DIAGEO PLC
Form 20-F
September 11, 2009

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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 2009

Commission file number 1-10691

DIAGEO plc

(Exact name of Registrant as specified in its charter)

England

(Jurisdiction of incorporation or organisation)

8 Henrietta Place, London, W1G 0NB, England

(Address of principal executive offices)

Paul Tunnacliffe Company Secretary
Tel: +44 20 7927 5200 Fax: +44 20 7927 4600
8 Henrietta Place, London W1G 0NB, England

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

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

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

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 2,821,857,259 ordinary shares of $28^{101}/_{108}$ pence each.

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

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

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

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

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

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

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

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

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

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2009 of Diageo plc (the 2009 Form 20-F). Reference is made to the cross reference to Form 20-F table on pages 219 to 221 hereof (the Form 20-F Cross reference table). Only (i) the information in this document that is referenced in the Form 20-F Cross reference table, (ii) the cautionary statement concerning forward-looking statements on pages 26 and 27 and (iii) the Exhibits, shall be deemed to be filed with the Securities and Exchange Commission for any purpose, including incorporation by reference into the Registration Statements on Form F-3 File Nos. 333-110804, 333-132732 and 333-153488 and Registration Statements on Form S-8 File Nos. 333-153481 and 333-154338, and any other documents, including documents filed by Diageo plc pursuant to the Securities Act of 1933, as amended, which purport to incorporate by reference the 2009 Form 20-F. Any information herein which is not referenced in the Form 20-F Cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference.

Contents

Contents (continued)

This is the Annual Report on Form 20-F of Diageo plc for the year ended 30 June 2009. 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 2009, 2008 or 2007. KPMG Audit Plc has reported on those accounts; their audit reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 237 (2) or (3) of the Companies Act 1985 in respect of the accounts for the years ended 30 June 2008 or 2007 nor a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for the year ended 30 June 2009. The accounts for 2008 and 2007 have been delivered to the registrar of companies and those for 2009 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 26 and 27.

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 document.

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

The brand ranking information presented in this report, when comparing volume information with competitors, has been sourced from data published during 2009 by Impact Databank. Market data information is taken from industry sources in the markets in which Diageo operates.

Information presented

Percentage movements in this document are organic movements unless otherwise stated. These movements and operating margins are before exceptional items. Commentary, unless otherwise stated refers to organic movements. Share, unless otherwise stated, refers to volume share. See the 'Business review' for an explanation of organic movement calculations. The financial statements for the year ended 30 June 2009 have been prepared in accordance with IFRS.

The content of the company's website (www.diageo.com) should not be considered to form a part of or be incorporated into this Form 20-F.

Historical information

The following table presents selected consolidated financial data for Diageo prepared under 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) for the five years ended 30 June 2009 and as at the respective year ends. References to IFRS hereafter should be construed as references to both IFRS as adopted by the EU and IFRS as issued by the IASB, unless otherwise indicated. Consolidated financial data was prepared in accordance with IFRS for the first time for the year ended 30 June 2006, following the implementation of IFRS by the group, and the data for the year ended 30 June 2005 was adjusted accordingly to IFRS. The data presented below has been derived from Diageo's audited consolidated financial statements.

						Year ended 30 June
	Notes	**2009**	**2008**	**2007**	**2006**	**2005**
		£ million	**£ million**	**£ million**	**£ million**	**£ million**
Income statement data						
Sales		**12,283**	10,643	9,917	9,704	8,968
Operating profit	2	**2,443**	2,226	2,159	2,044	1,731
Profit for the year						
Continuing operations	2,3	**1,723**	1,571	1,417	1,965	1,326
Discontinued operations	4	**2**	26	139		73
Total profit for the year	2,3	**1,725**	1,597	1,556	1,965	1,399
		pence	**pence**	**pence**	**pence**	**pence**
Per share data						
Dividend per share	5	**36.10**	34.35	32.70	31.10	29.55
Earnings per share						
Basic						
Continuing operations		**65.1**	58.3	50.2	67.2	42.8
Discontinued operations		**0.1**	1.0	5.2		2.4
Basic earnings per share		**65.2**	59.3	55.4	67.2	45.2
Diluted						
Continuing operations		**64.9**	57.9	49.9	66.9	42.8
Discontinued operations		**0.1**	1.0	5.1		2.4
Diluted earnings per share		**65.0**	58.9	55.0	66.9	45.2
		million	**million**	**million**	**million**	**million**
Average shares		**2,485**	2,566	2,688	2,841	2,972

						As at 30 June
		2009	**2008**	**2007**	**2006**	**2005**
		£ million	**£ million**	**£ million**	**£ million**	**£ million**
Balance sheet data						
Total assets		**18,096**	16,027	13,956	13,927	13,921
Net borrowings	6	**7,419**	6,447	4,845	4,082	3,706
Equity attributable to the parent company's equity shareholders		**3,221**	3,498	3,972	4,502	4,459
Called up share capital	7	**797**	816	848	883	883

Historical information (continued)

Notes to the historical information

1 Accounting policies The financial statements for the four years ended 30 June 2009 were prepared in accordance with IFRS. Extracts from the income statement and balance sheet as of and for the year ended 30 June 2005 presented here have been restated under IFRS as applied by the group from financial information previously reported in accordance with UK GAAP. The group adopted the provisions of *IAS 39 Financial instruments: recognition and measurement* from 1 July 2005. As permitted under *IFRS 1 First-time adoption of International Financial Reporting Standards,* financial instruments in the year ended 30 June 2005 remain recorded in accordance with previous UK GAAP accounting policies, and the adjustment to IAS 39 was reflected in the consolidated balance sheet at 1 July 2005. The IFRS accounting policies applied by the group to the financial information in this document are presented in 'Accounting policies of the group' in the financial statements.

