DIAGEO PLC
Form 20-F
August 09, 2016

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 2016

Commission file number 1-10691

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organisation)

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

(Address of principal executive offices)

David Harlock, Company Secretary

Tel: +44 20 8978 6000

E-mail: the.cosec@diageo.com

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

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

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

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

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

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

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

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the Annual Report: 2,754,380,836 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 x No ¨

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

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

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

Indicate by check mark whether 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 x	Accelerated Filer ¨	Non-Accelerated Filer ¨

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

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

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

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

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2016 of Diageo plc (the 2016 Form 20-F).

Contents

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Introduction

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.

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

This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2016. 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 2016, 2015 or 2014. PricewaterhouseCoopers LLP has reported on the accounts for the year ended 30 June 2016 and the group s former auditors, KPMG LLP has reported on the accounts for the year ended 30 June 2015 and 2014; their respective audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the years ended 30 June 2016, 2015 or 2014. The accounts for 2015 and 2014 have been delivered to the registrar of companies for England and Wales and those for 2016 will be delivered in due course.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo s control. For more details, please refer to the cautionary statement concerning forward-looking statements on pages 46-47.

The content of the company s website (www.diageo.com) or any other documents referred to herein 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.

Information presented

Organic movements and organic operating margins are before exceptional items. Share, unless otherwise stated, refers to value share. For a definition of organic movement and reconciliations of non-GAAP measures to GAAP measures see on page 133.

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

Disclosures not incorporated by reference

The following pages and sections of the Annual Report of Diageo plc for the year ended 30 June 2016, are not incorporated by reference into this report on Form 20-F and are furnished to the United States Securities and Exchange Commission (SEC) for information only:

Disclosures under the headings Doing business the right way and Our role in society in the section Strategic Report Our business on page 12.

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Introduction (continued)

Disclosures included under the titles Number of responsible drinking programs (%) , Water withdrawals and Carbon emissions in the section Strategic Report Our Global Reach Diageo reports as five regions on page 17.
Disclosures on pages 21 and 22 in the section Strategic Report Our business model under the sub-headings Values , Our role in society and Sustainability and responsibility priorities .
Disclosures on pages 25 and 27 in the section Strategic Report How we measure performance: key performance indicators of non-financial key performance indicators.
Disclosures under the heading Our role in society in the Chairman s Statement on page 30.
Disclosures under the heading Our role in society in the Chief Executive s statement on pages 33 and 34.
Disclosures on pages 36 and 37 under the heading Strategic Report Market Dynamics Earning the trust and respect which support performance .
Disclosures included under the heading Strategic Report How we will deliver our Performance Ambition our three Sustainability and responsibility priorities on page 38.
Disclosures included under the titles Sustainability and responsibility on pages 61, 64, 68, 71, and 74 in relation to each reporting segment in the Business Review.
Disclosures in the section Strategic report Our role in society on pages 114 to 132.

Recent trends

The following comments were made by Ivan Menezes, Chief Executive of Diageo, in Diageo s preliminary results announcement on 28 July 2016:

This is a good set of results delivering what we set out to achieve this time last year and demonstrating our momentum.

This better performance reflects the work we have done to strengthen our big brands through marketing and innovation, as well as expanding our distribution reach. Our six global brands and our US spirits business are all back in growth and we have seen a significant improvement in the performance of our scotch and beer portfolios. The delivery of volume growth; organic margin expansion; increased free cash flow; and the disposal of £1bn in non-core assets, comes from an everyday focus on efficiency in each aspect of our business. We have also made significant progress this year in our aim to improve the role of alcohol in society, partner with our communities and reduce our environmental impact.

These results position us well to deliver a stronger performance in F17. We are confident of achieving our objective of mid-single digit top line growth, and in the three years ending F19 delivering 100bps of organic operating margin improvement.

Historical information

The following tables present selected consolidated financial data for Diageo for the five years ended 30 June 2016 and as at the respective year ends. The data presented below for the five years ended 30 June 2016 and the respective year ends has been derived from Diageo s consolidated financial statements, audited by Diageo s independent auditor. The group s former auditors, KPMG LLP and its affiliates (KPMG) reported on the financial statements for the four years ended 30 June 2015.

Income statement data					**Year ended 30 June**
	2016	**2015**	**2014**	**2013**	**2012**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Sales	**15,641**	15,966	13,980	15,276	14,392
Excise duties	**(5,156)**	(5,153)	(3,722)	(3,973)	(3,753)
Net sales	**10,485**	10,813	10,258	11,303	10,639
Cost of sales	**(4,251)**	(4,610)	(4,029)	(4,416)	(4,208)
Gross profit	**6,234**	6,203	6,229	6,887	6,431
Marketing	**(1,562)**	(1,629)	(1,620)	(1,769)	(1,671)
Other operating expenses	**(1,831)**	(1,777)	(1,902)	(1,738)	(1,652)
Operating profit	**2,841**	2,797	2,707	3,380	3,108
Non-operating items	**123**	373	140	(83)	147
Net interest and other financial charges	**(327)**	(412)	(388)	(457)	(441)
Share of other tax results of associates and joint ventures	**221**	175	252	217	229
Profit before taxation	**2,858**	2,933	2,711	3,057	3,043
Taxation	**(496)**	(466)	(447)	(507)	(1,011)
Profit from continuing operations	**2,362**	2,467	2,264	2,550	2,032
Discontinued operations			(83)		(11)
Profit for the year	**2,362**	2,467	2,181	2,550	2,021
Weighted average number of shares	**million**	**million**	**million**	**million**	**million**
Shares in issue excluding own shares	**2,508**	2,505	2,506	2,502	2,495
Dilutive potential ordinary shares	**10**	12	11	15	14
	2,518	2,517	2,517	2,517	2,509
Per share data	**pence**	**pence**	**pence**	**pence**	**pence**
Dividend per share	**59.2**	56.4	51.7	47.4	43.5
Earnings per share					
Basic					

Continuing operations	**89.5**	95.0	93.0	98.0	76.6
Discontinued operations			(3.3)		(0.4)
Basic earnings per share	**89.5**	95.0	89.7	98.0	76.2
Diluted					
Continuing operations	**89.1**	94.6	92.6	97.4	76.2
Discontinued operations			(3.3)		(0.4)
Diluted earnings per share	**89.1**	94.6	89.3	97.4	75.8

Historical information (continued)

Balance sheet data

					As at 30 June
	2016	**2015**	**2014**	**2013**	**2012**
	£ million	**£ million**	**£ million**	**£ million**	**£ million**
Non-current assets	**19,639**	18,134	15,495	16,481	15,098
Current assets	**8,852**	7,670	7,469	8,510	7,171
Total assets	**28,491**	25,804	22,964	24,991	22,269
Current liabilities	**(6,187)**	(5,290)	(4,851)	(5,519)	(4,762)
Non-current liabilities	**(12,124)**	(11,258)	(10,523)	(11,384)	(10,715)
Total liabilities	**(18,311)**	(16,548)	(15,374)	(16,903)	(15,477)
Net assets	**10,180**	9,256	7,590	8,088	6,792
Share capital	**797**	797	797	797	797
Share premium	**1,347**	1,346	1,345	1,344	1,344
Other reserves	**2,625**	1,994	2,243	3,154	3,213
Retained earnings	**3,761**	3,634	2,438	1,741	234
Equity attributable to equity shareholders of the parent company	**8,530**	7,771	6,823	7,036	5,588
Non-controlling interests	**1,650**	1,485	767	1,052	1,204
Total equity	**10,180**	9,256	7,590	8,088	6,792
Net borrowings	**(8,635)**	(9,527)	(8,850)	(8,403)	(7,573)

Notes to the historical information

1. Accounting policies The consolidated financial statements for the five years ended 30 June 2016 have been prepared in accordance with IFRS. The IFRS accounting policies applied by the group to prepare the financial information in this document are disclosed in the notes to the consolidated financial statements.

Historical information (continued)

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

					Year ended 30 June
	2016 £ million	2015 £ million	2014 £ million	2013 £ million	2012 £ million
Items included in operating profit					
Brand, goodwill and tangible asset impairment	**(118)**		(264)	(50)	(59)
Restructuring programmes		(82)	(163)	(69)	(96)
Duty settlements		(146)			
Associate impairment		(41)			
Pension changes past service credits				20	115
Disengagement agreements relating to United Spirits Limited	**(49)**				
	(167)	(269)	(427)	(99)	(40)
Non-operating items					
Gains/(losses) on sale of businesses	**215**	247		(83)	23
Step up gains		156	140		124
Other non-operating items	**(92)**	(30)			
	123	373	140	(83)	147
Items included in taxation					
Tax credit on exceptional operating items	**7**	51	99	27	19
Tax on sale of businesses	**49**			28	
Loss of future tax amortisation					(524)
	56	51	99	55	(505)
Exceptional items in continuing operations	**12**	155	(188)	(127)	(398)
Discontinued operations net of taxation (note 3)			(83)		(11)

Exceptional items	**12**	155	(271)	(127)	(409)

3. Discontinued operations in the year ended 30 June 2014 comprised a charge after taxation of £83 million (£91 million less tax of £8 million) (2012 - £16 million less deferred tax of £5 million) in respect of the settlement of thalidomide litigation in Australia and New Zealand and anticipated future payments to thalidomide organisations.

