe, Turkey and the African and Eastern European operations of Global Travel.

Diageo has 14 breweries in Africa including Sedibeng in South Africa which is 25% owned by Diageo. In addition, Diageo's beer and spirits brands are produced by third parties in 20 other African countries. Diageo also owns six other manufacturing facilities including glass manufacturing, blending, malting and cider plants.

In Nigeria, Guinness, Harp and Malta are the principal brands that are brewed and distributed by Guinness Nigeria plc. Diageo owns 54.3% of the company, which has been brewing Guinness locally since 1962. Diageo's spirits brands are distributed by a wholly owned subsidiary.

East African Breweries Limited (EABL) is the leading premium drinks business in East Africa and produces and distributes beer and spirits brands to a range of consumers. Diageo owns 50.03% of EABL which in turn owns 100% of Kenya Breweries Limited, 98% of Uganda Breweries Limited and 51% of Serengeti Breweries Limited in Tanzania. South Sudan, Rwanda and Burundi are serviced through third party arrangements. EABL also owns a glass manufacturer and a malting business.

Within Africa Regional Markets, Diageo has wholly owned subsidiaries in Cameroon, Ethiopia and Reunion and majority owned subsidiaries in Ghana and the Seychelles. Angola and Mozambique are currently supplied by third party arrangements. Diageo also owns 100% of the equity of Meta Abo Brewery in Ethiopia, of which Meta beer is the principal brand.

In South Africa, Diageo's business consists of its spirits business through its wholly owned subsidiary Diageo South Africa Limited (DSA); a 42.25% share in DHN Drinks (Pty) Ltd (DHN), a joint venture with Heineken International (Heineken) and Namibia Breweries Ltd (NBL) in respect of beer, cider and ready to drink brands; and a 25% interest in Sedibeng Brewery (Pty) Ltd, the remainder being owned by Heineken. The route to market for DSA and DHN's brands in South Africa is managed by brandhouse Beverages (Pty) Ltd (brandhouse). Brandhouse is a cost sharing joint venture owned equally between DSA and DHN. Diageo also owns 15.01% of NBL. NBL is the producer of Windhoek lager which is sold mainly in Namibia and through DHN in South Africa.

In June 2013, Diageo completed the acquisition of a 50% equity interest in United National Breweries (UNB), a traditional sorghum beer business in South Africa. The other 50% equity interest is owned by the UB Group and Diageo accounts for its equity holding in UNB as an associate.

Diageo has brewing arrangements with the Castel Group to license brew and distribute Guinness in the Democratic Republic of Congo, Gambia, Gabon, Ivory Coast, Togo, Benin, Burkina Faso, Chad, Mali and Guinea. Diageo sells spirits through distributors in most other sub-Saharan countries.

Russia and Eastern Europe comprises Russia, Poland and 32 distributor serviced countries in Central and Eastern Europe. In Russia and Poland Diageo operates through wholly owned subsidiaries.

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Business description (continued)

Throughout the whole of the former Soviet Union and Eastern Block (excluding Russia and Poland) plus Iceland, Finland, Malta, Cyprus and Israel, Diageo sells and markets its brands via local distributors. In Hungary, Diageo sells its brands through its associate company, Zwack.

In Turkey, Diageo sells its products via the distribution network of its wholly owned subsidiary, Mey Içki. Mey Içki distributes both local brands (raki, other spirits and wine) which are produced in its distilleries and wineries and Diageo's global spirits brands. Sales to traditional on and off trade outlets are made through Mey Içki's exclusive distributors and sales to some large store chains are made directly by Mey Içki.

Latin America and Caribbean Latin America and Caribbean (LAC) comprises PUB (Paraguay, Uruguay and Brazil), Andean (Venezuela and Colombia), WestLAC (Central America and Caribbean, Argentina, Chile, Peru, Ecuador and Bolivia), Mexico and the operations of Global Travel in Latin America and Caribbean.

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

In PUB, sales are made directly to international retailers and through distributors and wholesalers for the remainder of the business in Brazil. In addition to Diageo Brazil, the group also owns 100% of Ypióca, a leading cachaça producer and distributor. In Paraguay, the majority of customers are served by Diageo with a portion of sales completed through wholesalers. In Uruguay, Diageo's distribution company manages approximately half of the sales in the market with the other half managed through wholesalers.

In Andean, all products in Venezuela are sold through dedicated third party distributors. In Colombia, Diageo sells directly to major grocers, serving all other accounts and channels through distributors.

In Mexico, distribution of Smirnoff is managed by Casa Cuervo SA. All other brands are sold directly by Diageo, either through direct sales to international accounts or through wholesalers and distributors.

In selected markets in WestLAC such as the Free Trade Zone, Bolivia and Ecuador, sales are managed directly by Diageo. In key markets such as Costa Rica and the Dominican Republic sales are made via exclusive distributors, while in Puerto Rico, Trinidad, Guatemala and Panama, third party distributors purchase directly from Diageo and sell on to the local trade. In Chile, Diageo sells directly to international retailers, partnering with an exclusive distributor for other channels. In Argentina, Diageo's business is managed through a combination of wholesalers and distributors outside of major grocers, to whom Diageo sells directly. Diageo Argentina also owns and operates the Navarro Correas winery in Mendoza, Argentina. The winery sells directly to consumers. Jamaica sells to wholesalers and directly to retail trade accounts on the island.

Asia Pacific Asia Pacific comprises South East Asia (Vietnam, Thailand, Philippines, Indonesia, Malaysia and Singapore), Greater China (China, Taiwan, Hong Kong and Macau), India, Australia, North Asia (Korea and Japan) and Global Travel Asia and Middle East. Diageo operates through a combination of Diageo companies, joint ventures and third party distributors in the region.

In South East Asia, Diageo distributes its spirits brands through joint venture arrangements with Moët Hennessy in Thailand, Malaysia and Singapore and through its own company in the Philippines and Vietnam. In Indonesia, Guinness is brewed by PT Multi Bintang Indonesia, and is distributed

Business description (continued)

through a distribution agreement with PT Dima Indonesia while spirits brands are distributed by government licensed distributors. In Malaysia, Diageo's own and third party beers are brewed and distributed by a listed business (Guinness Anchor Berhad) in which Diageo and its partner, Asia Pacific Breweries, have a majority share through a jointly controlled entity. In Singapore, Diageo's beer brands are brewed and distributed by Asia Pacific Breweries. In Vietnam, Diageo also has a 45.5% equity stake in Hanoi Liquor Joint Stock Company.