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

	Year ended 30 June				
	2009 £ million	**2008 £ million**	**2007 £ million**	**2006 £ million**	**2005 £ million**
Exceptional items (charged)/credited to operating profit					
Global restructuring programme	**(166)**				
Restructuring of Irish brewing operations	**(4)**	(78)			
Disposal of Park Royal property			40		
Park Royal brewery accelerated depreciation					(29)
Seagram integration costs					(30)
Thalidomide Trust					(149)
Disposal of other property					7
	(170)	(78)	40		(201)
Other exceptional items					
Gain on disposal of General Mills shares				151	221
Gains/(losses) on disposal and termination of businesses		9	(1)	6	(7)
		9	(1)	157	214
Tax exceptional items					
Tax credit in respect of exceptional operating items	**37**	8			58
Tax credit in respect of other exceptional items				2	20
Tax credit in respect of settlements agreed with tax authorities	**155**			313	
	192	8		315	78
Total exceptional items	**22**	(61)	39	472	91

3 Taxation The taxation charge deducted from income for the year was £292 million (2008 £522 million; 2007 £678 million; 2006 £181 million; 2005 £599 million). Included in the taxation charge were the following items: in the year ended 30 June 2009, a net tax credit of £155 million in

Historical information (continued)

respect of settlements agreed with tax authorities which gave rise to changes in the value of deferred tax assets and tax provisions, and a tax credit of £37 million on exceptional items; in the year ended 30 June 2008, a tax credit of £8 million on exceptional operating items; in the year ended 30 June 2007, a net tax charge of £24 million from intra group reorganisations of brand businesses, a reduction in the carrying value of deferred tax assets primarily following a reduction in tax rates of £74 million, and a provision for settlement of tax liabilities related to the GrandMet/Guinness merger of £64 million; in the year ended 30 June 2006, an exceptional tax credit of £315 million arose principally as a consequence of the agreement with fiscal authorities of the carrying values of certain brands, which resulted in an increase to the group's deferred tax assets of £313 million; and in the year ended 30 June 2005, there were £58 million of tax credits on exceptional operating items and £20 million of tax credits on exceptional business disposals.

4 **Discontinued operations** Discontinued operations in the years ended 30 June 2009, 30 June 2008, 30 June 2007 and 30 June 2005 are adjustments in respect of the former quick service restaurants business (Burger King, sold 13 December 2002) and the former packaged food business (Pillsbury, sold 31 October 2001).

5 **Dividends** The board expects that in each year Diageo will pay an interim dividend in April and a final dividend in October. 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 information provided in the tables above and below represents the amounts payable in respect of the relevant financial year, and the final dividend amount included in these tables represents the dividend proposed by the directors but not approved by the shareholders and therefore is not reflected as a deduction from reserves at the balance sheet date.

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

						Year ended 30 June
		2009	**2008**	**2007**	**2006**	**2005**
		pence	**pence**	**pence**	**pence**	**pence**
Per ordinary share	Interim	**13.90**	13.20	12.55	11.95	11.35
	Final	**22.20**	21.15	20.15	19.15	18.20
	Total	**36.10**	34.35	32.70	31.10	29.55
		$	**$**	**$**	**$**	**$**
Per ADS	Interim	**0.82**	1.05	0.99	0.84	0.85
	Final	**1.47**	1.46	1.64	1.43	1.29
	Total	**2.29**	2.51	2.63	2.27	2.14

Note: Subject to shareholder approval, the final dividend for the year ended 30 June 2009 will be paid on 19 October 2009 and payment to US ADR holders will be made on 23 October 2009. In the table above, an exchange rate as of 30 June 2009 of £1 = $1.65 has been used to calculate this dividend, but

Historical information (continued)

the exact amount of the payment to US ADR holders will be determined by the rate of exchange on 19 October 2009.

6 Definitions Net borrowings are defined as total borrowings (short term borrowings and long term borrowings plus finance lease obligations), interest rate fair value hedging instruments and foreign currency swaps and forwards, less cash and cash equivalents and other liquid resources. Other liquid resources represent amounts with an original maturity date of greater than three months but less than one year.

7 Share capital The called up share capital represents the par value of ordinary shares of $28^{101}/_{108}$ pence in issue. There were 2,754 million ordinary shares in issue and fully paid up at the balance sheet date (2008 2,822 million; 2007 2,931 million; 2006 3,051 million; 2005 3,050 million). Of these, 23 million are held in employee share trusts (2008 26 million; 2007 33 million; 2006 42 million; 2005 43 million) and 255 million are held as treasury shares (2008 279 million; 2007 281 million; 2006 252 million; 2005 86 million). Shares held in employee share trusts and treasury shares are deducted in arriving at equity attributable to the parent company's equity shareholders.

During the year ended 30 June 2009, the company repurchased 38 million ordinary shares as part of its share buyback programmes at a cost including fees and stamp duty of £354 million (2008 97 million ordinary shares, cost of £1,008 million; 2007 141 million ordinary shares, cost of £1,405 million; 2006 164 million ordinary shares, cost of £1,407 million; 2005 94 million ordinary shares, cost of £710 million) and 6 million ordinary shares to be held as treasury shares for hedging share scheme grants provided to employees during the year at a cost of £63 million (2008 11 million ordinary shares, cost of £124 million; 2007 9 million ordinary shares, cost of £82 million; 2006 2 million ordinary shares, cost of £21 million; 2005 nil, £nil). In addition the company utilised 0.3 million ordinary shares held as treasury shares with an historical purchase cost of £3 million to satisfy options exercised by employees during the year (2008 1 million ordinary shares, cost of £11 million; 2007 1 million ordinary shares, cost of £10 million; 2006 and 2005 nil, £nil).

8 Exchange rates A substantial portion of the group's assets, liabilities, revenues and expenses are denominated in currencies other than pounds sterling. For a discussion of the impact of exchange rate fluctuations on the company's financial condition and results of operations, see 'Business review Risk management'.

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

	Year ended 30 June				
	2009	**2008**	**2007**	**2006**	**2005**
	$	**$**	**$**	**$**	**$**
Year end	**1.65**	1.99	2.01	1.85	1.79
Average rate(a)	**1.60**	2.01	1.93	1.78	1.86

Historical information (continued)

The following table shows period end, high, low and average US dollar/pound sterling noon buying exchange rates by month, for the six month period to 31 August 2009, expressed in US dollars per £1.

						2009
	August	July	June	May	April	March
	$	$	$	$	$	$
Month end	**1.63**	**1.67**	**1.65**	**1.62**	**1.48**	**1.43**
Month high	**1.70**	**1.67**	**1.66**	**1.62**	**1.50**	**1.47**
Month low	**1.62**	**1.60**	**1.60**	**1.49**	**1.44**	**1.37**
Average rate(b)	**1.65**	**1.64**	**1.64**	**1.54**	**1.47**	**1.42**

The average exchange rate for the period 1 to 7 September 2009 was £1=$1.63 and the noon buying rate on 7 September 2009 was £1=$1.63.