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

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

						Year ended 30 June
		2016 pence	**2015 pence**	**2014 pence**	**2013 pence**	**2012 pence**
Per ordinary share	Interim	**22.60**	21.50	19.70	18.10	16.60
	Final	**36.60**	34.90	32.00	29.30	26.90
	Total	**59.20**	56.40	51.70	47.40	43.50
		$	**$**	**$**	**$**	**$**
Per ADS	Interim	**1.27**	1.28	1.31	1.10	1.05
	Final	**1.95**	2.14	2.06	1.89	1.72
	Total	**3.22**	3.42	3.37	2.99	2.77

Historical information (continued)

Note: Subject to shareholders approval the final dividend for the year ended 30 June 2016 will be paid on 6 October 2016, and payment to US ADR holders will be made on 12 October 2016. In the table above, an exchange rate of £1 = $1.33 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 6 October 2016.

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

6. Share capital There were 2,754 million ordinary share of 28 $^{101}/_{108}$ pence each in issue with a nominal value of £797 million throughout the five year period ended 30 June 2016.

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

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

					Year ended 30 June
	2016	**2015**	**2014**	**2013**	**2012**
	$	**$**	**$**	**$**	**$**
Year end	**1.32**	1.57	1.71	1.52	1.57
Average rate(i)	**1.47**	1.57	1.64	1.57	1.59

(i) The average of the noon buying rates on the last business day of each month during the year ended 30 June.
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 2016, expressed in US dollars per £1.

						2016
	July	**June**	**May**	**April**	**March**	**February**
	$	**$**	**$**	**$**	**$**	**$**
Month end	**1.33**	**1.32**	**1.45**	**1.46**	**1.44**	**1.39**
Month high	**1.33**	**1.48**	**1.47**	**1.46**	**1.45**	**1.46**
Month low	**1.29**	**1.32**	**1.44**	**1.41**	**1.39**	**1.39**
Average rate(i)	**1.31**	**1.42**	**1.45**	**1.43**	**1.42**	**1.43**

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

The noon buying exchange rate as at 29 July 2016 was £1 = $1.33.

These rates have been provided for information only. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the consolidated financial statements. See note 1 to the consolidated financial statements for the actual rates used in the preparation of the consolidated financial statements.

Strategic report

Business description

OUR BUSINESS

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

Diageo has built a strong platform for growth. We have grown through investment in our brands, and by acquisition to broaden our geographical footprint and category depth and range.

Our 21 market model[(i)] has established strong local business units, well positioned to win in increasingly competitive and fast paced operating environments.

We want to make a positive contribution to society, to communities, to individuals, and to the environment while continuing to prosper as a business. We actively create the shared value that is part of our heritage, and essential to our future.

Strength through global reach and iconic brands

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

Doing business the right way

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

We produce	We innovate	We market	We sell
We produce our brands from more than 150 sites in around 30 countries. We are committed to efficient, sustainable production to the highest quality standards. Our export-led International Supply Centre (ISC) employs over 4,000 people across more than 55 sites in Scotland, England, Ireland, Italy and the Netherlands.	Innovation is a mindset driving everything we do and an important growth engine for our business. We combine our world-leading technical and research capability with investments in smaller start-ups. We partner with entrepreneurs to actively experiment in digital technology, new business models and partnerships to solve business issues and unlock new opportunities.	For decades our brands have been at the forefront of marketing innovation and the same remains true today. We invest in world-class marketing to build our brands, focused on programmes which recruit and re-recruit consumers. We take our obligations to market responsibly and help consumers make informed decisions seriously.	Everyone at Diageo sells or understands how they can help sell. This is just one expression of the sales-led organisation we are building. We work to extend our sales reach by ensuring our products are available where people want them and by delivering memorable consumer experiences.

Our role in society

Everywhere we operate, we set out to have a positive impact on the world around us. Doing so is good for our business, for our communities and for our consumers.

At the core of our approach is a commitment to create a positive role for alcohol in society. This is fundamental to our purpose celebrating life, every day, everywhere. We are also committed to tackling alcohol misuse through effective programmes that prevent and reduce alcohol misuse, and work with others to raise awareness and change people s attitudes and behaviour. We market our products responsibly and provide the information consumers need to make informed decisions.

Our distilleries and breweries are at the very heart of the communities in which we work, which gives us an opportunity to create shared value. To do this, we work hard to increase access to opportunity through: enabling entrepreneurship, employability and skills; improving access to clean water, sanitation and hygiene; and helping to empower women.

By reducing carbon packaging, water and waste now, we are reducing our environmental impact to support future opportunities.

(i) Throughout this Annual Report 2016, reference to Diageo s 21 geographically based markets are stated as 21 markets .

Business description (continued)

Production

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

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

The locations, principal activities, products, packaging production capacity and packaging production volume of Diageo s principal production centres in the year ended 30 June 2016 were as follows:

Location	Principal products	Production capacity in millions of equivalent units (i)	Production volume in 2016 in millions of equivalent units
United Kingdom (Spirits)	Scotch whisky, gin, vodka, rum, ready to drink	96	52
UK, Ireland (Guinness)	Beer	8	7
Ireland (Baileys)	Irish cream liqueur	12	7
Italy (Santa Vittoria)	Vodka, wine, rum, ready to drink	11	4
Turkey	Raki, vodka, gin, liqueur, wine	8	6
United States, Canada, US Virgin Islands	Vodka, gin, tequila, rum, Canadian whisky, American whiskey, progressive adult beverages, ready to drink	43	34
Brazil	Cachaça, vodka	11	8
Mexico	Tequila	1	1
Australia	Rum, vodka, ready to drink	4	2
Singapore	Finishing centre	7	1
India	Rum, vodka, whisky, scotch, brandy, gin, wine	160	111
Nigeria	Beer	7	5
South Africa	Beer, spirits and ready to drink	8	6
East Africa (Uganda, Kenya, Tanzania)	Beer and spirits	13	11
Africa Regional Markets (Ethiopia, Cameroon, Ghana, Seychelles)	Beer	7	4

(i)

Capacity represents ongoing production capacity. The production capacities quoted in the table are based on actual production levels for the year ended 30 June 2016 adjusted for the elimination of unplanned losses and inefficiencies. On 7 October 2015 the group disposed of its brewing operations in Jamaica and Singapore and Malysia. On 1 January 2016 Diageo disposed of its wine operations in the United States. The figures above exclude the production capacity and volume for these operations.

Spirits

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

Business description (continued)

Diageo s maturing Scotch whisky is located in warehouses in Scotland (the largest at Blackgrange holding approximately 50% of the group s maturing Scotch whisky), its maturing Canadian whisky in La Salle and Gimli in Canada and its maturing American whiskey in Kentucky and Tennessee in the United States. In May 2014 the company announced its intention to invest approximately $115 million (£86 million) over three years to build a distillery and six barrel storage warehouses in Shelby County, Kentucky. The new distillery is expected to be in operation by the end of calendar year 2016.

In June 2012, the company announced a multi-year investment plan in Scotch whisky production and inventory and has spent approximately £1 billion to date. The investment program was completed in the year ended 30 June 2016. Investments made during the year ended 30 June 2016 in Clynelish and increases in warehousing capacity to support distilling and maturing activities are intended to provide for long term Scotch sales growth.

Diageo owns a controlling equity stake in United Spirits Limited (USL) which is the leading alcoholic beverage company in India selling over 90 million equivalent cases of Indian-Made Foreign Liquor (IMFL). USL has a significant market presence across India and operates 26 owned, 17 leased and 39 third party manufacturing facilities in India and Nepal. USL also operates spirit distillation plants for neutral alcohol, malt spirit, grape spirit and rum spirit with accompanying maturation facilities. USL has many leading Indian brands such as McDowell s (Indian whisky, rum and brandy), Black Dog (scotch), Signature (Indian whisky), Antiquity (Indian whisky) and Bagpiper (Indian whisky).

Beer

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

On 1 December 2015, Diageo disposed of its 25% equity stake in Sedibeng Brewery (Pty) Limited, which owned a brewery in South Africa. On 7 October 2015, Diageo also completed the disposal of its 57.87% shareholding in Desnoes & Geddes (Jamaican Red Stripe business) and its 49.99% stake in GAPL Pte Limited (Singapore and Malaysian beer business) to Heineken. GAPL owns 51% of Guinness Anchor Berhad, operating in Malaysia, which was also disposed of.

Guinness is brewed by over 50 third parties around the world under licence arrangements. Guinness flavour extract is shipped from Ireland to all overseas Guinness brewing operations which use the flavour extract to brew Guinness locally. 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 which is transported to Great Britain in bulk.

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 95% of the manufacturing, distilling, brewing, bottling and administration facilities it uses across the group s worldwide operations. It holds approximately 3% of properties on leases in excess of 50 years. The principal production facilities are described above. As at 30 June 2016, Diageo s land and buildings are included in the group s consolidated balance sheet at a net book value of £1,083 million. Diageo s two largest individual facilities, in terms of book value, are the Leven bottling, blending and warehousing facility in Scotland and St James s Gate brewery in Dublin. Approximately 38% of the net book value of Diageo s land and buildings are properties located in Great Britain, 14% in India, and 12% both in the United States and Ireland.

Business description (continued)

Raw materials and supply agreements

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

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

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

Competition

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

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

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

Research and development

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

In the year ended 30 June 2016, the group s research and development expenditure amounted to £28 million (2015 £26 million; 2014 £24 million), representing principally the cost of developing new products, from idea generation through to full product development. Research and development expenditure is generally written off in the year in which it is incurred.

Trademarks

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

Regulations and taxes

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

Business description (continued)

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

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

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

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

Acquisitions and disposals

Diageo has disposed of its wines and certain beer assets in the year ended 30 June 2016. For a description of principal acquisitions and disposals since 1 July 2013, see note 9 to the consolidated financial statements.