In Greater China, a significant part of Diageo's spirits business is conducted through a joint venture arrangement with Moët Hennessy in China, Hong Kong and Macau. Diageo's wholly owned subsidiary in China distributes brands not included in the joint venture such as Smirnoff, Windsor and Baileys. Diageo's beer brands are sold through a distribution agreement with Carlsberg in China and Hong Kong. Through Sichuan Chengdu Shuijingfang Group Co., Ltd. (SJF Holdco) (formerly Sichuan Chengdu Quanxing Group Company Ltd.), Diageo has a controlling equity interest in Sichuan Shuijingfang Co., Ltd. (Shuijingfang), a super premium Chinese white spirits company. Diageo is the sole distributor of Shuijingfang's Chinese white spirits outside of China. On 7 June 2013, Diageo acquired an additional 40% equity stake in SJF Holdco which brought its equity shareholding to 93% and increased its effective interest in Shuijingfang to 37%. In Taiwan, Diageo has its own distribution company for spirits.

In India, Diageo has its own spirits distribution company. In May and July 2013, Diageo completed the acquisition of a 25.02% equity interest in United Spirits Limited (USL), the leading spirits company in India. USL has a strong distribution network and point of sale coverage in India, with sales offices in key Indian state capitals and established manufacturing and bottling plants in all major Indian states.

In Australia, Diageo has its own production and distribution company and in New Zealand operates through third party distributors. A licensed brewing arrangement is in place in both countries with Lion Nathan.

In North Asia, Diageo has its own distribution company in Korea. In Japan, the joint venture with Moët Hennessy distributes the majority of super premium brands, while the joint venture with Kirin distributes Diageo's other super premium and premium spirits such as Johnnie Walker Platinum, Gold Reserve and Black Label as well as Smirnoff, Smirnoff Ice and Guinness. Other spirits brands, which are not distributed by either Moët Hennessy or the Kirin joint venture, are distributed by third parties.

Airport shops and airline customers in Asia Pacific are serviced through a dedicated Diageo sales and marketing organisation. In the Middle East, distribution is achieved through third party distributors. Lebanon is an exception, where a Diageo subsidiary distributes the majority of the Diageo brands sold there.

Global Supply Global Supply was responsible for the production of approximately 73% of Diageo's products sold globally, for sourcing materials and services through global procurement and for providing logistics, customer service and other technical support through the global technical function.

Global procurement has responsibility for sourcing goods and services on behalf of the Diageo group. A global network of suppliers provides for a wide range of raw materials and packaging items that are necessary to ensure consistency of quality to support the brands. For commodities, for example cereals, hops and sugar, forward-buying takes place to minimise value at risk. In marketing, global procurement supports the business in sourcing creative media solutions, sponsorship and point of sale activities. Global procurement also supports business services, facilities and computer services.

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Business description (continued)

In March 2013, Diageo announced that its Global Supply and procurement operation will be refocused to enhance alignment between supply operations and Diageo's markets. From 1 July 2013, responsibility for a number of local operations was transferred to the markets and regional structures are being reduced. The Global Supply function will remain responsible for ensuring excellence across all supply operations.

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

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

Employees Diageo's people are at the heart of its global strategy, and its leaders know that its people, culture and the company's values are what give Diageo its competitive edge. Helping people reach their potential strengthens the company's ability to achieve its own ambitions. Development whether part of a graduate or apprenticeship scheme, management training, a functional skills programme or Diageo's senior leadership intervention is an important factor in Diageo's success. A broad range of programmes are available to support people at all levels and in all functions and locations, and are delivered in person or through Diageo's online training tool, the Diageo Academy. The Diageo Sales University, for example, is now available to commercial teams across the globe in nine languages.

Diageo is proud of its broad range of initiatives designed to create a working environment that is welcoming but also challenging, stimulating and inspiring. It is pleased to have been recognised in the Great Place to Work Institute's prestigious '25 Best Multinational Workplaces' achieving 9th place, reinforcing its position as a leading global employer. Diageo has also been recognised as a great employer in Argentina, Germany, Greece, Ireland, Kenya, Mexico, Iberia and Canada. These are achievements which have only been possible through the commitment of thousands of talented and inspirational employees who together make Diageo a great place to work.

During the year Diageo announced changes to the structure of its Global Supply operation. As with any change programme, this has represented a period of uncertainty for those in supply and procurement. Diageo is always committed to providing its employees with regular updates and appropriate support during any transition period.

Diversity is an important area of focus for Diageo and the year ending 30 June 2013 has been particularly significant. In March 2013, Diageo became the first beverage alcohol company to sign up to the Women's Empowerment Principles. The principles, a joint initiative between the UN Women and the UN Global Compact, set a blueprint for the business in advancing the equality of men and women in business generally, the market place and communities. This is aligned with Diageo's target to have 30% of its senior leadership roles filled by women by the end of the year ending 30 June 2014, and the coming year will see further initiatives aimed at encouraging more women to develop their careers with Diageo.

Diageo aims to support and provide opportunities for a wide range of people including those with disabilities and caring responsibilities and is taking action to make working for the business compatible with a variety of lifestyles. Where possible, the company encourages a flexible approach to working, consistent with its inclusion and diversity ambitions. Diageo emphasises the importance of treating individuals justly and in a non-discriminatory manner throughout the employment relationship,

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Business description (continued)

including recruitment, compensation, training, promotion and transfers. Factors that are not relevant to any role, such as race, religion, or marital status will not be taken into consideration, ensuring that no one is disadvantaged.

Diageo believes strongly in the value of its employees sharing in the company's success and actively encourages employees to become shareholders. The group seeks out opportunities to extend employee share ownership around the world and both in 2012 and 2013, 34 of its local markets operated an employee share plan. This, combined with existing employee share plans, will further extend the opportunity to the majority of employees across a significant number of Diageo's markets to share in the company's growth and success. As at 30 June 2013, 16,788 past and present employees held 1.27% (2012 1.27%) of Diageo's ordinary issued share capital (excluding treasury shares).

Average number of employees	2013	2012 (restated)*	2011 (restated)*
North America	**1,157**	1,105	1,229
Western Europe	**2,323**	2,280	2,397
Africa, Eastern Europe and Turkey	**7,240**	6,638	4,769
Latin America and Caribbean	**2,556**	1,631	1,413
Asia Pacific	**4,269**	2,902	2,639
Global Supply	**7,853**	8,120	8,202
Corporate and other	**3,012**	3,022	3,137
	28,410	25,698	23,786

* Restated for changes in reporting segments, see page 34.