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

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

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

Business description

Diageo is the world's leading premium drinks business with a collection of international brands. Diageo was the eighteenth largest publicly quoted company in the United Kingdom in terms of market capitalisation on 7 September 2009, with a market capitalisation of approximately £24 billion.

Diageo plc is incorporated as a public limited company in England and Wales. Diageo plc's principal executive office is located at 8 Henrietta Place, London W1G 0NB and its telephone number is +44 (0) 20 7927 5200.

Diageo is a major participant in the branded beverage alcohol industry and operates globally. It brings together world-class brands and a management team committed to the maximisation of shareholder value. The management team expects to continue its strategy of investing in global brands, expanding internationally and launching innovative new products and brands.

Diageo produces and distributes a leading collection of branded premium spirits, beer and wine. The wide range of premium brands it produces and distributes includes Smirnoff vodka, Johnnie Walker scotch whisky, Baileys Original Irish Cream liqueur, Captain Morgan rum, JεB scotch whisky, Tanqueray gin and Guinness stout. In addition it also has the distribution rights for the José Cuervo tequila brands in North America and many other markets.

Strategy

Diageo is the world's leading premium drinks business and operates on an international scale. It is one of a small number of premium drinks companies that operate across spirits, beer and wine. Diageo is the leading premium spirits business in the world by volume, by net sales and by operating profit and it manages eight of the world's top 20 spirits brands as defined by Impact Databank. Diageo's beer brands include the only global stout brand, Guinness, and together these beer brands account for approximately 22% of net sales while Diageo's wine brands represent approximately 6% of Diageo's net sales.

Diageo's size provides for scale efficiencies in production, selling and marketing. This enables cost efficiencies and the dissemination of best practices in business operations across markets and brands, allowing Diageo to serve its customers and consumers better.

All of the above factors enable Diageo to attract and retain talented individuals with the capabilities to contribute to the delivery of Diageo's strategy, which is to focus on premium drinks to grow its business through organic sales and operating profit growth and the acquisition of premium drinks brands that add value for shareholders.

Diageo's brands have broad consumer appeal across geographies, and the company and its employees are proud of the responsible manner in which the brands are marketed and the role that moderate consumption of these brands plays in the lives of many people.

Diageo acknowledges that like many other products when misused, alcohol may lead to health or social problems for the individual or society as a whole. Diageo seeks to be at the forefront of industry efforts to promote responsible drinking and works with other stakeholders to combat alcohol misuse. Diageo's approach is based on three principles: combating alcohol misuse; setting world-class standards for responsible marketing and innovation; and promoting a shared understanding of what responsible drinking means in order to reduce alcohol-related harm.

Market participation Diageo targets its geographical priorities in terms of the major regional economies in which it operates. These markets are managed under four business areas: North America, Europe, International and Asia Pacific. The North American business area comprises the United States

Business description (continued)

and Canada. The European business area comprises Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe. The International business area comprises Latin America and the Caribbean (including Mexico), Africa and the Global Travel and Middle East business. The Asia Pacific business area comprises India, The People's Republic of China, South Korea, Japan and other Asian markets, Australia and New Zealand. North America accounts for the largest proportion of Diageo's operating profit.

Product offering Diageo manages its brands in terms of global priority brands, local priority brands and category brands. Acting as the main focus for the business, global priority brands are Diageo's primary growth drivers across markets. Local priority brands have leading positions in the markets in which they are distributed. They drive growth on a significant scale but with a narrower geographical reach than the global priority brands. Category brands comprise the smaller scale brands in Diageo's collection.

Business effectiveness Over the long term, Diageo's strategy continues to focus on driving growth and increasing shareholder value.

Incorporation Diageo was originally incorporated as Arthur Guinness Son & 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).

Premium drinks

Diageo is engaged in a broad range of activities within the beverage alcohol industry, with products trading in approximately 180 markets around the world. Its operations include producing, distilling, brewing, bottling, packaging, distributing, developing and marketing a range of brands. Diageo markets a wide range of recognised beverage alcohol brands including a number of the world's leading spirits and beer brands. In calendar year 2008, the Diageo brand range included 17 of the top 100 premium distilled spirits brands worldwide.

References to ready to drink products in this document include progressive adult beverages in the United States and certain markets supplied by the United States. References to Smirnoff ready to drink include Smirnoff Ice, Smirnoff Black Ice, Smirnoff Twisted V, Smirnoff Mule, Smirnoff Spin, Smirnoff Storm, Smirnoff Caipiroska, Smirnoff Signatures and Smirnoff Cocktails. References to Smirnoff Black Ice include Smirnoff Ice Triple Black in the United States and Smirnoff Ice Double Black in Australia. In the year ended 30 June 2009, Diageo sold 113.4 million equivalent units of spirits (including ready to drink), 24.7 million equivalent units of beer and 3.2 million equivalent units of wine. In the year ended 30 June 2009, ready to drink products contributed 6.2 million equivalent units of total volume, of which Smirnoff ready to drink variants accounted for 4.1 million equivalent units. Volume has been measured on an equivalent units basis to nine litre cases of spirits. An equivalent unit represents one nine litre case of spirits, which is approximately 272 servings. A serving comprises 33 ml of spirits, 165 ml of wine, or 330 ml of ready to drink or beer. Therefore, to convert volume of products other than spirits to equivalent units, the following guide has been used: beer in hectolitres divide by 0.9, wine in nine litre cases divide by five, ready to drink in nine litre cases divide by 10 and certain pre-mixed products that are classified as ready to drink in nine litre cases divide by five.

Business description (continued)

The collection of premium drinks comprises brands owned by the company as a principal and brands held by the company under agency or distribution agreements. They include:

Global priority brands:
Smirnoff vodka and Smirnoff ready to drink products
Johnnie Walker scotch whiskies
Baileys Original Irish Cream liqueur
Captain Morgan rum
José Cuervo tequila (agency brand in North America and many other markets)
JεB scotch whisky
Tanqueray gin
Guinness stout

Other spirits brands include:	**Wine brands include:**	**Other beer brands include:**
Crown Royal Canadian whisky	Blossom Hill	Malta Guinness non-alcoholic malt
Buchanan's scotch whisky	Sterling Vineyards	Harp lager
Gordon's gin and vodka	Beaulieu Vineyard	Smithwick's ale
Windsor Premier scotch whisky	Chalone Vineyard	Tusker lager
Seagram's whiskey	Rosenblum Cellars	Red Stripe lager
Cacique rum	Barton & Guestier	
Old Parr scotch whisky	Piat d'Or	
Bell's scotch whisky		
Bundaberg rum		
Bushmills Irish whiskey		
Ketel One vodka (exclusive worldwide distribution rights)		

Diageo's agency agreements vary depending on the particular brand, but tend to be for a fixed number of years. Diageo's principal agency brand is José Cuervo in North America and many other markets (with distribution rights extending to 2013). There can be no assurances that Diageo will be able to prevent termination of distribution rights or rights to manufacture under licence, or renegotiate distribution rights or rights to manufacture under licence on favourable terms when they expire.