Seasonality

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

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Business description (continued)

OUR GLOBAL REACH

Diageo is the leading spirits player in every region of the world. This regional profile provides us with exposure to the greatest consumer growth opportunities in our sector. We operate as 21 geographically based markets around the world and have a presence in over 180 countries. We employ more than 32,000 talented people across our global business.

Diageo reports as five regions

	North America	Europe, Russia and Turkey	Africa	Latin America and Caribbean	Asia Pacific
% Share by region					
Volume (%)	19.1	17.8	12.7	8.4	42.0
Net sales(i) (%)	34.1	24.3	13.4	8.3	19.9
Operating profit before exceptional items(ii) (%)	49.1	25.4	6.7	6.3	12.5
Operating profit(iii) (%)	51.8	26.8	7.1	2.7	11.6
Number of responsible drinking programmes (%)	21.2	25.4	15.6	15.7	22.1
Water withdrawals(iv) (%)	10.0	38.2	37.8	1.8	12.2
Carbon emissions(iv) (%)	6.7	42.7	37.4	2.3	10.9
Number of employees(v) (%)	9.0	33.5	16.5	9.8	31.2

(i) Does not include corporate net sales of £36 million. (ii) Excluding exceptional operating charges of £167 million (2015 £269 million) and corporate and ISC costs before exceptional items of £150 million (2015 £123 million). (iii) Excluding corporate and ISC costs of £150 million (2015 £139 million). (iv) Excludes corporate offices which account for <2% of combined impacts. (v) Employees have been allocated to the region in which they reside. Most people who work on behalf of Diageo are employed by Diageo, although, we also employ fixed term or temporary employees. In 2016 we hired 1,386 fixed-term or temporary employees. We have a strong commitment to dialogue, and in 2016, 46% of our employees were covered by collective bargaining agreements. Diageo aims to maintain regular, open dialogue with unions over issues of common interest.

Business description (continued)

OUR BRANDS

Our global reach is matched by our broad portfolio of international and local brands. We own the top two largest spirits brands in the world, Johnnie Walker and Smirnoff, and 20 of the world s top 100 spirits brands.

Our portfolio spans consumer drinking occasions. Using local market insights, our teams are able to select the most relevant brands from our global portfolio to meet the consumer opportunity in their market. All of our marketing activities adhere to the Diageo Marketing Code to ensure our brands are marketed responsibly. A selection of our brands are included in the table below.

			Global giants(i)		
			Our business is anchored around our six biggest global brands.		
Johnnie Walker	Smirnoff	Captain Morgan	Baileys	Tanqueray	Guinness
	Local stars			**Reserve**	
	Can be individual to any one market, and provide a platform for our business to grow.			Exceptional spirits brands at above-premium price points to capture the global luxury opportunity.	
Crown Royal	Yenì Raki	JeB	Johnnie Walker Blue Label	Johnnie Walker Gold Label Reserve	Johnnie Walker King George V
Buchanan s	Windsor	Grand Old Parr	Private Collection	Lagavulin	The Singleton of Glen Ord
Bundaberg	Bell s	McDowell s No. 1	Cîroc	Ketel One vodka	Tanqueray No. TEN
Ypióca	Cacique	Shui Jing Fang	Ron Zacapa Centenario XO	Tequila Reserva de Don Juilo	Bulleit Bourbon

Source: Impact Databank Value Ratings, May 2016. (i) Global giants represent 40% of Diageo net sales.

Business description (continued)

BREADTH AND DEPTH ACROSS PRICE POINTS

Our portfolio, well diversified across price tiers, enables us to participate where the consumer opportunity is greatest, and to capture shifts in consumer preference.

We hold strong positions across all key international spirits categories to serve consumer occasions and price points with our brands. Our most strategically important category is scotch. We have also established footholds in key emerging markets through participation in local spirits categories: raki in Turkey, cachaça in Brazil, local whisky in India, and a small position in the baiju category in China.

	Ultra premium	Super premium	Premium	Standard	Value
Scotch whisky	Johnnie Walker Blue Label	The Singleton of Glen Ord	Buchanan s	Johnnie Walker Red Label	VAT 69
North American whisk(e)y	Crown Royal Extra Rare	Bulleit Bourbon	Crown Royal	Seagram s 7 Crown	
Vodka	Cîroc	Ketel One vodka	Smirnoff Sourced	Smirnoff	Istanblue
Rum	Ron Zacapa Centenario XO	Pampero Aniversario Ron Extra Añejo	Captain Morgan Private Stock	Captain Morgan	
Liqueur			Sheridan s Original Layered Liqueur	Baileys	Emmets
Tequila	Tequila Reserva de Don Juilo	Peligroso Tequila			
Gin	Tanqueray No. TEN	Jinzu	Tanqueray	Gordon s	Gilbey s
Local spirits	Shui Jing Fang		Yenì Raki	Ypióca	McDowell s No. 1
Beer		Kilkenny	Guinness	Tusker Finest Quality Lager	Dubic Extra Lager

Business description (continued)

OUR STRATEGY

We pursue the following strategy to deliver our Performance Ambition:

We aim to grow our participation in international premium spirits, driven by growth in both populations and incomes, and the increasing penetration of spirits in emerging markets. To support this, we participate in both beer and mainstream spirits selectively to deliver organisational scale and distribution reach, and to shape responsible drinking trends in markets where international premium spirits is an emerging category.

Our intent is to build breadth and depth across drinking occasions by shaping consumer demand for our international premium spirits brands. In developed markets our strategy is to drive premiumisation through spirits price tiers up to our reserve portfolio. In emerging markets our strategy is to develop from an import-based premium spirits model to become a local player where appropriate, participating in categories that give us the scale and access to the fast growing middle-class consumer. Everywhere we operate, we do so in a responsible and sustainable way.

Prioritised investment in:		**Targeted investment in:**	
Premium core spirits[i]	**Reserve**	**Mainstream spirits[i]**	**Beer**
The brands at the core of our business that provide both scale and strong margin contribution.	Exceptional spirits brands at above-premium price points to capture the global luxury opportunity.	Spirits-based brands priced at a similar amount per serve to mainstream beer or local spirits that enable us to shape local spirits consumption.	Provides local scale and route to consumer, with focused participation in markets where we have leadership positions.

Outcomes of our strategy

Efficient growth	Credibility and trust
Consistent value creation	Motivated people

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

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

See our key performance indicators (KPIs) pages: 23 27.

(i) Spirits include ready to drinks (RTDs).

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Business description (continued)

OUR BUSINESS MODEL

From our position as a global leader, we deliver returns for shareholders, while creating value for our customers and employees. In everything we do, we set out to make a positive contribution to society.

We have structured our organisation into a 21 market business model, applying country-specific strategies to meet local consumer and customer needs. This business model enables us to identify and execute against the most valuable growth opportunities, and also to supply our brands efficiently and effectively using our global expertise, while sourcing and producing locally where optimal to do so. This market-driven business model helps us to capture consumer trends early to deliver sustainable performance.

Global leader	**Agile business model**	**Focused on:**
Broad portfolio Global reach Financial strength Efficient supply and procurement Leading capabilities Values Our role in society	**21 markets** Consumer insights Participation strategy Supply resources **Global functions**	**Performance drivers** Read more: page 38. **Sustainability and responsibility priorities** Read more: page 38
Broad portfolio**:** we have world-leading brands across categories and price points.	***Consumer insights*****:** in-market consumer insight teams are able to identify trends more accurately and quickly, delivering more locally relevant solutions.	***Performance drivers*****:** we have identified six performance drivers which are key to improving execution and achieving our aims: **premium core brands; reserve; innovation; route to consumer; cost and productivity;** and **talent**. Each market focuses on the priorities that will drive performance in that market.
Global reach**:** we have global reach through the breadth and depth of our global and local brands.	***Participation strategy***: flexibility to select the best portfolio of brands that capture the unique consumer opportunity that exists in each specific market and then to invest directly against the largest identified growth opportunities. Each market is able to deploy a customised combination of global and local brands to provide brand price tier coverage that is best suited to its specific consumer needs.	***Sustainability and responsibility priorities***: every business decision, every operation, and every programme and initiative must work towards our three sustainability and responsibility priorities: **creating a positive role for alcohol in society; building thriving communities;** and **reducing our environmental impacts.**
Financial strength**:** our competitive advantage is reflected by our strong	***Supply resources*****:** our 21 markets are	Our performance drivers and sustainability and responsibility

financial returns and consistent financial performance.

***Efficient supply and procurement*:** across

the world we have efficiency in supply and procurement, with high-quality manufacturing operations and environmental standards.

designated as import markets, import and

third party production markets, or import

and local production markets. Where we have dedicated in-market supply resource it increases the speed with which we can respond to local consumer demand and helps to protect our supply chain from political and economic volatility.

***Global functions*:** our 21 markets are

supported by a global structure and shared services designed to leverage scale, drive efficiency, share best practice, impart knowledge and help build capability at a local level, as well as apply governance of controls, compliance and ethics.

priorities are underpinned by our commitment to the highest standards of governance and ethics.

Business description (continued)

Leading capabilities**:** our focus is on brilliant execution including cutting-edge consumer insights and marketing, scalable innovation, and winning relationships with our customers through distribution and sales.

Values**:** at the heart of everything we do are our company values: passionate about customers and consumers; be the best; freedom to succeed; proud of what we do; valuing each other.

Our role in society**:** we are passionate about ensuring alcohol continues to play a positive role in society, and are committed to playing our part in tackling alcohol misuse.

Business description (continued)

HOW WE MEASURE PERFORMANCE: Key performance indicators

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

NET SALES GROWTH (%)

Definition
Sales growth after deducting excise duties.