The average number of employees in the year ended 30 June 2013, for developed markets has decreased by 285 from 15,591 to 15,306 and has increased, for new high growth markets, by 2,997 from 10,107 to 13,104.

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, 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, SABMiller, Molson Coors and Carlsberg.

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

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 new high growth 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.

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Business description (continued)

In the year ended 30 June 2013, the group's research and development expenditure amounted to £21 million (2012 £18 million; 2011 £17 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 covering virtually every aspect of its operations, including production, distribution, marketing, promotion, sales, pricing, labelling, packaging and advertising.

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

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

Advertising, marketing and sales of alcohol are subject to various restrictions in markets around the world. These range from a complete prohibition of alcohol in certain countries and cultures, through the prohibition of the import of spirits, wine and beer, to restrictions on the advertising style, media and messages used. In a number of countries, television is a prohibited medium for spirits brands and in other countries, television advertising, while permitted, is carefully regulated. 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, Canada, Norway and certain US states) to the common system of licensed on trade outlets (for example, licensed bars and restaurants) which prevails in much of the Western world (for example, most US states and the European Union). In about one-third of the states in the United States, price changes must be filed or published 30 days to three months, depending on the state, before they become effective.

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Business description (continued)

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.

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

Diageo uses shared services operations to deliver transaction processing and certain central finance activities, using captive and outsourced centres. Captive business service centres in Budapest, Hungary; Nairobi, Kenya and Bogotá, Colombia perform various process tasks for markets and operational entities. Certain central finance activities, including elements of financial planning and reporting and treasury, are also performed in the business service centre in Budapest. Diageo also uses third party service centres in Manila, Shanghai, Bucharest, Nairobi, Bogotá and Delhi to perform tasks for basic processes. In the year ended 30 June 2013, Diageo announced its plans to expand the current arrangement with its business process outsourcing partner in respect of the business service centre in Manila. This centre will grow to include a number of Diageo employees, giving broader oversight and management of financial transactions for the Asia Pacific region.

Associates Diageo's principal associate is Moët Hennessy. It also owns shares in a number of other associates. In the year ended 30 June 2013, the share of profits of associates after tax was £199 million (2012 £213 million; 2011 £176 million), of which Moët Hennessy accounted for £230 million (2012 £205 million; 2011 £179 million).

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

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

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Business description (continued)

In May and July 2013 Diageo completed the acquisition of a 25.02% equity interest in USL, the leading spirits company in India. USL is based in Bangalore, India and listed on the Bangalore Stock Exchange, the Bombay Stock Exchange and the National Stock Exchange of India. USL possesses an unparalleled brand portfolio in India with strong customer recognition and range of brands across categories and price points. It also has a strong distribution network and retail coverage, with sales offices in key Indian state capitals and established manufacturing and bottling plants in all major Indian states. USL's principal brands include the McDowell's No. 1 family, one of the largest spirits brand in the world by volume consisting whisky, brandy and rum products, as well as a selection of other spirits brands such as Bagpiper, Old Tavern, Hayward's and Honey Bee which are also in the top 100 spirits brands in the world by volume. The financial statements of USL, prepared under Indian GAAP, for the year ended 31 March 2013 disclosed net sales of INR 106.0 billion (£1,173 million) and operating profit of INR 10.6 billion (£117 million). Total assets disclosed as at 31 March 2013 were INR 163.8 billion (£1,813 million) and total liabilities were INR 115.9 billion (£1,282 million).

Acquisitions and disposals Diageo has made a number of acquisitions of brands, distribution rights and equity interests in premium drinks businesses. Since 1 July 2010 the following acquisitions and disposals have been made:

Acquisitions	Date acquired	Consideration* £ million	Location	Principal brands acquired	Status
United Spirits Limited	13 May 4 July 2013	594	India	McDowell's Nr 1. family and other Indian whisky, brandy and rum products	Acquisition of 25.02% equity interest in United Spirits Limited
United National Breweries	27 June 2013	23	South Africa	Chibuku, Leopard Special and Ijuba sorghum beer products	Acquisition of 50% equity interest in United National Breweries traditional sorghum beer business
SJF Holdco and Shuijingfang	27 January 2007 7 June 2013 (control of Shuijingfang from 29 June 2012)	267**	China	Shui Jing Fang Chinese white spirit	Acquisition of 93% equity stake in SJF Holdco which owns a 39.7% controlling equity interest in Shuijingfang
Ypióca	9 August 2012	284	Brazil	Ypióca cachaça	Acquisition of 100% of the equity share capital of Ypióca Bebidas S.A.
Meta	9 January 2012	153	Ethiopia	Meta beer	Acquisition of 100% of the equity share capital of Meta Abo Brewery Share Company SC
Philippines	14 December 2011	15	Philippines	Distribution company	Acquisition of 49% of Diageo Philippines Inc not already owned by the group
Kenya Breweries	25 November 2011	134	Kenya	Producer of Tusker and other beer products	Acquisition of 20% of Kenya Breweries Ltd not already owned by the group
Halico	13 May 2011 24 June 2012	60	Vietnam	Vodka Hanoi	Acquisition of 45.5% of the equity share capital of Hanoi Joint Stock Company (Halico)
Mey Içki	23 August 2011	1,260	Turkey	Yenì Raki, Terkirdag Raki and Istanblue vodka	Acquisition of 100% of the equity share capital of Mey Içki Sanayi ve Ticaret A.S.

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Business description (continued)

Acquisitions	Date acquired	Consideration* £ million	Location	Principal brands acquired	Status
Zacapa	5 July 2011	148	Guatemala	Zacapa rum	Acquisition of a 50% controlling equity stake in Rum Creation and Products Inc
Serengeti	22 October 2010	60	Tanzania	Serengeti lager	Acquisition of a 51% equity stake in Serengeti Breweries Limited via a 50.03% equity owned subsidiary
22 Marquis	30 September 2010	6	United States	22 Marquis sparkling liqueur	Acquisition of a 20% equity stake in LNJ Group

* Includes net borrowings acquired but excludes the value of put options and transaction costs

** Excludes cash acquired in Shuijingfang when first consolidated

Disposals	Date disposed of	Consideration £ million	Location	Status
Nuvo and 22 Marquis	5 June 2013		United States	Disposal of the group's 71.25% equity stake in the Nuvo brand and 20% equity stake in the 22 Marquis brand
Tanzania Breweries	18 January 2012	47	Tanzania	Disposal of 20% equity in Tanzania Breweries Ltd
Wine brands	Years ended 30 June 2011 and 2012	25	United States and France	Disposal of a number of non-strategic wine businesses
Gilbeys distribution	31 August 2010	7	Ireland	Disposal of Gilbeys wine distribution and wholesale drinks business

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 securities could decline.