Diageo also brews and sells other companies' beer brands under licence, including Budweiser and Carlsberg lagers in Ireland, Heineken lager in Jamaica and Tiger beer in Malaysia.

Global priority brands Diageo has eight global priority brands that it markets worldwide. Diageo considers these brands to have the greatest current and future earnings potential. Each global priority brand is marketed consistently around the world, and therefore can achieve scale benefits. The group manages and invests in these brands on a global basis. Figures for global priority brands include related ready to drink products, unless otherwise indicated.

In the year ended 30 June 2009, global priority brands accounted for 58% of total volume (81.7 million equivalent units) and contributed net sales of £5,131 million.

Smirnoff achieved volume of 28.6 million equivalent units in the year ended 30 June 2009. Smirnoff vodka volume was 24.5 million equivalent units. It was ranked, by volume, as the number one premium vodka and the number one premium spirit brand in the world. Smirnoff ready to drink volume totalled 4.1 million equivalent units.

Business description (continued)

Johnnie Walker scotch whiskies comprise Johnnie Walker Red Label, Johnnie Walker Black Label and several other brand variants. During the year ended 30 June 2009, Johnnie Walker Red Label sold 9.2 million equivalent units, Johnnie Walker Black Label sold 4.6 million equivalent units and the remaining variants sold 0.7 million equivalent units. The Johnnie Walker franchise was ranked, by volume, as the number one premium scotch whisky and the number three premium spirit brand in the world.

Baileys was ranked, by volume, as the number one liqueur in the world, having sold 6.7 million equivalent units in the year ended 30 June 2009.

Captain Morgan was ranked, by volume, as the number two premium rum brand in the world with volume of 8.6 million equivalent units in the year ended 30 June 2009.

Guinness is the group's only global priority beer brand, and for the year ended 30 June 2009 achieved volume of 11.1 million equivalent units.

Other global priority brands were also ranked, by volume, among the leading premium distilled spirits brands by Impact Databank. These include: José Cuervo, ranked the number one premium tequila in the world; JεB scotch whisky (comprising JεB Rare, JεB Reserve, JεB Exception and JεB Jet), ranked the number three premium scotch whisky in the world; and Tanqueray, ranked the number four premium gin brand in the world. During the year ended 30 June 2009, José Cuervo, JεB and Tanqueray sold 5.1 million, 5.2 million and 1.9 million equivalent units, respectively.

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

Local priority brands represent the brands, apart from the global priority brands, that make the greatest contribution to operating profit in a business area (North America, Europe, International or Asia Pacific), rather than worldwide. Diageo manages and invests in these brands within its business areas and, unlike the global priority brands, may not have a consistent marketing strategy around the world for such brands. For the year ended 30 June 2009, local priority brands contributed volume of 27.3 million equivalent units, representing 19% of total volume, and net sales of £2,148 million. Examples of local priority brands include Crown Royal Canadian whisky in North America, Buchanan's scotch whisky in International, Windsor Premier scotch whisky in Asia Pacific, Gordon's gin in Europe, Bundaberg rum in Asia Pacific, Cacique rum in Europe, Malta Guinness non-alcoholic malt in International, Tusker lager in International, Seagram's 7 Crown whiskey and Seagram's VO whisky in North America, Bell's scotch whisky in Europe and Sterling Vineyards wines in North America.

The remaining brands are grouped under category brands. Category brands include spirits, beer and wine brands and for the year ended 30 June 2009, these category brands contributed volume of 32.3 million equivalent units, representing 23% of total volume, and net sales of £2,032 million. Of this, spirits achieved volume of 19.8 million equivalent units and contributed £1,326 million to Diageo's net sales in the year ended 30 June 2009. Examples of category spirits brands are Gordon's gin (all markets except Europe in which it is a local priority brand), Gordon's vodka, The Classic Malt whiskies and White Horse scotch whisky.

In the year ended 30 June 2009, Diageo sold 13.5 million equivalent units of beers other than Guinness, achieving net sales of £894 million. Other beer volume was mainly attributable to owned brands, such as Red Stripe, Pilsner, Tusker and Harp lager, with a minority being attributable to beers brewed and/or sold under licence, such as Tiger beer in Malaysia and Heineken lager in Jamaica.

Business description (continued)

In addition, Diageo produces and markets a wide selection of wines. These include well known labels such as Beaulieu Vineyard, Sterling Vineyards, Rosenblum Cellars and Chalone Vineyard in the United States, Blossom Hill in the United Kingdom, and Barton & Guestier and Piat d'Or in Europe. For the year ended 30 June 2009, other wine volume was 2.4 million equivalent units, contributing net sales of £291 million.

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

Approximately 80% of total production (including third party production) is undertaken in five Diageo production areas, namely the United Kingdom, Baileys, Guinness, Santa Vittoria and North America centres. The majority of these production centres have several production facilities. The locations, principal activities, products, packaging production capacity and packaging production volume in 2009 of these principal production centres are set out in the following table:

Production centre	Location	Principal products	Production capacity in millions of equivalent units*	Production volume in 2009 in millions of equivalent units
United Kingdom	United Kingdom	Scotch whisky, gin, vodka, rum, ready to drink	62	42
Baileys	Ireland	Irish cream liqueur, vodka	10	8
Guinness	Ireland	Beers	11	8
Santa Vittoria	Italy	Vodka, wine, rum, ready to drink	7	5
North America	United States, Canada	Vodka, gin, tequila, rum, Canadian whisky, American whiskey, progressive adult beverages, wine, ready to drink	48	40

* Capacity represents ongoing production capacity at any production centre.

Spirits are produced in distilleries located worldwide. The group owns 29 whisky distilleries in Scotland, an Irish whiskey distillery in Northern Ireland, two whisky distilleries in Canada, and gin distilleries in the United Kingdom and the United States. Diageo produces Smirnoff vodka internationally, Popov vodka and Gordon's vodka in the United States, and Baileys in the Republic of Ireland and Northern Ireland. Rum is blended and bottled in the United States, Canada, Italy and the United Kingdom, and is distilled, blended and bottled in Australia and Venezuela. All of Diageo's maturing scotch whisky is located in warehouses in Scotland.