Performance
Net sales declined by 3% due to disposals and adverse exchange, partially offset by organic growth and acquisitions.

OPERATING MARGIN IMPROVEMENT (BPS)

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

Performance
Operating margin improved by 123bps mainly driven by lower exceptional operating charges.

BASIC EARNINGS PER SHARE (PENCE)

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

Performance
Basic eps of 89.5 pence reduced by 5.5 pence principally due to the change in net exceptional charges from a charge of £44 millon in the year ended 30 June 2016 compared with a net gain of £104 million in the year ended 30 June 2015.

NET CASH FROM OPERATING ACTIVITIES (£ MILLION)

Definition

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

Performance

RETURN ON CLOSING INVESTED CAPITAL (%)

Definition

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

Performance

Net cash from operating activities was flat. Adverse movements in working capital and translation exchange were offset by higher operating profit.

Return on closing invested capital decreased by 350bps due to the increase in net assets driven by the weakening of sterling, partially offset by an increase in post employment liabilities.

Business description (continued)

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

They measure progress against our strategy and our performance against our KPIs are explained below:

Relevance to strategy

#1 Efficient growth

#2 Consistent value creation

#3 Credibility and trust

#4 Motivated people

Financial ® Organic net sales growth (%) #1	Financial ® Organic operating margin improvement (bps) #1	Financial ® Earnings per share before exceptional items (pence)[i] #1
Definition	**Definition**	**Definition**
Sales growth after deducting excise duties, excluding the impact of exchange rate movements, acquisitions and disposals.	The percentage point movement in operating profit before exceptional items, divided by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.	Profit before exceptional items attributable to equity shareholders of the parent company, divided by the weighted average number of shares in issue.
Why we measure	**Why we measure**	**Why we measure**
This measure reflects our performance as the result of the choices made in terms of category and market participation, and Diageo s ability to build brand equity, increase prices and grow market share.	The movement in operating margin measures the efficiency of the business. Consistent operating margin improvement is a business imperative, driven by investment choices, our focus on driving out costs across the business and improving mix.	Earnings per share reflects the profitability of the business and how effectively we finance our balance sheet. It is a key measure for our shareholders.
Performance	**Performance**	**Performance**
Volume growth of 1.3% driven by North America and Europe combined with positive price/mix, primarily mix effect resulted in an organic net sales growth of 2.8%.	Organic operating margin improvement was driven by favourable mix effect which helped gross margin increase combined with procurement efficiencies in marketing activity offset by higher	Earnings per share before exceptional items increased 0.6 pence largely driven by operating profit growth, higher associate income and lower finance charges partially offset by adverse exchange

	overheads.	effects and the impact of disposals.
More detail: see pages 49	More detail: see pages 50-51	More detail: see pages 51

Business description (continued)

Non-Financial **Alcohol in society[ii] (reach and impact of responsible drinking programmes) #3, #4**	Non-Financial **Health and safety (lost-time accident frequency per 1,000 employees) #3, #4**	Non-Financial **Water use efficiency[iv] (l/l) #1**
Definition Number of programmes supported by Diageo that aim to reduce harmful drinking.	**Definition** Number of accidents per 1,000 full-time employees and directly supervised contractors resulting in time lost from work of one calendar day or more.	**Definition** Ratio of the amount of water required to produce one litre of packaged product.
Why we measure We put our resources and skills into programmes that encourage a responsible attitude to alcohol and are effective in preventing and reducing alcohol misuse, working with others to maximise impact. These programmes address the risk of harm to consumers or communities and help us deliver our Performance Ambition.	**Why we measure** Safety is a basic human right: everyone has the right to work in a safe environment, and our Zero Harm safety philosophy is that everyone should go home safe, every day, everywhere.	**Why we measure** Water is the main ingredient in all of our brands. To sustain production growth and respond to the growing global demand for water, we aim to improve efficiency, minimising our water use, particularly in water-stressed areas.
Performance We seek to broaden the reach of programmes, but we are prioritising the impact they have. This involves supporting projects that are effective in meeting their objectives. We share case studies showing impact evaluation on www.diageo.com.	**Performance** In 2016, we improved our performance with a reduction in LTAs of 13% compared with 2015. This was driven by a strong focus on embedding standards into newer markets to reduce accident levels and leveraging best practice safety management tools. In some of our more established markets, this enabled us to get close to our target of zero accidents.	**Performance** 12.1% improvement on 2015, resulting from process optimisations and improvements across all sites and in particularly at our Tusker Brewery in Kenya and our Gimli Distillery in Canada.
More detail: see pages 115-117	More detail: see pages 120-121	More detail: see pages 125-128

Business description (continued)

Financial ®
Free cash flow

(£ million) #1

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

Why we measure

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

Performance

Improvement was driven by lower capex, increased operating profit and lower interest payments partially offset by adverse working capital impact mainly driven by prior year improvement in debtor collection.
More detail: see page 52

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

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

Why we measure

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

Performance

Adverse exchange led in a decline of ROIC partially offset by the increased return from growth in operating profit and income from associates.

More detail: see page 53

Financial ®
Total shareholder return

(%) #2

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

Why we measure

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

Performance

Diageo delivered total shareholder return of 17% as dividends paid increased by 5% and share price increased driven by underlying business improvement and exchange.

Business description (continued)

Non-Financial
Carbon emissions[v]

(1,000 tonnes CO_2e) #1, #3

Definition

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

Why we measure

Carbon emissions are a key element of our environmental impact and the impact of the industry. We recognise the importance of reducing our carbon emissions to mitigate climate change and position us well for a low-carbon economy in the future, as well as creating efficiencies and savings now.

Performance

7.7% reduction in total carbon emissions resulting from cumulative impacts of multiple energy efficiency initiatives and switches to renewable fuels, predominately biogas recovery and reuse and displacement of fossil fuels.

More detail: see pages 128-129

Non-Financial
Employee engagement index[vi]

% #3, #4

Definition

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

Why we measure

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

Performance

This year, 97% of our people participated in our Values Survey (24,843 out of the 25,712 able to participate). 77% of our people were identified as engaged, with 80% feeling they were enabled to perform . Our survey scores have improved each year since 2014.

More detail: see pages 121-123

Remuneration

Some KPIs are used as a measure in the incentives plans for the remuneration of executives. These are identified with the symbol®. See our Directors remuneration report from page 165 for more detail.

(i) For reward purposes this measure is further adjusted for the impact of exchange rates and other factors not controlled by management, to ensure focus on our underlying performance drivers.
(ii) Alcohol in society KPI has been redesigned to measure reach and impact of programmes. See more details on page 116.
(iii) Non-financial KPIs for the year ended 30 June 2015 include United Spirits Limited, except health and safety (see pages 120-121).
(iv) In accordance with Diageo s environmental reporting methodologies, data for each of the four years in the period ended 30 June 2015 has been restated and total water used excludes irrigation water for agricultural purposes on

land under the operational control of the company.

(v) Data for each of the four years in the period ended 30 June 2015 has been restated in accordance with the WRI/WBCSD GHG Protocol and Diageo s environmental reporting methodology.

(vi) In 2014, we reviewed our overall approach to measuring engagement, and adopted a revised index. The new index allows us to compare our results with other best-in-class organisations, and sets us a more stretching benchmark for employee engagement.

See reconciliation of non-GAAP measures to GAAP measures on page 133.

Business description (continued)

CHAIRMAN S STATEMENT

Diageo is a global leader in an industry that is growing and financially attractive. As we deliver on our future opportunities with our brands and geographic reach, we will continue to promote responsible drinking as part of a balanced lifestyle. This is at the centre of Diageo s purpose to celebrate life every day, everywhere.

Recommended final dividend per share
2016: 36.6p h5%
2015: 34.9p
Total dividend per share(i)
2016: 59.2p h5%
2015: 56.4p
Total shareholder return (%)
2016: h17%
2015: h2%

(i) Includes recommended final dividend.

A stronger, more competitive business

I am pleased with the performance Diageo has delivered this year, my last as Chairman. We are a stronger business and have returned to growth, and I would like to thank our Chief Executive, Ivan Menezes, and the Diageo Executive team for leading this progress. Diageo has positioned the consumer at the heart of the business, through marketing, innovation, local participation strategies and now has the consumer-facing culture required to succeed in today s competitive marketplace.

Diageo s opportunity for growth lies in positive global demographics and income growth, and the increasing penetration of spirits in emerging markets. Our footprint is made up of enviable positions in key geographies: in Africa and India, which together represent almost half of the global growth opportunity for our industry, and also a leading competitive position in North America, the biggest driver of developed market growth. In each of these markets we have a strong portfolio of brands, a proven capability in identifying and acting on consumer insights, leading skills in marketing and innovation, and a reputation for operating in a responsible and sustainable way.

Business description (continued)

Business development

Responsiveness and agility are key drivers of performance and the Diageo Executive team have enhanced these capabilities in several areas during the year, including: a continued focus on building a world-class sales organisation, investment in local production, and building the capability of local talent. Alongside the continued focus on organic growth, Diageo released £1 billion from the sale of non-core assets through a more proactive approach to managing our portfolio. This included the sale of our wine interests primarily the US-based Chateau and Estate Wines and the UK-based Percy Fox businesses to Treasury Wine Estates and the sale of non-core beer assets in Jamaica and Malaysia. These transactions followed the restructuring of our business in Southern Africa, having achieved our goal of leadership in spirits and growth in the beer business through the successful brandhouse joint venture with Heineken and Namibia Breweries. Diageo now has the scale to move to the next stage of growth in South Africa with a focused, simplified ownership structure.