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

Diageo's ability to fund its long term strategies may be adversely affected if there is an extended period of constraint in the capital markets, particularly the debt markets, at the same time that cash

Business description (continued)

flows from Diageo's business are under pressure. Such developments may adversely affect shareholder returns or share price. Additionally, continued volatility in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo's reported results. Changes in the trustees' valuations of the assets and liabilities of Diageo's pension plans may also increase pension funding requirements.

Risks related to the global economy

Diageo's business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates Diageo may be adversely affected by political, economic or social developments in any of the countries where it has distribution networks, production facilities or marketing companies. Diageo's business is dependent on general economic conditions in the United States, countries that form the European Union and other important markets. If the economy in any of these markets does not recover as forecast, or if there is a significant deterioration in the economic conditions in any of Diageo's important markets, including any resulting social unrest, reduction in consumer confidence and spending levels, customer destocking, the failure of customer, supplier or financial counterparties or a reduction in the availability of, or an increase in the cost of financing to, Diageo, it could have a material adverse effect on Diageo's business and performance. In particular, the ongoing sovereign debt crisis in certain countries in Europe has increased concerns that, were one or more countries to leave the euro, Diageo's investment in any of the countries concerned could be impaired and may be subject to redenomination and other risks going forward. This crisis, as well as other economic events, may lead to reduced economic growth and, in turn, reduced demand for Diageo's products, in Europe and other markets in which Diageo operates. This could have a material adverse effect on Diageo's business.

Diageo's operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Political and/or social unrest, potential health issues, natural disasters and terrorist threats and/or acts may also occur in various places around the world, which will have an impact on trade, tourism and travel. Many of these risks are heightened, or occur more frequently, in new high growth markets. These disruptions can affect Diageo's ability to import or export products and to repatriate funds, as well as affecting the levels of consumer demand (for example, in duty free outlets at airports or in on trade premises in affected regions) and therefore Diageo's levels of sales or profitability. A substantial portion of Diageo's operations, representing more than 40% of Diageo's net sales for the year ended 30 June 2013, are carried out in new high growth markets. New high growth markets are also generally exposed to relatively higher risk of liquidity constraints, inflation, devaluation, price volatility, currency convertibility and sovereign default. Due to Diageo's specific exposures, any or all of the aforementioned factors may affect Diageo disproportionately or in a different manner as compared to its competitors.

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

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Business description (continued)

Risks related to the 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 collection of brands includes some of the world's leading beverage alcohol brands as well as brands of local prominence. Maintaining Diageo's competitive position depends on its continued ability to offer products that have a strong appeal to consumers. Consumer preferences may shift due to a variety of factors including changes in demographic and social trends, public health regulations, changes in travel, vacation or leisure activity patterns, weather effects and a downturn in economic conditions, which may reduce consumers' willingness to purchase premium branded products. Continued economic pressures could also lead to consumers selecting products at lower price points, whether Diageo's or those of its competitors, which may have an adverse effect on Diageo's profitability. The competitive position of Diageo's brands could also be affected adversely by any failure to achieve consistent, reliable quality in the product or in service levels to customers.

In addition, the social acceptability of Diageo's products may decline due to public concerns about alcohol consumption. These concerns could also result in regulatory action, litigation or customer complaints against companies in the industry and may have an adverse effect on Diageo's profitability.

Growth in Diageo's business has benefited from both the launch of new products and the creation of brand extensions and product innovation remains a significant element of Diageo's growth plans. The launch and ongoing success of new products is inherently uncertain, especially as to their appeal to consumers. The failure to launch successfully a new product can give rise to inventory write-offs and other costs and can affect 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 of the profitable lifespan of newly or recently developed products.

Diageo is subject to litigation directed at the beverage alcohol industry and other litigation Companies in the beverage alcohol industry are, from time to time, exposed to class action or other litigation relating to alcohol advertising, product liability, alcohol abuse problems or health consequences from the misuse of alcohol. Diageo may also be subject to litigation arising from legacy and discontinued activities, as well as other litigation in the ordinary course of its operations. Diageo is further subject to the risk of litigation by tax, customs and other regulatory authorities, including with respect to the methodology for assessing importation value, transfer pricing or compliance matters. 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 it is compliant with international best practice guidelines. Any such litigation may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and as a result, Diageo's business could be materially adversely affected. For additional information with respect to legal proceedings, see 'Additional information for shareholders Legal proceedings' and note 26 to the consolidated financial statements.

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 a growing concern that carbon dioxide and other so-called 'greenhouse' gases in the atmosphere may have an adverse impact on global temperatures, weather patterns and the frequency and severity of extreme weather and natural disasters. In the event that such climate change has a negative effect on agricultural productivity, Diageo may be subject to decreased availability or increased pricing for certain raw materials that are necessary for Diageo's products, such as sugar, cereals, hops, agave and grapes. Water is the main ingredient in substantially

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Business description (continued)

all of Diageo's products and it 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 or capacity constraints, which could adversely affect Diageo's operations and profitability.

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

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.

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

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

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

Diageo is subject to increasing costs of monitoring and maintaining compliance with anti-corruption laws; and a breach of such laws or of Diageo's related internal policies may have a material adverse effect on its business Certain countries in which Diageo operates are reported to have high levels of corruption. There is increasing scrutiny and enforcement by regulators in many jurisdictions of anti-bribery laws including the US Foreign Corrupt Practices Act and the UK Bribery Act. This

Business description (continued)

oversight 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.

While Diageo has implemented and maintains internal practices, procedures and controls designed to ensure compliance with anti-bribery legislation 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.

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 our personnel, including senior management, from our business. Adverse publicity, governmental scrutiny and legal and enforcement proceedings can also have a negative impact on our reputation and on the morale and performance of our employees. To the extent that violations of Diageo's policies and procedures are found, possible regulatory sanctions and fines and other consequences may also be material.

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 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 in the jurisdictions in which it operates.