On 1 July 2009, the group announced a restructuring of its operations in Scotland. The plans include the consolidation of distilling, packaging and warehousing activities into fewer sites and involve the closure of a packaging plant, a distillery and a cooperage over a two-year period. New investment is concentrated in the production sites in Leven in Fife and in Shieldhall near Glasgow.

In June 2008, Diageo and the government of the US Virgin Islands announced a public/private initiative for the construction and operation of a high capacity distillery in St Croix. This new facility,

Business description (continued)

expected to open in 2010, will have the capacity to distil up to 20 million proof gallons per year and will supply all bulk rum used to produce Captain Morgan branded products for the United States.

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

Diageo's principal brewing facilities are at the St James's Gate brewery in Dublin and in Kilkenny, Waterford and Dundalk in the Republic of Ireland, and in Nigeria, Kenya, Ghana, Cameroon, Malaysia and Jamaica. Ireland is the main export centre for the Guinness brand. In other countries, Guinness is brewed by third parties under licence arrangements.

All Guinness Draught production is at the St James's Gate brewery in Dublin in the Republic of Ireland. Guinness Draught in cans and bottles, which uses an in-container system to replicate the taste of Guinness Draught, is packaged at Runcorn and Belfast in the United Kingdom. The Runcorn facility performs the kegging of Guinness Draught, transported to the United Kingdom in bulk for the Great Britain market.

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

Property, plant and equipment Diageo owns or leases land and buildings throughout the world. The principal production facilities are described above. As at 30 June 2009, Diageo's land and buildings were included in the group's consolidated balance sheet at a net book value of £818 million. Diageo's largest individual facility, in terms of net book value of property, is St James's Gate brewery in Dublin. Approximately 96% by value of the group's properties are owned and approximately 3% are held under leases running for 50 years or longer. Diageo's properties are primarily a variety of manufacturing, distilling, brewing, bottling and administration facilities spread across the group's worldwide operations, as well as vineyards and wineries in the United States. Approximately 40% and 20% of the book value of Diageo's land and buildings comprise properties located in the United Kingdom and the United States, respectively.

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

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

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

Diageo has a supply agreement with Casa Cuervo SA de CV, a Mexican company, for the supply of bulk tequila used to make the José Cuervo line of tequilas and tequila drinks in the United States. The supply agreement extends to June 2013.

Business description (continued)

Diageo has a supply agreement with Destiléria Serrallés Inc, a Puerto Rican corporation, for the supply of rum used to make the Captain Morgan line of rums and rum drinks in the United States. The supply agreement is for 10 years from 2002 and can be terminated either (1) in the last 18 months before the expiration of the 10-year term, on notice of the shorter of one year or the time remaining until the expiration of the original 10-year term, or (2) on three years' notice once the original 10-year term has expired.

Marketing and distribution Diageo is committed to investing in its brands. In the year ended 30 June 2009, £1,312 million was spent worldwide on marketing brands. Diageo aims to maintain and improve its market position by enhancing the consumer appeal of its brands through consistent high investment in marketing support focused around the eight global priority brands, which accounted for 65% of total marketing expenditure in the year ended 30 June 2009. Diageo makes extensive use of magazine, newspaper, point of sale and poster and billboard advertising, and uses radio, cinema, television and internet advertising where appropriate and permitted by law. Diageo also runs consumer promotional programmes in the on trade (for example, licensed bars and restaurants). Diageo also uses sponsorship to market its brands and is a sponsor of Formula One Team Vodafone McLaren Mercedes, a NASCAR racing team and the Johnnie Walker golf championships.

Diageo markets and distributes its brands under a business area organisation comprising North America, Europe, International and Asia Pacific.

Business analysis In the year ended 30 June 2009, North America, Europe, International and Asia Pacific contributed 41%, 30%, 23% and 6%, respectively, of the group's operating profit before exceptional items and corporate costs.

An analysis of net sales and operating profit by market for the year ended 30 June 2009 is as follows:

	Net sales £ million	**Operating profit/(loss) £ million**	**Operating profit/(loss) before exceptional items £ million**
North America	**3,290**	**1,131**	**1,156**
Europe	**2,750**	**790**	**856**
International	**2,286**	**623**	**645**
Asia Pacific	**910**	**128**	**164**
Corporate	**75**	**(229)**	**(208)**
Total	**9,311**	**2,443**	**2,613**

North America North America is the largest market for Diageo in terms of operating profit, and the largest market for premium drinks in the world. Diageo markets its products through four operating units: US Spirits, Diageo-Guinness USA, Diageo Chateau & Estate Wines Company and Diageo Canada.

The US Spirits business, while managed as a single business unit, executes sales and marketing activities through 14 teams or clusters. National brand strategy and strategic accounts marketing are managed at the corporate North America level. The spirits clusters market the majority of Diageo's collection of spirits (including Smirnoff vodka, Baileys Irish Cream liqueur, José Cuervo tequila, Johnnie Walker scotch whisky, Captain Morgan rum, Tanqueray gin, JεB scotch whisky, Crown Royal Canadian whisky, Seagram's 7 Crown American whiskey, Seagram's VO Canadian whisky, Buchanan's scotch whisky and Ketel One vodka) across the United States. Diageo-Guinness USA distributes

Business description (continued)

Diageo's US beer brands (including Guinness stout, Harp lager, Red Stripe lager and Smithwick's ale) as well as the group's progressive adult beverages (including Smirnoff Ice and Captain Morgan Parrot Bay Tropical Malt Beverage). Diageo Chateau & Estate Wines owns and operates wineries in California and Washington State (including Beaulieu Vineyard, Sterling Vineyards, Chalone Vineyard and Provenance Vineyards) and markets these and other wines across the United States. The Canada business unit distributes the group's collection of spirits, wine and beer brands across all Canadian territories.