Our investment in United Spirits Limited (USL) in India offers Diageo a transformational growth opportunity in one of the most attractive spirits markets in the world. India is set to become the second country after China with a population of more than one billion consumers of legal purchase age, with the expected growth of 18 19 million legal purchase age consumers per year.

Since Diageo became the principal shareholder in USL in India in July 2013, we have been determined to capture the significant growth opportunity of one of the largest spirits markets in the world. On 25 February 2016, Diageo announced that it had entered into an agreement with Dr Vijay Mallya under which he resigned from his position as Chairman and Non-Executive Director of USL and from the boards of other USL group companies. The agreement brought to an end the uncertainty relating to the governance of USL and put in place a five-year global non-compete (excluding the United Kingdom), non-interference and standstill arrangement with Dr Mallya.

Value creation and dividend

We measure our progress towards achieving our Performance Ambition through four areas: efficient growth, value creation, credibility and trust, and motivated people. We improved against each of our efficient growth metrics, and Ivan will discuss these in his statement. Our value creation measures also improved. Return on average invested capital (ROIC) was broadly flat against a decline last year and our total shareholder return (TSR) performance has improved on last year, up 17%.

Diageo targets dividend cover (basic earnings per share before exceptional items/ dividend per share) within the range of 1.8 to 2.2 times. The recommended final dividend for the year ended 30 June 2016 is 36.6 pence per share, an increase of 5% over the prior year in line with our policy to rebuild dividend cover to our targeted range. This brings the full year dividend to 59.2 pence per share and dividend cover to 1.5 times. Subject to approval by shareholders, the final dividend will be paid to shareholders on 6 October 2016. Payment to US ADR holders will be made on 12 October 2016.

Business description (continued)

Our role in society

Ensuring we make a positive contribution to society has always been a priority for Diageo and is at the core of our Performance Ambition. Doing so is good for our business, good for our communities and good for our consumers, and it is also true to our values and our people. The Diageo Code of Business Conduct defines these values and helps our employees live by them every day.

We put our resources and skills into hundreds of programmes around the world that reduce alcohol misuse, working closely with other stakeholders to raise awareness and change people s attitudes and behaviour. This forms part of our support of the industry s Global Producers Commitments to Reduce the Harmful Use of Alcohol, now in their fourth year, which are making a tangible difference in areas such as reducing drink driving and tackling underage drinking. We are also proud that we are supporting skills and social enterprise in the community, through programmes like Learning for Life, bringing opportunities for training and careers in the hospitality industry, and Plan W, empowering women through learning. And we are working hard, including with our suppliers, to reduce our environmental impact, setting ourselves new, challenging targets around water, carbon and waste for 2020. These priorities represent an interlinked, holistic approach to understanding and managing our impact on society.

Partnerships are key to delivering positive outcomes, and we have recently announced a global strategic partnership with the NGO WaterAid, building on our efforts to improve access to safe water across Africa. Also this year, through a partnership with the United States Agency for International Development, we have extended our work on skills as part of their programme in Colombia, and have set up a new farming supply chain in South Sudan, supporting livelihoods for hundreds of people. These partnerships, with more to follow, increase the reach of our programmes and help us contribute to the UN Global Goals.

Managing geo-political risks and opportunities

Political and other volatility continues to be a growing feature of the global economy and many of the markets in which we operate. We are continually improving our ability to understand and interpret it; and to evaluate and act against the potential risks and the opportunities for the business. We have integrated the work of our strategy, risk and public affairs teams and also improved our in-depth analysis of, and scenario planning for, priority markets. I am confident this will further enhance our resilience and growth potential.

It is too early to assess the implications of the United Kingdom s decision to leave the European Union for our business and operations over the longer term. We believe, however, that with our proven record of managing trade and operating globally, Diageo remains well placed to deliver its Performance Ambition.

Board changes

In November 2015, Deirdre Mahlan stepped down from the Board, as she moved from her role as Chief Financial Officer to take up the role of President, Diageo North America. I wish to thank Deirdre most sincerely for her excellent contribution to the Board and am pleased that she continues to play a pivotal role in leading this important business for Diageo. I am also delighted to have welcomed Kathryn Mikells to the Board as Chief Financial Officer, effective 9 November 2015. Kathryn joined us with a track record for capital discipline and for developing strong cost cultures to create efficient, agile organisations.

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Business description (continued)

Diageo announced on 18 May 2016, that Javier Ferrán would be appointed to the Board as a Non-Executive Director from 22 July 2016. On my retirement from the Board on 31 December 2016, Javier will take over as Chairman from 1 January 2017. On behalf of the Board, I would like to welcome Javier to Diageo and say how delighted I am that he has agreed to be the next Chairman. Through his roles at Lion Capital and Bacardi, Javier has a wealth of experience across the consumer goods sector and brings a strong set of skills to the role of Chairman.

A global leader

It has been an honour to serve as your Chairman. During the past eight years Diageo has become a truly global leader, with the assets and consumer-facing culture required to succeed. Diageo s values are deeply rooted in the principle of always doing the right thing. I am therefore confident that Diageo will continue to prosper, and succeed in delivering its Performance Ambition for all stakeholders around the world.

Dr Franz B Humer

Chairman

Business description (continued)

CHIEF EXECUTIVE S STATEMENT

This has been a year of significant progress for Diageo. Our performance demonstrates our focus on disciplined execution in everything we do. It is this focus which has delivered volume growth, our fifth consecutive year of organic margin improvement and strong cash conversion. I am confident we now have the platform to deliver sustainable growth.

Reported volume movement	**Organic volume movement**
2016: h0.1% 2015: h58%	2016: h1.3% 2015: i1%
Reported net sales movement	**Organic net sales movement**
2016: i3.0% 2015: h5%	2016: h2.8% 2015: flat
Reported operating profit movement	**Organic operating profit movement**
2016: h1.6% 2015: h3%	2016: h3.5% 2015: h1%

Performance

We have a clear strategy, consistently applied which has returned Diageo to both organic volume and organic net sales growth, delivered margin improvement and a strong cash performance.

This year we delivered organic volume up 1.3%, and organic net sales up 2.8%, with a stronger performance across both in the second half. The improvement in organic net sales has been driven by a return to volume growth, and a significant turnaround in US Spirits.

We are a more focused company following the disposal of non-core businesses. These disposals, along with adverse exchange, did however impact reported net sales, which declined 3.0%.

We have sustained positive price/mix despite a weaker pricing environment globally, and we have strengthened our leadership position and brought our brands to an increasing number of consumers. Our beer business has grown for seven successive quarters and continues to provide a strong distribution platform for our spirits ambitions in Africa.

All six global giant brands reported improved organic performance this year. Smirnoff s and Captain Morgan s improvement was driven by their performance in the United States combined with continued good growth in Europe. Guinness momentum continues with the brand growing in Africa and in Great Britain and Ireland, supported by innovations from The Brewers Project.

North America delivered organic net sales growth of 3%. This performance is in line with our expectations, with the biggest contributor to organic net sales improvement being that our biggest brands are back in growth.

Organic operating margin was up, driven by favourable mix effect and marketing efficiency. Operating profit grew 3.5% on an organic basis. On a reported basis, operating profit was up 1.6%, negatively impacted by exchange and disposals. Earnings per share before exceptional items was up 1% as profit growth, higher associates income and lower finance charges more than offset the impact of exchange and disposals.

Business description (continued)

We continue to drive productivity and cash conversion, delivering over 100% cash conversion for a second year and free cash flow improved by £134 million.

Business transformation

Over the past three years, my goal has been to put the consumer at the heart of our business. Consumer trends are moving faster than ever before and companies that can interpret and deliver quickly against consumer insights will thrive. The renewed momentum we have in the business is because we have the consumer-facing culture required to succeed and the agility to move at pace.

We have shifted the focus of our marketing to be centred on the recruitment and re-recruitment of consumers and on what drives consumption occasions, and we are introducing more rigour around the evaluation of the effectiveness of our spend. We continue to uphold the highest standards of responsibility, ensuring that all our marketing activities adhere to our strict Diageo Marketing Code.

Our role in society

We know that the issues that are most material to our business and stakeholders are:

- To create a positive role for alcohol in society
- Build thriving communities
- Reduce our environmental impacts.

Our strategy recognises that these issues are connected to our opportunities as a business, as well as the UN Global Goals launched in 2015. Our strategy also reflects how the elements of our value chain are interdependent, and how contributing to society, to communities, and to the environment strengthens our business.

We are passionate about ensuring alcohol has a positive role in society as part of a balanced lifestyle and are committed to tackling misuse. We do this through our implementation of the Global Producers Commitments to Reduce the Harmful Use of Alcohol, an unprecedented partnership of the world s largest alcohol companies coming together to tackle harmful drinking and, as an industry, we are seeing good progress against the targets we set ourselves for 2017. We welcome the trends we are seeing, such as consumers, and particularly young adults, drinking better not more, and the significant fall in the number of alcohol-related road traffic fatalities in many countries. This suggests that initiatives such as the multi-stakeholder approach advocated by the Global Producers   Commitments are having a positive impact.

Business description (continued)

We are not complacent and there is more to do. This year, we signed a strategic partnership agreement with the United Nations Institute for Training and Research (UNITAR) which, over the next two years, will work towards reducing traffic death and injuries, and improve road safety globally. I was proud to learn that we were approached to partner with UNITAR on the basis of our strong track record in supporting programmes and policies to address drink driving.