Diageo also maintains an online presence as part of its business operations. 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 proliferation of new methods of mass communication facilitated by the internet makes it easier for false or unfounded allegations to adversely affect Diageo's brand image and reputation, which may in turn affect Diageo's profitability.

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

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

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Business description (continued)

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further business combinations, acquisitions, disposals, joint ventures and/or partnerships (including any associated financing or the assumption of actual or potential liabilities, depending on the transaction contemplated). There can be no assurance that any transaction will be completed 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.

Similarly, there can be no assurance that the cost-saving or restructuring programmes implemented by Diageo in order to improve efficiencies and deliver cost-savings will deliver the expected benefits. Diageo continues to undertake change programmes designed to improve the effectiveness and efficiency of end-to-end operations, including changes to organisational structures, business processes and business systems. There may also be disruption caused to business processes as a result of such change which could impact Diageo operations and lead to adverse customer or consumer reaction.

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. Diageo may 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 them. A bad consumer experience with such a product could cause them to refrain from purchasing Diageo brands in the future and in turn could impair brand equity, adversely affecting Diageo's business.

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

Diageo's operating results may be adversely affected by disruption to production facilities, business service centres or information systems Diageo would be affected if there was a catastrophic failure of its major production facilities or business service centres. Diageo operates production facilities around

Business description (continued)

the world. If there was a technical failure in Diageo production facilities, or fire or explosion at one of Diageo's production facilities, it could result in damage to the facilities, plant or equipment, their surroundings and/or the local environment. Such an event could lead to a loss in production capacity, or could result in regulatory action, legal liability or damage to 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 it arises. There can be no assurance that insurance proceeds would cover the replacement value of Diageo's maturing inventory or other assets, were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third parties. In addition, there is an inherent risk of forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption. A forecasting error could lead to Diageo being unable to meet future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks.

Any failure of information systems or Diageo's data infrastructure could adversely impact Diageo's ability to operate. As with all large systems, Diageo's information systems could be penetrated by outside parties' intent on extracting information, corrupting information or disrupting business processes. Such unauthorised access could disrupt Diageo's business and/or lead to loss of assets or to outside parties having access to confidential information, including privileged data or strategic information of Diageo and its employees, customers and consumers, or to making such information 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.

Diageo's operations and financial results may be adversely affected by movements in the value of its pension funds, fluctuations in exchange rates and fluctuations in interest rates Diageo has significant pension funds. These funds may be affected by, among other things, the performance of assets owned by these plans, the underlying actuarial assumptions used to calculate the surplus or deficit in the plans, in particular the discount rate and long term inflation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. If there are significant declines in financial markets and/or deterioration in the value of fund assets or changes in discount rates or inflation rates, Diageo may need to make significant contributions to the pension funds in the future. Furthermore, if the market values of the assets held by Diageo's pension funds decline, or if the valuations of those assets by the pension trustees decline, pension expenses may increase 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 or that pension fund assets can earn the assumed rate of return annually; Diageo's actual experience may be significantly more negative than the assumptions used.

Diageo may be adversely affected by fluctuations in exchange rates. In particular, any redenomination of the euro or its constituent parts could materially adversely affect Diageo. The results of operations of Diageo are accounted for in pounds sterling. Approximately 37% of sales in the year ended 30 June 2013 were in US dollars, approximately 12% were in euros and approximately 10% were

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Business description (continued)

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

Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense. To partly delay any adverse impact from interest rate movements, the group's policy is to maintain fixed rate borrowings within a certain percentage of forecast net borrowings, and the overall net borrowings portfolio is managed according to a duration measure. See note 19 to the consolidated financial statements.

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 sales and operating profit. In addition, Diageo's sales and operating profit may be adversely affected by any disputes with distributors of its products or with suppliers of raw materials.

Diageo may not be able to protect its intellectual property rights Given the importance of brand recognition to its business, Diageo has invested considerable effort in protecting its intellectual property rights, including trademark registration and domain names. Diageo's patents cover some of its process technology, including some aspects of its bottle marking technology. Diageo also uses security measures and agreements to protect its confidential information and trade secrets. However, Diageo cannot be certain that the steps it has taken will be sufficient or that third parties will not infringe on or misappropriate its intellectual property rights in its brands or products. Moreover, some of the countries in which Diageo operates offer less intellectual property protection than Europe or North America. Given the attractiveness of Diageo's brands to consumers, it is not uncommon for counterfeit products to be manufactured and traded. 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 the directors of Diageo Diageo is a public limited company incorporated under the laws of England and Wales. The majority of Diageo's directors and officers, and some of the experts named in this document, reside outside of the United States, principally in the United Kingdom. A substantial portion of Diageo's assets, and the assets of such persons, are located outside of the United States. Therefore, it may not be possible to effect service of process within the United States upon Diageo or these persons in order to enforce judgements of US courts against Diageo or these persons based on the civil liability provisions of the US federal securities laws. There is doubt as to the enforceability in England and Wales, in original actions or in actions for enforcement of judgements of US courts, of civil liabilities solely based on the US federal securities laws.

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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 risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo's control. These factors include, but are not limited to:

- changes in political or economic conditions in countries and markets in which Diageo operates, including changes in levels of consumer spending, failure of customer, supplier and financial counterparties or imposition of import, investment or currency restrictions;

- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues, or contamination, counterfeiting or other circumstances which could harm the integrity or sales of Diageo's brands;

- developments in any litigation or other similar proceedings (including with tax, customs and other regulatory authorities) directed at the drinks and spirits industry generally or at Diageo in particular, or the impact of a product recall or product liability claim on Diageo's profitability or reputation;

- the effects of climate change and regulations and other measures to address climate change including any resulting impact on the cost and supply of water;

- changes in the cost or supply of raw materials, labour and/or energy;

- legal and regulatory developments, including changes in regulations regarding production, product liability, distribution, importation, labelling, packaging, consumption or advertising; changes in tax law, rates or requirements (including with respect to the impact of excise tax increases) or accounting standards; and changes in environmental laws, health regulations and the laws governing labour and pensions;

- the costs associated with monitoring and maintaining compliance with anti-corruption and other laws and regulations, and the costs associated with investigating alleged breaches of internal policies, laws or regulations, whether initiated internally or by external regulators, and any penalties or fines imposed as a result of any breaches;

- ability to maintain Diageo's brand image and corporate reputation, and exposure to adverse publicity, whether or not justified, and any resulting impacts on Diageo's reputation and the likelihood that consumers choose products offered by Diageo's competitors;

- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo's market share, increase expenses and hinder growth potential;

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Business description (continued)

- the effects of Diageo's strategic focus on premium drinks, the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergies and/or costs savings;

- Diageo's ability to complete existing or future business combinations, restructuring programmes, acquisitions and disposals;

- contamination, counterfeiting or other events that could adversely affect the perception of Diageo's brands;

- increased costs or shortages of talent;

- disruption to production facilities or business service centres, and systems change programmes, existing or future, and the ability to derive expected benefits from such programmes;

- changes in financial and equity markets, including significant interest rate and foreign currency exchange rate fluctuations and changes in the cost of capital, which may reduce or eliminate Diageo's access to or increase the cost of financing or which may affect Diageo's financial results and movements to the value of Diageo's pension funds;

- renewal of supply, distribution, manufacturing or licence agreements (or related rights) and licences on favourable terms when they expire;

- technological developments that may affect the distribution of products or impede Diageo's ability to protect its intellectual property rights.