Within the United States, there are generally two types of regulatory environments: open states and control states. In open states, spirits companies are allowed to sell spirits, wine and beer directly to independent distributors. In these open states, Diageo generally trades through a three tier distribution system, where the product is initially sold to distributors, who then sell it to on and off trade retailers. In most control states, Diageo markets its spirits products to state liquor control boards through the bailment warehousing system, and from there to state or agency liquor stores. There are variations for example, certain states control distribution but not retail sales. Generally, wines are treated in the same way as spirits, although most states that are control states for spirits are open states for wines. Beer distribution generally follows open states regulation across the United States. In Canada, beer and spirits distribution laws are generally consistent and similar to those of control states in the United States. Diageo, however, has some licences to deliver keg beer directly to licensed accounts, which account for approximately 20% of Diageo's beer business in Canada.

Across the United States, Diageo's distributors and brokers have over 2,300 dedicated sales people focused on selling its spirits and wine brands. Diageo has pursued a distribution strategy centred around consolidating the distribution of Diageo's US spirits and wine brands into a single distributor or broker in each state where possible. The strategy is designed to provide a consolidated distribution network, which will limit the duplication of activities between Diageo and the distributor, improve Diageo's and distributors' selling capabilities and enable a number of alternative approaches to optimise product distribution. To date, Diageo has consolidated its business in 41 markets (40 states plus Washington DC), representing over 80% of Diageo's US spirits and wine volume. The remaining states will be consolidated as opportunities arise. Diageo is now focused on building the capabilities and selling tools of the distributors' dedicated sales forces and creating a more efficient and effective value chain.

Europe Diageo Europe comprises six operating units: Great Britain, Ireland, Iberia, Northern Europe, Southern Europe, and Russia and Eastern Europe.

In Great Britain, Diageo sells and markets its products via three business units: Diageo GB (spirits, beer and ready to drink), Percy Fox & Co (wines) and Justerini & Brooks Retail (private client wines). Products are distributed both via independent wholesalers and directly to the major grocers, convenience and specialist stores. In the on trade (for example, licensed bars and restaurants), products are sold through the major brewers, multiple retail groups and smaller regional independent brewers and wholesalers. The customer base in Great Britain has seen consolidation in recent years in both the on trade and home consumption channels. In particular, Great Britain's top four national multiple grocers together make up over 40% of home consumption total spirits volume.

Ireland comprises the Republic of Ireland and Northern Ireland. In both territories, Diageo sells and distributes directly to both the on trade and the off trade (for example, retail shops and wholesalers) through a telesales operation, extensive sales calls to outlets and third party logistics providers. The Guinness, Smirnoff and Baileys brands are market leaders in their respective categories of long alcoholic drinks, vodka and liqueurs. Budweiser and Carlsberg lagers, also major products in

Business description (continued)

the Diageo collection of brands in Ireland, are brewed and sold under licence in addition to the other European local priority brands of Smithwick's ale and Harp lager.

In Russia, Diageo previously sold and marketed its products through a company in which Diageo owned a 75% interest, and this company was the exclusive distributor of Diageo spirits brands in Russia. In December 2008, Diageo purchased the remaining 25% interest and now operates in Russia through its wholly owned subsidiary.

Across the remainder of mainland Europe, Diageo distributes its spirits brands primarily through its own distribution companies. Exceptions to this are:

- France, where Diageo sells its spirits and wine products through a joint arrangement with Moët Hennessy, and its beer products through Brasseries Kronenbourg (part of the Carlsberg group);
- the Baltic states, Hungary, Czech Republic, Slovakia, Romania, Bulgaria, Cyprus, Malta, various territories in the Balkans and Israel, where Diageo sells and markets its brands via local distributors; and
- the Nordic countries, where Diageo has sales offices in Sweden, Norway and Denmark, and representation through third party distributors in Finland and Iceland. In all Nordic markets except Denmark, off premise sales are controlled by state monopolies, with alcohol tax rates among the highest in the world, and border trade and duty free are important sources of purchase.

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

International Diageo International comprises Latin America and the Caribbean (including Mexico), Africa and the Global Travel and Middle East business.

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

Africa (excluding North Africa) is one of the longest established and largest markets for the Guinness brand, with the brewing of Guinness Foreign Extra Stout in a number of African countries, either through subsidiaries or under licence. Diageo has a three-way venture with Heineken and Namibia Breweries Limited in South Africa for a combined beer, cider and ready to drink collection of brands. Diageo also has a 25% equity interest in a venture with Heineken which is constructing a brewery in Gauteng, South Africa. Diageo has a wholly-owned subsidiary in Cameroon and also has majority-owned subsidiaries in Nigeria, Kenya, Ghana, Uganda, Réunion and the Seychelles.

Global Travel and Middle East (GTME) encompasses a sales and marketing organisation which targets the international consumer in duty free and travel retail outlets such as airport shops, airlines and ferries around the world, and distribution of Diageo brands in the Middle East and North Africa. The global nature of the travel channel and its organisation structure allows a specialist Diageo management team to apply a co-ordinated approach to brand building initiatives and to build on consumer insights in this trade channel, where consumer behaviour tends to be different from domestic markets. In the Middle East and North Africa, distribution is achieved through third party distributors. Lebanon is an exception, where a Diageo subsidiary distributes most of the Diageo brands sold there.

Business description (continued)

Asia Pacific Diageo Asia Pacific comprises India, the People's Republic of China, South Korea, Japan, Thailand, Vietnam, Singapore, Malaysia and other Asian markets, Australia and New Zealand.

Diageo works with a number of joint venture partners in Asia Pacific. In Singapore, Malaysia, Hong Kong and Macau, the People's Republic of China, Thailand and Japan, Diageo distributes the majority of its spirits brands through joint venture arrangements with Moët Hennessy. Diageo has established in-market companies in China (for brands not included in the joint venture such as Smirnoff and Baileys) and Vietnam (for all brands). In South Korea and Taiwan, Diageo's own distribution companies distribute the majority of Diageo's brands. In Japan, during the year ended 30 June 2009, Diageo and Kirin Brewery Co Ltd formed a joint venture to expand distribution of Diageo products and contribute to the growth objectives of both companies. Kirin now distributes Guinness beer and Smirnoff Ice. Other spirits and wine brands, which are not distributed by either the Moët Hennessy joint venture or Kirin, are handled by third parties. In Malaysia, Diageo's own and third party beers are brewed and distributed by a listed business (Guinness Anchor Berhad) in which Diageo and its partner, Asia Pacific Breweries, have a majority share through a jointly controlled joint venture company. In Singapore, Diageo's beer brands are brewed and distributed by Asia Pacific Breweries. In India, distribution of both imported and locally produced products is achieved through a combination of Diageo's own distribution company and third party distributors. A joint venture has been formed with Radico Khaitan to manufacture and distribute certain premium local spirits, the first of which was Masterstroke.