We are long-standing leaders in providing consumer information to help people make informed choices as part of a balanced lifestyle, and recently announced that Johnnie Walker Red Label will be the first global brand to provide per serving alcohol content and nutritional information on-pack. The new labels are designed to help consumers understand what s in their glass, and conform to the new Diageo Consumer Information Standards which came into force on 1 July 2016 and applies to all Diageo brands.

During the year, I also had the opportunity to launch our new DRINKiQ exhibit at the Guinness Storehouse in Dublin, Ireland, which is one example of our work to help people make informed decisions. This exhibit supports our global responsible drinking website, DRINKiQ.com, which was relaunched in January this year in 12 languages.

United Kingdom (UK) and the European Union (EU)

Following the UK s vote to leave the EU on 23 June 2016, we are working closely with government and our industry bodies to ensure our views are reflected in the transition process. We welcome the formation of a specialist international trade department, as it is

important for Diageo that the UK continues to benefit from open access to the EU as well as favourable international trade agreements. We believe that the outcome of this referendum will not have any material near-term impact on our business and we are well placed to continue our global business without significant disruption.

Our people

I would like to thank all our 32,000 people for their energy and dedication during the year. I am fortunate to lead a business with motivated, committed teams around the world. This was demonstrated by this year s annual employee Values Survey, which showed another year of improving engagement scores. Our results compare very well with those of other multinational companies, which I see as a real competitive advantage for Diageo.

Franz, in his statement, highlighted that Javier Ferrán, who joined the Board as a Non-Executive Director on 22 July 2016, will succeed him as Chairman on 1 January 2017. I would like to extend my thanks to Franz for his role in making Diageo the strong business it is today, and for his stewardship of the Diageo Board during his eight years as Chairman. I look forward to working with Javier as we build on Diageo s leadership position.

Outlook

Diageo has an enviable portfolio of brands, a truly global footprint and exposure to the fastest growing opportunities in our sector. The business is now able to respond faster to consumer insights, to shape trends and to deliver. We have been embedding a productivity culture, and are committed to sustainable efficiency in every area of our cost base to achieve £500 million in savings in the coming three years. Two-thirds of the efficiencies identified will be re-invested back into the business to drive growth. We are confident of achieving our objective of mid-single digit organic net sales growth, and in the three financial years ending 2019 delivering 100 basis points of organic operating margin improvement.

I am also confident that, with the consumer at the heart of our business, we will extend our leadership position and become one of the most trusted and respected consumer products companies in the world.

Ivan Menezes

Chief Executive

Business description (continued)

MARKET DYNAMICS

The global beverage alcohol market is large and diverse, with an estimated six billion[i] equivalent units of alcohol sold each year, generating £260 billion[i] of net sales. Like other consumer goods companies, beverage alcohol companies operate in a context of increasing stakeholder expectation with the added element of high, and highly diverse, levels of regulation. This environment presents opportunities for Diageo, with our global reach, our range of iconic brands across price tiers, and our approach to responsibility, sustainability, governance and ethics.

A market that is profitable and expanding

The beverage alcohol market is profitable, growing and attractive. Over the medium term, the industry is expected to grow overall in both volume and value. This is driven by consumer fundamentals including a rise in global incomes and a growing legal purchase age population. At the same time, margins remain significantly higher than for the overall consumer goods market.

The market for beverage alcohol is also highly diverse, with significant variations in culture and conditions between, and within, individual countries and regions. It is broadly split between developed and emerging markets, but each individual market presents different consumer dynamics and a different outlook. This diversity presents opportunities to agile businesses that can act on consumer insight and deliver trusted, competitive products.

Developed market opportunities

Typically, developed market populations are ageing and growing more slowly than those in emerging markets. Overall, levels of disposable income are higher, and consumers are often prepared to pay a premium for high quality brands with heritage and provenance. We see consumption occasions as opportunities to promote our international spirits brands, and, within those brands, to encourage consumers to trade up to our reserve portfolio.

Emerging market opportunities

Opportunities in emerging markets are driven by growth in both populations and wealth. Each country is different, and growth occurs at different price points depending on wealth and local conditions. An understanding of local consumers and the categories, brands and price points they are seeking is vital to accessing this growth.

The emerging middle-class plays an important role. These relatively affluent consumers already drink beer or local spirits, and the opportunity is to further access this existing consumption pool with our brands and to offer an opportunity to trade up to our international spirits brands for certain occasions. Outside this group, an estimated 25% of global alcohol consumption is from non-commercial or illicit products. Capturing market share in this consumer segment by offering legitimate, safe, attractive brands that deliver quality at an affordable price is an important opportunity.

There is also a significant and growing number of globally affluent consumers in the emerging markets, who represent an opportunity for our reserve portfolio.

Geo-political volatility

While there are positive medium-term prospects for the beverage alcohol industry, all consumer goods businesses, including beverage alcohol businesses, continue to navigate a volatile global economy. Our Chief Executive discusses the United Kingdom s referendum vote to leave the European Union on 23 June 2016 on page 34.

The slowdown in the Chinese economy, oil price shocks, persistent conflicts in many parts of the world, and terrorist attacks in Europe are just some of the events and trends that have contributed to an unpredictable environment. The resulting uncertainty, changes to economic variables such as exchange rates and commodity prices, and fluctuations in political security can all reduce consumer confidence and spending power.

Our broad participation across geographies, categories and price tiers acts as a natural hedge against individual market volatility, while we retain the flexibility in each market to respond quickly to local dynamics through our 21 market business model. Continued focus on local sourcing of ingredients, scenario planning and risk management, and management of foreign exchange exposure all work to protect the business against the challenges of volatility.

(i) Diageo estimates.

Business description (continued)

Earning the trust and respect which support performance

Our ambition is to be one of the best performing, most trusted and respected consumer products companies in the world ensuring we play a positive role in society is at the heart of this. Operating in a responsible and sustainable way every day, everywhere, not only helps us be a trusted and respected business, it also helps drive our performance.

The launch of the UN Global Goals in September 2015 and the Paris Agreement on climate change in December 2015 represent an important milestones in what was arguably an unprecedented period of concerted action to address global issues. These initiatives both reflect and drive a wider trend in which stakeholders of all kinds, including consumers and in particular millennials, have increasing expectations that businesses must create value beyond their economic contribution.

Delivering measurable social benefits, tackling alcohol misuse, demonstrating good corporate governance and reducing environmental impacts in line with a clear sustainable development strategy are, more than ever, business imperatives which drive performance.

We have built on our long history of sustainability and responsibility programmes by developing a strategy that is aligned with the UN Global Goals and Paris Agreement and focuses on the three areas that are most material to us and our stakeholders: creating a positive role for alcohol in society; building thriving communities; and reducing our environmental impact. We have set ourselves targets to achieve in each of these areas by 2020.

Creating a positive role for alcohol in society

Alcohol has been enjoyed for centuries and is part of celebrations around the world. Whether people drink beer, wine or spirits, alcohol is alcohol, and the vast majority of people who choose to enjoy it, do so moderately and responsibly. We respect that some people choose not to drink, and recognise that the misuse of alcohol can be harmful to individuals and society. Putting our resources and skills into programmes that prevent and reduce alcohol misuse and working with others to raise awareness and change attitudes and behaviour is good for society and good for the long-term future of our business.

Support for effective alcohol policies

The beverage alcohol industry is one of the most highly regulated in the world, with regulation varying widely between countries and jurisdictions. Diageo complies with all laws and regulations, wherever we operate, as a minimum requirement. We advocate effective alcohol policies that are evidence-based, account for drinking patterns, target at-risk groups, treat all forms of alcohol equally, and involve all stakeholders. Such policies include mandating a minimum legal purchasing age of not less than 18; a maximum blood alcohol concentration (BAC) level for drivers of no more than 0.08mg; and lower BACs for novice and commercial drivers.

However, we advocate against measures that are not based on evidence or are likely to have unintended consequences in what are often complex markets. A particular concern is policies that inadvertently push consumers towards unregulated or illicit alcohol, which can be a risk to public health.

Industry collaboration

We are one of 12 global producers of beer, wine and spirits which, in 2013, launched a set of commitments designed to support Member States implementation of the World Health Organization s (WHO) global strategy to Reduce the Harmful Use of Alcohol. These commitments focus on reducing underage drinking, strengthening and expanding marketing codes of practice, providing consumer information and responsible product innovation, reducing drink driving, and enlisting the support of retailers to reduce harmful drinking. Diageo goes beyond industry collaboration and works in partnership with governments, law enforcement, educators and civil society to support campaigns to reduce harmful drinking.

Business description (continued)

Building thriving communities

We can add significantly to the contribution we make to communities through direct and indirect employment, taxes, and community investment efforts by working to leverage the economic and social impact of our entire value chain. Helping communities thrive within the supply chain also builds resilience within our business. We build trust with government and other stakeholders by focusing on human rights throughout our value chain, and through local sourcing initiatives, particularly in Africa where we aim to source 80% of agricultural materials for use in local markets by 2020. This helps secure supply, and delivers wider benefits to the local community.

Climate change and water scarcity

All businesses, particularly those that rely on agricultural raw materials, are exposed to a variety of environmental issues associated with climate change, such as droughts, floods and biodiversity loss. These issues can affect a business operations directly, or indirectly as a result of their impact on the wider value chain and associated communities. Water scarcity is particularly important to us because water is our main ingredient. Our Water Blueprint, launched in April 2015, defines our strategic approach to water stewardship, and focuses specifically on stewardship in the water-stressed areas shown in the map below.

Trust and transparency

As part of the process of creating value, we are increasingly expected to be transparent about our most material social and environmental issues. This is delivered through reporting frameworks such as the International Integrated Reporting Framework, the Global Reporting Initiative Guidelines, and the United Nations Global Compact principles. We report against all three of these, and believe that this regulation and scrutiny can be an advantage to companies with good corporate governance and the right approach to sustainability and responsibility.