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 '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 includes 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.

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Business review

Introduction

The following discussion is based on Diageo's results for the year ended 30 June 2013 compared with the year ended 30 June 2012, and the year ended 30 June 2012 compared with the year ended 30 June 2011. In addition to describing the significant factors that have impacted the income statement for the years ended 30 June 2013 and 30 June 2012, in each case as compared to the immediately preceding year, additional information is also presented on the operating performance and cash flows of the group.

There are several principal financial key performance indicators not specifically used in the consolidated financial statements themselves (non-GAAP measures) that are used by the group's management to assess the performance of the group in addition to income statement performance measures. These are volume, organic movements in volume, sales, net sales, marketing spend, operating profit and operating margin and free cash flow. These key performance indicators are described in 'Definitions and reconciliations of non-GAAP measures to GAAP measures' on page 83.

Revised segmental information for prior reporting periods In the year ended 30 June 2013, Diageo changed its internal reporting structure to reflect changes made to management responsibilities. As a result of this change, Diageo reports the following geographical segments both for management reporting purposes and in the external financial statements: North America; Western Europe; Africa, Eastern Europe and Turkey; Latin America and Caribbean; Asia Pacific and Corporate.

Diageo has also made changes in respect of the allocation of specific corporate items and the allocation of the operating profit before exceptional items of Global Supply to better reflect the geographical segment to which the cost relates. In addition, certain transaction exchange differences, previously included in Corporate, have been allocated to the geographical segments to better reflect which geographical segment the item is in respect of.

As a consequence of these changes, comparative prior period figures have been restated. Restated segmental information for volume, sales, net sales, marketing spend and operating profit before exceptional items for prior periods with a reconciliation to previously reported figures are provided in 'Definitions and reconciliations of non-GAAP measures to GAAP measures' on page 91.

Trend information

The following comments were made by Ivan Menezes, Chief Executive of Diageo, in Diageo's preliminary announcement on 31 July 2013:

"These results reflect Diageo's strengths. We have delivered 5% net sales growth reflecting the strength of our US spirits business and continued double digit growth in the emerging markets, slightly below our original expectations for the year as a result of weakness in some markets. Price increases in each region, positive mix in North America and Latin America and the rigour we have in managing our cost of production and controlling our overheads drove significant expansion in operating margin.

The effectiveness of our marketing campaigns remains a competitive advantage for us and this year we have seen these campaigns extend the leadership of our brands in many markets during the year. This has been a key driver of our performance in scotch, our biggest and most profitable category, especially for Johnnie Walker which is now a 20 million case brand. Innovation is driving growth in every region with our biggest launches in US spirits where we continue to lead the innovation agenda in the industry. Elsewhere, the investments we have made to enhance our routes to market in Africa, Latin America and Eastern Europe have driven strong growth.

The breadth of our good performance is reflected in the strength of the cash flow, in our double digit eps growth and a recommended 9% increase in the final dividend. This year we have again made a strong business stronger and we remain on track to deliver our medium term guidance."

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Business review (continued)

Operating results 2013 compared with 2012

Financial review

Summary consolidated income statement

	Year ended 30 June	
	2013	**2012**
	£ million	**£ million**
Sales	**15,487**	14,594
Excise duties	**(4,054)**	(3,832)
Net sales	**11,433**	10,762
Operating costs before exceptional items	**(7,903)**	(7,564)
Operating profit before exceptional items	**3,530**	3,198
Exceptional operating items	**(99)**	(40)
Operating profit	**3,431**	3,158
Sale of businesses	**(83)**	147
Net finance charges	**(424)**	(397)
Share of associates' profits after tax	**199**	213
Profit before taxation	**3,123**	3,121
Taxation	**(529)**	(1,038)
Profit from continuing operations	**2,594**	2,083
Discontinued operations		(11)
Profit for the year	**2,594**	2,072
Attributable to:		
Equity shareholders of the parent company	**2,485**	1,942
Non-controlling interests	**109**	130
	2,594	2,072

Sales and net sales On a reported basis, sales increased by £893 million from £14,594 million in the year ended 30 June 2012 to £15,487 million in the year ended 30 June 2013 and net sales increased by £671 million from £10,762 million in the year ended 30 June 2012 to £11,433 million in the year ended 30 June 2013. Exchange rate movements decreased reported sales by £81 million and reported net sales by £60 million. Acquisitions increased reported sales by £317 million and reported net sales by £233 million and disposals decreased both reported sales and net sales by £19 million.

Operating costs before exceptional items On a reported basis, operating costs before exceptional items increased by £339 million from £7,564 million in the year ended 30 June 2012 to £7,903 million in the year ended 30 June 2013 due to an increase in cost of sales of £215 million from £4,228 million to £4,443 million, an increase in marketing spend of £96 million from £1,691 million to £1,787 million, and an increase in other operating expenses before exceptional costs of £28 million, from £1,645 million to £1,673 million. Exchange rate movements benefited total operating costs before exceptional items by £56 million.

Cost of sales excluding exceptional items was £4,443 million in the year ended 30 June 2013 compared with £4,228 million in the year ended 30 June 2012. The 1% volume increase together with some favourable mix impact added £37 million to cost of sales. Acquisitions and disposals added £

Business review (continued)

96 million, with Ypióca and Shuijingfang being the main contributors, and positive exchange movements reduced cost of sales by £23 million. As expected cost increases on materials, utilities and logistics amounted to around 4% of cost of sales. This was partially mitigated by cost reductions through packaging sourcing initiatives, asset rationalisation, procurement benefits and operational efficiencies arising from restructuring programmes implemented in recent years.