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

In Australia, Diageo has its own production and distribution company, which handles the majority of products sold in the Australian market. It also has production and distribution arrangements with VOK Beverages and a licensed brewing arrangement with Fosters. In New Zealand, Diageo operates through third party distributors and has a licensed brewing arrangement with Lion Nathan.

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

Seasonal impacts The festive holiday season provides the peak period for sales. Approximately 43% of annual net sales occur in the last four months of each calendar year.

Employees Diageo's people, its culture and its values are at the heart of the company's strategy and Diageo's directors believe this to be a source of competitive advantage.

Employee engagement is a key element of Diageo's people strategy. Diageo's values are embedded in the business and guide how all employees operate and behave. A values survey, which includes a measure of employee engagement, is conducted with employees every year. Now in its seventh year, this survey provides an annual insight into what employees are thinking and feeling about the business. The employee values survey allows Diageo, at group-wide, function and team levels, to assess how the business is tracking against the long term goals of engaging employees and consistently bringing Diageo's values to life. Independent research has shown a strong correlation between high levels of employee engagement and strong business performance.

Diageo aims to be amongst the most admired companies in all key geographies. Consistent with this, Diageo has increased participation in independent surveys during the last year and has achieved 'Top 10' ratings in 10 published best company results around the world. This is Diageo's best performance in these awards since the company was formed. Further to this aim, Diageo endeavours to

Business description (continued)

create a workplace that is both welcoming and challenging for all employees. Diageo values diversity in its workforce and works to ensure that the group is inclusive of all people, regardless of their background or style. To enhance diversity, Diageo aims to create opportunities that are attractive to a wide range of candidates, including those with disabilities, and seeks to make working for Diageo compatible with a variety of lifestyles. The group also seeks to design and adjust roles to accommodate people. Not only is this approach to inclusion and diversity consistent with Diageo's values, it is also believed to be important for the long term health of the organisation.

Strong and inspiring leadership is critical to the success of the business. To this end, the Diageo Leadership Performance Programme was developed and 900 leaders participated and completed the programme in the years ended 30 June 2008 and 2009. The aim is for Diageo to be recognised for the outstanding quality of its business leaders and their ability to deliver great performance for the group.

Consistent with the desire that its people have a stake in the company's performance, Diageo currently has share plans in place in the United Kingdom, North America and Ireland. Employees in 22 additional countries are able to participate in Diageo's International Sharesave Plan, giving them the opportunity to take a stake in the company's future. Implementation of a new share match plan for international participants is planned for 2010. These plans are created and administered by employees for employees with a view toward both uniting and motivating Diageo's people.

Diageo's average number of employees during each of the three years ended 30 June 2009 was as follows:

	2009	2008	2007
Average number of employees			
Full time	**23,802**	23,908	22,086
Part time	**468**	465	434
Total	**24,270**	24,373	22,520

Diageo strives to keep its employees well informed on and engaged with the company's strategy and business goals as a high priority, focusing on dialogue and consultation (both formal and informal) on changes that affect its employees.

In light of the current economic environment, Diageo conducted a review of its organisation and cost base during the year ended 30 June 2009. The objectives of the review were to achieve significant cost efficiencies as well as to create a more efficient and effective organisation, and, as a result, a restructuring of elements of Diageo's global business is in the process of being implemented. The restructuring will mean the loss of a number of valued colleagues from the business. Throughout this process, as always, the company and its leadership have endeavoured to treat all Diageo employees with compassion and respect.

Environmental, social and community matters Diageo realises that it is an increasingly important factor for investors to understand not only its financial performance, but also the manner in which it manages and operates its business. Diageo seeks to fulfil its responsibilities as a corporate citizen in a number of areas, including through examining its impact on the environment and its policies relating to employees as well as social and community matters.

Diageo has set stretching targets to reduce its impact on the environment, and to benefit the planet, the communities in which it operates and the business. The Diageo executive environmental working group is responsible for setting policy. This year, the working group revised and re-issued Diageo's environmental policy to reflect the increased ambition the company has for environmental

Business description (continued)

improvement. The policy is supported by Diageo's risk management framework which sets implementation criteria and provides a mechanism for monitoring compliance. As stated in Diageo's policy, the company's actions on the environment are planned in light of prevailing scientific knowledge and do not depend on having absolute proof of specific damage, thus supporting the concept of a precautionary approach.

The release of greenhouse gases notably carbon dioxide generated by burning fossil fuels has an impact on climate change which, either directly or indirectly, presents considerable risk both to business and the planet. The risks include impacts on the agriculture on which the company depends for raw materials, disruption of the company's operations or those of commercial partners, and changes to the nature or distribution of consumer demand. Diageo assumes that the risks from climate change could be mitigated if releases of greenhouse gases were sufficiently diminished and, as such, has worked for many years to reduce direct emissions (from fuels) and indirect emissions (from electricity).

Diageo recognises that its success in the future will depend in part on the prosperity of the communities in which the company operates and the strength of its relationships with those communities.

Supporting long term sustainable initiatives in the communities where Diageo does business advances development of those communities, engages employees, builds the company's reputation and enhances its relationships with governments and other stakeholders. Diageo focuses on projects that develop skills, increase access to water, promote conservation, support employees and respond to natural disasters.

Diageo takes pride in its record of community investment. Most of this investment comes from Diageo businesses around the world in the form of cash, in-kind donations and volunteer time. It also includes grants from the Diageo Foundation and support for the community aspects of responsible drinking projects from Diageo's Responsible Drinking Fund.

In addition to global initiatives, Diageo supports direct involvement by employees to benefit local communities. In difficult economic circumstances, Diageo employees chose World Water Day to show their commitment to the company's community programme through co-ordinated activities in support of Diageo's Africa Water of Life programme. There were 30 'Make a Splash' events in 20 countries for employees and their families to enjoy, including half marathons, fun days, writing contests and water conservation games. More than £1.7 million was raised and donated to the Water of Life 1 Million Challenge and other community water projects.

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

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

In beer, the Guinness brand 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, Coors Brewing (Carling) and Carlsberg.

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

Research and development The overall nature of the group's business does not demand substantial expenditure on research and development. However, the group has ongoing programmes for developing new drinks products. In the year ended 30 June 2009, the group's research and development

Business description (continued)

expenditure amounted to £17 million (2008 £17 million; 2007 £17 million). Research and development expenditure is generally written off in the year in which it is incurred.