Business description (continued)

HOW WE WILL DELIVER OUR PERFORMANCE AMBITION

Diageo s performance drivers and sustainability and responsibility priorities are key to achieving our aims. Each of our 21 markets focuses on the priorities that are most relevant to driving growth and creating shared value in that market.

Our six performance drivers

1 Strengthen and accelerate growth of our premium core brands

Our premium core brands are sold in more than 180 countries around the world. They are enjoyed by consumers in developed markets and have wide appeal in emerging markets. They include iconic brands Johnnie Walker, Smirnoff, Captain Morgan and Baileys.

2 Win in reserve in every market

Seven years ago we shifted our approach to luxury spirits and made reserve a strategic priority. The results demonstrate what building capability and having focus can do.

3 Innovate at scale to meet new consumer needs

We are a company built and sustained through innovation, which gives us the drive to create new products, new categories and new experiences for consumers. We are the leaders in our industry, inventing today for tomorrow, staying on the edge of, and anticipating, consumer behaviour.

4 Build and then constantly extend our advantage in route to consumer

We have put the consumer at the centre of our business. Our route to consumer transformation has driven a clear understanding of what success looks like in a store, in a bar and in the hands of our consumers. We now have the consumer-facing culture to succeed.

5 Drive out costs to invest in profitable growth

We want to continuously get more efficient and effective in everything we do to further enable us to invest in growth for our business, our people and our brands. We have set a goal to deliver productivity savings of £500 million over the next three years, with two-thirds of this re-invested for growth.

6 Ensure we have the talent to deliver our Performance Ambition

We employ bright, collaborative people at all levels in our business, and must continue to do so if we are to achieve our aims. Our people, culture and values are what will make the difference.

Our three sustainability and responsibility priorities

1 Create a positive role for alcohol in society

We are committed to maintaining our leadership position by ensuring we make a positive contribution to society and work to tackle alcohol misuse alongside the industry. We will continue to operate in a responsible way every day, everywhere, to remain a trusted and respected business and drive our performance. We remain focused on delivering the five Global Producers Commitments and our own stretching 2020 targets.

2 Building thriving communities

We create value for millions of people as a buyer of goods and services, as an employer, as corporate citizens, and as producers of some of the world s best-loved brands. We want to continue to help those communities thrive, by making Diageo a great, safe, and diverse place to work, by building sustainable supply chains, and through programmes that empower communities and individuals.

3 Reducing our environmental impacts

We re dependent on the natural resources we share with the communities around us, and with the wider world. We want to use those resources responsibly, and make a net positive contribution to the environment through our operations and supply chain. We are working to reduce our impacts in the areas of water, carbon, packaging, and waste.

Business description (continued)

Risk factors

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

Risks related to the global economy

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

Diageo may be adversely affected by economic developments in any of the countries where it has distribution networks, production facilities or marketing companies. In particular, Diageo s business is dependent on general economic conditions in its most important markets, including the United States and the countries that form the European Union. If there is a significant deterioration in the economic conditions in any of Diageo s important markets, it may contribute to reduced demand for Diageo s products, reduction in consumer confidence and spending levels generally, customer destocking, negative impacts on Diageo s customer, supplier or financial counterparties or a reduction in the availability of, or an increase in the cost of financing to, Diageo. Diageo s business is also affected by other economic developments such as the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Any of these developments may have a material adverse effect on Diageo s business and financial results.

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

Many of these risks are heightened, or occur more frequently, in emerging 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 are conducted in emerging markets, and emerging markets represented approximately 42% of Diageo s net sales for the year ended 30 June 2016. Emerging markets are also generally exposed to relatively higher risk of liquidity constraints, inflation, devaluation, price volatility, currency convertibility, sovereign default, as well as additional legal and regulatory risks and uncertainties. Any of these factors may affect Diageo disproportionately or in a different manner as compared to its competitors, depending on Diageo s specific exposure to any particular emerging markets, and could have a material adverse effect on Diageo s business and financial results.

The results of the United Kingdom s referendum to leave the European Union may result in economic and political uncertainty and complexity, have a negative effect on economic conditions in Europe and adversely

affect Diageo s business and financial performance

Diageo is headquartered in the United Kingdom and has significant production and investment in Scotland. In June 2016, the United Kingdom voted by referendum to leave the European Union. Although it remains too early to assess the potential impact of this vote for Diageo, may lead to a sustained period of economic and political uncertainty and complexity until the detailed terms of the United Kingdom s exit from the European Union are finalised and as the United Kingdom negotiates and concludes any successor trading arrangement with other countries. The decision in the referendum that the United Kingdom should leave the European Union could also negatively impact economic conditions in Europe more generally and may have adverse effects on Diageo s business and financial performance. For instance, the referendum may contribute to volatility in exchange rates, risk to supply chains across the EU, restrictions on the mobility of employees, possible changes to customs duties and tariffs and/or industry specific requirement and regulations.

Business description (continued)

The United Kingdom s referendum vote to leave the European Union could also have further implications for the constitutional makeup of the United Kingdom and issues around independence and devolved government in Scotland and Northern Ireland, which could result in a further period of political uncertainty in the United Kingdom and may otherwise adversely affect Diageo s business and financial results, particularly in light of Diageo s substantial inventory and operations located in Scotland.

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 luxury or 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 business and financial results. The competitive position of Diageo s brands could also be affected adversely by any failure by Diageo to achieve consistent, reliable quality in its products or in its service levels to customers.

In addition, the social acceptability of Diageo s products may decline due to 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 business and financial results.

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 a company complies with international best practice guidelines. Changes in tax law (including tax rates), tax treaties, accounting policies and accounting standards, including as a result of the Organisation for Economic Co-Operation and Development s review of base erosion and profit shifting and the European Union s anti-tax abuse measures, could also result in litigation or other actions by relevant tax authorities. Any such litigation or other actions may result in damages, penalties or fines as well as reputational damage to Diageo or its brands, and as a result, Diageo s business and financial results could be materially adversely affected. For additional information with respect to legal proceedings, see Additional information for shareholders Legal proceedings and note 18 to the consolidated financial statements.

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

In the event that 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 all of Diageo s products and it is also a limited resource in many parts of the world.

Business description (continued)

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 business and financial results.

An increase in the cost of production 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, by increases in energy costs resulting in higher transportation, freight and other operating costs or by inflation. 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, tax and regulatory environment could increase Diageo s costs and liabilities or limit its business activities

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

Regulatory authorities under whose laws Diageo operates may also have enforcement power that can subject the group to actions such as product 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 and this may be subject to change following the Organisation for Economic Co-Operation and Development s review of base erosion and profit shifting and the European Union s anti-tax abuse measures. Changes in tax law (including tax rates), tax treaties, accounting policies and accounting standards could increase the cost of doing business and lead to rise in Diageo s effective tax rate.

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

Failure by Diageo to comply with anti-corruption laws or failure of Diageo s related internal policies and procedures to comply with applicable law may have a material adverse effect on Diageo s business and financial results

Diageo operates a global business, including in certain countries which are reported to have high levels of corruption risk (i.e., countries in which the Transparency International index of perceived levels of public sector corruption is less than or equal to fifty). There is increasing scrutiny and enforcement by regulators in many jurisdictions of anti-bribery laws, including pursuant to the US Foreign Corrupt Practices Act and the UK Bribery Act. Such enforcement has been enhanced by applicable regulations in the United States, which offer substantial financial rewards to whistleblowers for reporting information that leads to monetary fines.

Business description (continued)

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 Diageo s personnel, including senior management, from its business. Adverse publicity, governmental scrutiny and legal and enforcement proceedings can also have a negative impact on Diageo s reputation and on the morale and performance of its employees. To the extent that violations of anti-corruption laws and/or Diageo s internal policies and procedures are found, or Diageo s internal policies and procedures are found not to comply with applicable law, 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 or adapt to a changing media environment

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

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

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

Diageo faces competition that may reduce its market share and margins

Diageo faces substantial competition from several international companies as well as 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, the beverage industry has been experiencing continuing consolidation among major global producers, as evidenced by several business combinations of substantial value carried out by significant competitors in 2015. Consolidation is also taking place among Diageo s customers in many countries. These trends may lead to stronger competitors, increased competitive pressure from customers, negative impacts on Diageo s distribution network, downward pressure on prices, predatory marketing tactics by Diageo s competitors and/or a decline in Diageo s market share in any of these categories. Adverse developments in economic conditions or declines in demand or consumer spending may also result in intensified competition for market share, with potentially adverse effects on sales volume and price. Any of these factors may adversely affecting Diageo s results and growth potential.

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

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

Business description (continued)

It is also possible that Diageo s business strategies could give rise to further business combinations, acquisitions, disposals, joint ventures and/or partnerships (including any associated financing or the assumption of actual or potential liabilities, depending on the transaction contemplated). There can be no assurance that any transaction 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. Acquisitions may also expose Diageo to liabilities it may not be aware of at the time of the acquisition, for example if acquired companies and business do not act, or have not acted, in compliance with applicable laws and regulations. The current and ongoing issues in USL detailed in note 18 to the consolidated financial statements provide an example of integration and legal challenges.

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

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

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 business may be adversely affected by increased costs or shortages of talent

Diageo s business could be adversely affected by labour or skill shortages or increased labour costs due to increased competition for employees, higher employee turnover or increased employee benefit costs. Diageo s success is dependent on the capability of its employees. There is no guarantee that Diageo will continue to be able to recruit, retain and develop 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 Diageo s operations and could adversely affect Diageo s business and financial results.