Exceptional operating items Net exceptional operating charges of £99 million in the year ended 30 June 2013 comprised:

- £25 million (2012 £nil) for the Supply excellence restructuring programme,
- a charge of £44 million (2012 £27 million) for the restructuring of the group's Global Supply operations in Ireland, Scotland and in the United States,
- a gain of £20 million in respect of changes to future pension increases for the Diageo Guinness Ireland Group Pension Scheme (2012 £115 million in respect of the group's principal UK and Irish pension schemes), and
- a brand impairment charge of £50 million (2012 £59 million) in respect of the Cacique brand.

In the year ended 30 June 2012 exceptional operating items also included a charge of £69 million for the operating model review announced in 2011.

In March 2013, Diageo announced that its Global Supply and procurement operation will be refocused to enhance alignment between supply operations and Diageo's markets. From 1 July 2013, responsibility for local operations was transferred to the markets and regional structures are being reduced. The Global Supply function will remain responsible for ensuring excellence across all supply operations. In addition, a number of initiatives have been launched to consolidate and streamline the supply operations to create greater operating efficiencies. Total exceptional operating charges in the three years ending 30 June 2015 in respect of the restructuring are estimated to be £100 million.

In the year ended 30 June 2013 total restructuring cash expenditure was £61 million (2012 £158 million). An exceptional charge of approximately £85 million is expected to be incurred in the year ending 30 June 2014 in respect of the Supply excellence review and the restructuring of the group's supply operations in Ireland, and cash expenditure is expected to be approximately £110 million.

Post employment plans The deficit in respect of post employment plans before taxation decreased by £533 million from £1,085 million at 30 June 2012 to £552 million at 30 June 2013 primarily as a result of the one off cash contribution of £400 million into the Diageo UK Pension Scheme. In addition, an increase in the market value of plan assets was partially offset by a decrease in the discount rates used to calculate the liabilities of the Irish plans and an increase in the inflation assumptions in the United Kingdom. Cash contributions to the group's UK and Irish post employment plans in the year ended 30 June 2013 were £531 million (2012 £133 million) and are expected to be approximately £230 million for the year ending 30 June 2014.

Operating profit Reported operating profit for the year ended 30 June 2013 increased by £273 million to £3,431 million from £3,158 million in the prior year. Before exceptional operating items, operating profit for the year ended 30 June 2013 increased by £332 million to £3,530 million from £3,198 million in the prior year. Exchange rate movements decreased both operating profit and operating profit before exceptional items for the year ended 30 June 2013 by £4 million. Acquisitions increased reported operating profit by £98 million and disposals decreased reported operating profit by £3 million.

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Business review (continued)

Exceptional non-operating items In the year ended 30 June 2013 a loss of £83 million arose in respect of the Nuvo disposal. In the year ended 30 June 2012 the gain on sale of businesses of £147 million included a step up gain of £124 million on the revaluation of the group's equity holdings in Sichuan Chengdu Shuijingfang Group Co., Ltd. (SJF Holdco) (formerly Sichuan Chengdu Quanxing Group Company Ltd.) and Sichuan Shuijingfang Co., Ltd (Shuijingfang) to fair value as the associates became subsidiaries during the year. In addition, exceptional non-operating items included a gain of £23 million on the sale of the group's investment in Tanzania Breweries.

Net finance charges Net finance charges amounted £424 million in the year ended 30 June 2013 (2012 £397 million).

Net interest charge increased by £17 million from £382 million in the prior year to £399 million in the year ended 30 June 2013. The effective interest rate was 4.9% (2012 4.7%) in the year ended 30 June 2013 and average net borrowings decreased by £23 million compared to the prior year. For the calculation of effective interest rate, the net interest charge excludes fair value adjustments to derivative financial instruments and borrowings and average monthly net borrowings include the impact of interest rate swaps that are no longer in a hedge relationship but exclude the market value adjustment for cross currency interest rate swaps.

Net other finance charges for the year ended 30 June 2013 were £25 million (2012 £15 million). There was an increase of £12 million in finance charges in respect of post employment plans from an income of £7 million in the year ended 30 June 2012 to a charge of £5 million in the year ended 30 June 2013. Other finance charges also included £16 million (2012 £17 million) in respect of the unwinding of discounts on liabilities, and a hyperinflation adjustment of £4 million (2012 £3 million) in respect of the group's Venezuela operations.

Associates The group's share of associates' profits after interest and tax was £199 million for the year ended 30 June 2013 compared to £213 million in the prior year. Diageo's 34% equity interest in Moët Hennessy contributed £230 million (2012 £205 million) to share of associates' profits after interest and tax. The share of loss after tax of £31 million (2012 £8 million profit) from other associates contains a deferred tax write off of £23 million (2012 £nil).

Profit before taxation Profit before taxation increased by £2 million from £3,121 million in the prior year to £3,123 million in the year ended 30 June 2013.

Taxation The reported tax rate decreased from 33.3% in the year ended 30 June 2012 to 16.9% in the year ended 30 June 2013. During the year ended 30 June 2012 tax authority negotiations were concluded resulting in a favourable change to the taxation basis of certain overseas profit and intangible assets which reduced the ongoing tax rate but resulted in the loss of future tax amortisation deductions giving rise to an exceptional write off of the related deferred tax assets of £524 million. The tax rate before exceptional items for the year ended 30 June 2013 remained unchanged at 17.7% compared with the year ended 30 June 2012 and it is expected that it will remain at approximately 18%.

Discontinued operations Discontinued operations in the year ended 30 June 2012 represented a charge after taxation of £11 million in respect of anticipated future payments to additional thalidomide claimants.

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

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Business review (continued)

excluded from organic growth. The estimated effect of exchange rate and other movements on profit before exceptional items and taxation for the year ended 30 June 2013 is set out in the table below.

	Gains/(losses) £ million
Operating profit before exceptional items	
Translation impact	**(7)**
Transaction impact	**3**
Total exchange effect on operating profit before exceptional items	**(4)**
Interest and other finance charges	
Net finance charges translation impact	**(3)**
Impact of IAS 21 and IAS 39 on other finance charges	**2**
Associates translation impact	**(3)**
Total effect on profit before exceptional items and taxation	**(8)**

	Year ended 30 June 2013	2012
Exchange rates		
Translation £1 =	**$ 1.57**	$ 1.58
Transaction £1 =	**$ 1.57**	$ 1.57
Translation £1 =	**€ 1.21**	€ 1.18
Transaction £1 =	**€ 1.18**	€ 1.19

For the year ending 30 June 2014 foreign exchange movements are expected to adversely impact operating profit by £55 million and increase net finance charges by £5 million based on applying current exchange rates (£1 = $1.54 : £1 = €1.16). This guidance excludes the impact of IAS 21 and IAS 39.