Business description (continued)

Diageo may be adversely affected by disruption to production facilities, business service centres or information systems (including cyber-attack)

Diageo would be affected if there was a catastrophic failure of its major production facilities or business service centres. Diageo operates production facilities around 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 and/or injury or loss of life. 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, destruction resulting from negligence or the acts of third parties, or failure of information systems or data infrastructure.

As with all large systems, Diageo s information systems could be subject to cyber-attack 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 fluctuations in exchange rates and fluctuations in interest rates

Diageo is engaged in an international business that operates in, and makes sales into, countries with different currencies, while its financial results are presented in sterling. As a result, Diageo is subject to foreign currency risk due to exchange rate movements, which will affect the sterling value of its transactions, as well as the translation to sterling of the results and underlying net assets of its operations. In particular, approximately 31.9% of Diageo s net sales in the year ended 30 June 2016 were in US dollars, approximately 11% were in euros and approximately 14.9% were in sterling. Movements in exchange rates used to translate foreign currencies into sterling may have a significant impact on Diageo s reported results of operations from year to year. Exchange rate fluctuations may also expose Diageo to increased interest expense on borrowings denominated in currencies which appreciate against the sterling. As a result, Diageo s business and financial results may be adversely affected by fluctuations in exchange rates. Diageo may also be adversely impacted by fluctuations in interest rates, mainly through increased interest expense.

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

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

Business description (continued)

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

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

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

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. In addition, punitive damages in actions brought in the United States or elsewhere may be unenforceable in England and Wales.

Business description (continued)

Cautionary statement concerning forward-looking statements

This document contains forward-looking statements. These statements can be identified by the fact that they do not relate only to historical or current facts. In particular, forward-looking statements include all statements that express forecasts, expectations, plans, outlook and projections with respect to future matters. Examples of forward-looking statements include statements regarding exchange rates, interest rates, the availability or cost of financing to Diageo, social, political and environmental developments, consumer trends, preferences and purchasing power, overall market trends, the consequences of the referendum on the UK s membership in the EU, and their impact on Diageo s business operations and financial condition; statements made about Diageo s strategy, trends in results of operations, margins, and growth rates and growth rate objectives; estimates of Diageo s cash flows, effective interest rates, effective tax rates, cost savings, results of hedging instruments, cash contributions in post-employment plans, impacts of exchange rates, dividend policies and shareholders return objectives, executive compensation levels, outcomes of litigation, and the impact of new accounting policies on Diageo s consolidated results and financial position. 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:

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

the results of the decision in the United Kingdom s referendum on 23 June 2016 to leave the European Union, which may lead to a sustained period of economic and political uncertainty and complexity until the detailed terms of the United Kingdom s exit from the European Union are finalised and as the United Kingdom negotiates and concludes any successor trading arrangements with other countries, and which may also negatively impact economic conditions in Europe more generally which could have an adverse impact on Diageo s business operations and financial performance;

changes in consumer preferences and tastes, including as a result of changes in demographic and social trends, public health regulations and travel, vacation or leisure activity patterns, or as a result of contamination, counterfeiting or other circumstances which could harm the integrity or sales of Diageo s brands;

any litigation or other similar proceedings (including with tax, customs and other regulatory authorities), including that 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 related regulations and other measures to address climate change, including any resulting impact on the cost and supply of water;

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

legal and regulatory developments, including changes in regulations regarding production, product liability, distribution, importation, labelling, packaging, consumption, advertising and data privacy; changes in tax law (including tax treaties), 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 consequences of any failure by Diageo to comply with anti-corruption and other laws and regulations or any failure of Diageo s related internal policies and procedures to comply with applicable law;

Business description (continued)

- ability to maintain Diageo s brand image and corporate reputation or to adapt to a changing media environment, 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, including as a result of actions by increasingly consolidated competitors, that could negatively impact Diageo s market share, distribution network, costs or pricing;
- the effects of Diageo s business strategies, including in relation to expansion in emerging markets and growth of participation in international premium spirits markets, 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 benefit from its strategy, including its ability to expand into new markets, to complete and benefit from existing or future business combinations or other transactions, to implement cost saving and productivity initiatives or to forecast inventory levels successfully;
- 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 or information systems (including cyber-attack), existing or future;
- fluctuations in exchange rates and interest rates, which may impact the value of transactions and assets denominated in other currencies, increase the cost of financing or otherwise affect Diageo s financial results;
- movements in the value of the assets and liabilities related to Diageo s pension funds;
- renewal of supply, distribution, manufacturing or licence agreements (or related rights) and licences on favourable terms or at all when they expire; and
- failure of Diageo 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 principal risks set out in the Risk factors section above. Any forward-looking statements made by or on behalf of Diageo speak only as of the date they are made. Diageo does not undertake to update forward-looking statements to reflect any changes in Diageo s expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that Diageo may make in any documents which it publishes and/or files with the US Securities and Exchange Commission (SEC). All readers, wherever located, should take note of these disclosures.

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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.

Business review

Operating results 2016 compared with 2015

GROUP FINANCIAL REVIEW

This is a good set of results and reflects better execution across the business. Our improved performance was driven by the return to growth of each of our six global brands and our US spirits business. The delivery of volume growth; 19bps of organic margin expansion; increased free cash flow; and the disposal of £1 billion in non-core assets, comes from driving efficiency in every aspect of the business and across every expense item to fuel future growth. I believe this consistent approach to growth, productivity and cash will drive better value creation.

Kathryn Mikells,

Chief Financial Officer

Net sales declined 3.0% as organic growth in each region and acquisitions were more than offset by adverse exchange and disposals
Organic results improved with volume growth of 1.3%
Organic net sales growth of 2.8%
Operating profit grew 1.6% with organic growth, lower exceptional operating charges and acquisitions partially offset by adverse exchange and disposals
Organic operating profit growth of 3.5%
Net cash from operating activities was flat, £2.5bn
Free cash flow continued to be strong at £2.1bn up £134 million on last year
Basic eps of 89.5 pence was down 6% as lower exceptional income reduced basic eps by 6.1 pence
Eps before exceptional items increased 1% to 89.4 pence

(i) Excluding corporate net sales of £36 million (2015 - £80 million).
(ii) Excluding corporate and ISC costs of £150 million (2015 - £139 million).
(iii)

Excluding exceptional operating charges of £167 million (2015 - £269 million) and corporate and ISC costs before exceptional items of £150 million (2015 - £123 million).

Summary financial information		**2016**	**2015**
Volume	EUm	**246.4**	246.2
Net sales	£million	**10,485**	10,813
Marketing	£million	**1,562**	1,629
Operating profit before exceptional items	£million	**3,008**	3,066
Exceptional operating items	£million	**(167)**	(269)
Operating profit	£million	**2,841**	2,797
Share of associates and joint ventures profit after tax	£million	**221**	175
Non-operating items	£million	**123**	373
Net finance charges	£million	**327**	412
Tax rate	%	**17.4**	15.9
Tax rate before exceptional items	%	**19.0**	18.3
Profit attributable to parent company s shareholders	£million	**2,244**	2,381
Basic earnings per share	pence	**89.5**	95.0
Earnings per share before exceptional items	pence	**89.4**	88.8
Recommended full year dividend	pence	**59.2**	56.4

Business review (continued)

Growth by region	Volume %	Net Sales %	Marketing %	Operating profit %
North America	(1)	3		9
Europe, Russia and Turkey		(3)	4	2
Africa	19	(1)	(3)	(32)
Latin America and Caribbean	(5)	(16)	(14)	(69)
Asia Pacific	(3)	(6)	(13)	112
Diageo(i)		**(3)**	**(4)**	**2**

Organic growth by region	Volume %	Net sales %	Marketing %	Operating profit(ii) %
North America	**1**	**3**	**(2)**	**4**
Europe, Russia and Turkey	**2**	**4**	**5**	**6**
Africa	**9**	**3**	**1**	**(11)**
Latin America and Caribbean	**(2)**	**1**		**(1)**
Asia Pacific		**2**	**(12)**	**13**
Diageo(i)	**1**	**3**	**(2)**	**3**

(i) Includes Corporate. Corporate net sales in the year ended 30 June 2016 were £36 million (2015 £80 million) a decrease of 55% due to the sale of the Gleneagles Hotel in June 2015. Net operating charges before exceptional items were £150 million (2015 £123 million), increased due to costs related to the productivity programme, the reinvestment of the savings delivered by the organisational review announcement in January 2014, and increase in the annual incentive plan costs. These increases were partially offset by increased profit on land sales.

(ii) Before exceptional items.

KEY PERFORMANCE INDICATORS

Net sales growth (£ million)

Net sales declined 3.0%. Organic net sales growth of 2.8% driven by volume and mix.

(i) Exchange rate movements reflect the translation of prior year reported results at current exchange rates.
(ii) Diageo has reflected the full year impact of an accounting change USL made in its most recent quarterly results to account for sales by third party manufacturers on a net sales basis. See page 54 for more details.

Net sales declined 3.0%. Adverse impact of exchange and disposals reduced net sales by 5.3%. These movements were partially offset by organic net sales growth of 2.8% with volume growth of 1.3% and positive price/mix, primarily mix.

Net sales and operating profit were impacted by adverse exchange movements driven by the weakness of a number of currencies against sterling, in particular the Nigerian naira, the South African rand, the Venezuelan bolivar, the Brazilian real and the Turkish lira, partially offset by the strengthening of the US dollar.

Business review (continued)

Operating profit growth (£ million)

Operating profit growth of 1.6%. Organic operating profit growth of 3.5%.