Dividend The directors recommend a final dividend of 29.30 pence per share, an increase of 9% from the year ended 30 June 2012. The full dividend will therefore be 47.40 pence per share, an increase of 9% from the year ended 30 June 2012. Subject to approval by shareholders, the final dividend will be paid on 3 October 2013 to shareholders on the register on 16 August 2013. Payment to US ADR holders will be made on 8 October 2013. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 11 September 2013.

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Business review (continued)

Analysis by reporting segments

The organic movements for volume, net sales, marketing spend and operating profit before exceptional items by reporting segment for the year ended 30 June 2013 were as follows:

	Volume	Net sales	Marketing spend	Operating profit*
	%	%	%	%
Organic growth by region				
North America	**1**	**5**	**10**	**9**
Western Europe	**(3)**	**(4)**	**(6)**	**(7)**
Africa, Eastern Europe and Turkey	**4**	**10**	**16**	**10**
Latin America and Caribbean	**4**	**15**	**11**	**26**
Asia Pacific	**(1)**	**3**	**(1)**	**6**
Diageo**	**1**	**5**	**5**	**8**

*
Operating profit excluding exceptional items.

**
Including Corporate.

Corporate revenue and costs

Net sales were £76 million in the year ended 30 June 2013, up £6 million compared to last year. Net operating charges were £149 million in the year ended 30 June 2013 having been £165 million in the year ended 30 June 2012. The reduction comprised a £10 million decrease in corporate costs, primarily due to a reduction in acquisition costs and a £6 million favourable exchange rate movements.

2013

North America

"Diageo's organic performance in North America, with volume up 1% and net sales up 5%, has been driven by our strength in US spirits which continues to benefit from positive demographics and the consumers' wish to premiumise. Great innovation, impactful marketing campaigns, and our superior route to market have resulted in 3% volume growth and 8% net sales growth in US spirits. We have taken price increases across our brands, especially on our premium and super premium brands. The strong performance of Crown Royal, Johnnie Walker, Buchanan's, and Bulleit Bourbon, and double digit growth of our reserve brands, were the key contributors to mix. We have sustained our successful innovation pipeline and again we have 5 of the top 10 new launches in the United States, with Crown Royal Maple the number one US innovation this year. We have increased marketing spend 11% on our US spirits brands and we now have on air campaigns for all our core brands. DGUSA, in contrast, had a difficult year with increased competition from new entrants in flavoured beer. Wine has had a good year, benefiting from innovation and price increases. Canada has delivered good growth through price increases, innovation, and marketing investment in Tanqueray, Crown Royal, and Baileys. Strong price/mix across North America enhanced our gross margin and with our continued focus on overheads we were able to increase marketing investment while still delivering 120bpts of operating margin improvement."

Larry Schwartz
President, Diageo North America

Business review (continued)

Key highlights

US spirits net sales grew 8% driven by a strong performance in North American whiskey, scotch, and vodka. Crown Royal and Bulleit Bourbon contributed more than 45% of the net sales growth following successful innovations such as Crown Royal Maple Finished and Bulleit 10 year old which were launched this year. Smirnoff delivered a strong performance and grew net sales 6% with the expansion of the confectionery line and the launch of Smirnoff Kissed Caramel, Iced Cake and Root Beer Float. Johnnie Walker increased net sales 14% driven by the strong performance of both Johnnie Walker Black Label and Blue Label. 5ppts of positive price/mix arose from price increases put through across categories and positive mix from premiumisation as net sales of the reserve brands grew 9%. Net sales growth in the fourth quarter benefited from the shipment of a new Cîroc flavour which was launched in July.

Canada's net sales growth of 8% was driven by price increases across categories, successful innovation launches in whiskey, rum, and liqueurs, and the impact of increased marketing investment behind Johnnie Walker, Crown Royal and Baileys as well as bulk whiskey sales.

Net sales in beer declined 1%. Guinness lost share in the United States as we lapped the introduction of Guinness Black Lager and Red Stripe was affected by supply disruptions.

Ready to drink net sales declined 10% as Smirnoff Ice faced increased competition from established beer brands.

Marketing investment was up 10% driven by an increased investment behind strategic brands. Increased spend of 24% on Johnnie Walker was focused on the 'My Label is Black' campaign which was designed to celebrate the Hispanic community. Successful campaigns included the 'Reign On' campaign for Crown Royal, the continuation of the 'Master of the Mix' programme, featuring a DJ competition on cable TV, sponsored by Smirnoff, and the 'Luck Be a Lady' campaign for Cîroc featuring Sean Combs. Increased investment behind Bulleit Bourbon was focused on raising consumer awareness of the brand.

Price increases implemented across the portfolio and positive mix from the double digit net sales growth of our super and ultra premium brands drove 120bpts of organic operating margin improvement.

Performance

Key financials	2012 Reported (restated)	Exchange	Acquisitions and disposals*	Organic movement	2013 Reported	Reported movement
	£ million	£ million	£ million	£ million	£ million	%
Net sales	3,556	22	(24)	**179**	**3,733**	**5**
Marketing spend	547	6	(18)	**50**	**585**	**7**
Operating profit before exceptional items	1,360	14	(3)	**113**	**1,484**	**9**
Exceptional items	(11)					
Operating profit	1,349				**1,484**	**10**

* Diageo reported net sales of £267 million (2012 £266 million) from Jose Cuervo in North America. Acquisitions and disposals are in respect of the year on year movement for Jose Cuervo, as a result of the termination of the distribution agreement, and for disposals made in the years ended 30 June 2013 and 30 June 2012. The variance is primarily driven by the sales decline of Nuvo.

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Business review (continued)

	Organic volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Key markets and categories:			
North America	**1**	**5**	**5**
US Spirits	**3**	**8**	**7**
DGUSA	**(7)**	**(6)**	**(6)**
Diageo Chateau & Estate Wines	**1**	**3**	**4**
Canada		**8**	**7**
Spirits	**2**	**8**	**8**
Beer	**(2)**	**(1)**	**(3)**
Wine &nbs			