Trademarks Diageo produces and distributes branded goods and is therefore substantially dependent on the maintenance and protection of its trademarks. All brand names mentioned in this document are trademarks. The group also holds numerous 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 protections are available) in all material respects in its most important markets.

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

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

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

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

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

Labelling of beverage alcohol products is also regulated in many markets, varying from health warning labels to importer identification, alcohol strength and other consumer information. 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. Following the end of the voluntary restrictions on television advertising of spirits in the United States, Diageo and other spirits companies have been advertising products on the air on local cable television stations. Expressions of political concern signify the uncertain future of beverage

Business description (continued)

alcohol products advertising on network television in the United States. Further requirements for warning statements and any prohibitions on advertising and marketing could have an adverse impact on sales of the group.

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

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

Diageo uses shared services operations to deliver transaction processing and certain central finance activities, using captive and outsourced centres. A captive business service centre in Budapest, Hungary performs various process tasks for markets and operational entities. Diageo uses third party service centres in Manila, Shanghai and Bucharest to perform these tasks for basic processes. Certain central finance activities, including elements of group financial planning and reporting and treasury, are performed in the business service centre in Budapest.

Associates Diageo's principal associate is Moët Hennessy. It also owns shares in a number of other associates. In the year ended 30 June 2009, the share of profits of associates after tax was £164 million (2008 £177 million; 2007 £149 million), of which Moët Hennessy accounted for £151 million (2008 £161 million; 2007 £136 million).

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

Since 1987, a number of joint distribution arrangements have been established with LVMH, principally covering distribution of Diageo's premium brands of scotch whisky and gin and Moët Hennessy's premium champagne and cognac brands in the Asia Pacific region and France. Diageo and LVMH have each undertaken not to engage in any champagne or cognac activities competing with those of Moët Hennessy. The arrangements also contain certain provisions for the protection of Diageo as a minority shareholder in Moët Hennessy. The operations of Moët Hennessy in France are conducted through a partnership in which Diageo has a 34% interest and, as a partner, Diageo pays any tax due on its share of the results of the partnership to the tax authorities.

Acquisitions and disposals Diageo has made a number of acquisitions of brands, distribution rights and equity interests in premium drinks businesses including the following:

On 3 July 2006, Diageo acquired a 75% stake in the company that owns the Smirnov brand in Russia. This company unites the Smirnoff/Smirnov brands in Russia under common ownership and is the exclusive distributor of Smirnov and Diageo's spirits brands in Russia. In December 2008, Diageo purchased the remaining 25% stake in the company, and Diageo currently operates in Russia through this wholly owned subsidiary.

On 27 January 2007, Diageo completed the acquisition of a 43% equity stake in Sichuan Chengdu Quanxing Group Co Limited (Quanxing). Quanxing then held 39.48% of the equity in Sichuan ShuiJingFang Joint Stock Co Limited (ShuiJingFang), a leading maker of premium Chinese white

Business description (continued)

spirits, or baijiu. ShuiJingFang is listed on the Shanghai Stock Exchange. The agreed purchase price for the 43% equity interest in Quanxing was RMB 517 million (£37 million). Quanxing subsequently increased its equity stake in ShuiJingFang to 39.7%. On 30 July 2008, Diageo acquired a further 6% of the equity of Quanxing. Diageo now owns 49% of Quanxing and continues to equity account for this investment.

On 29 February 2008, Diageo acquired Rosenblum Cellars in North America for a total cost of £54 million (including acquisition costs).

On 1 May 2008 Diageo formed a new venture with Heineken and Namibia Breweries Limited (NBL) for their combined beer, cider and ready to drink businesses in South Africa, called DHN Drinks (Pty) Limited (DHN Drinks). The new venture builds on the success of brandhouse Beverages (Pty) Limited (brandhouse), the parties' existing venture in South Africa, which was formed in July 2004. Diageo and Heineken each own 42.25% of DHN Drinks and NBL owns 15.5%. The original cost of this acquisition was £43 million, with further deferred consideration of £3 million paid in the year ended 30 June 2009. Each party shares in the profits of DHN Drinks in proportion to their shareholding. Brandhouse continues to market and distribute the parties' products in South Africa. On 1 May 2008 Diageo and Heineken also entered into a second venture in South Africa called Sedibeng Brewery (Pty) Limited whereby a brewery and bottling plant is being constructed in Gauteng province, South Africa, which will produce Amstel and certain other key brands. Heineken owns 75% and Diageo owns 25% of Sedibeng Brewery (Pty) Limited. The cost of this acquisition in the year ended 30 June 2008, was £8 million, with an additional cost of £19 million recognised in the year ended 30 June 2009.

On 9 June 2008, Diageo completed the acquisition of Ketel One Worldwide BV (KOW), a 50:50 company based in the Netherlands, with the Nolet Group, owners of the Ketel One brand. The company owns the exclusive and perpetual global rights to market, sell and distribute Ketel One vodka products, including Ketel One vodka, Ketel One Citroen vodka and any line extensions of Ketel One vodka and Ketel One Citroen vodka. The business is operated pursuant to a global agreement and ancillary agreements relating to intellectual property, supply, distribution services and certain other matters. Diageo paid a total of £472 million (including acquisition costs) for a 50% equity stake in the company and is entitled to certain governance rights under the global agreement. Diageo consolidates the company with a minority interest. The Nolet Group has an option to sell their stake in the company to Diageo for $900 million (£545 million) plus interest from 9 June 2011 to 9 June 2013. If the Nolet Group exercises this option but Diageo chooses not to buy their stake, Diageo will pay $100 million (£61 million) and the Nolet Group may then pursue a sale of their stake to a third party, subject to rights of first offer and last refusal on Diageo's part.

On 16 June 2009, Diageo acquired the remaining 80% of equity in Stirrings LLC for £6 million and provided £7 million as deferred consideration payable. Diageo initially acquired a 20% equity stake for £5 million in the year ended 30 June 2007.

Disposed businesses

Pillsbury/General Mills Diageo acquired an investment in the shares of General Mills on the disposal of Pillsbury to General Mills in October 2001. On 4 October 2004, Diageo sold 50 million shares of common stock in General Mills and transferred a further 4 million shares to the Diageo UK pension fund and Diageo ceased to be an affiliate of General Mills for US federal securities laws purposes at that time. In November 2005, Diageo sold its remaining 25 million shares of common stock of General Mills.

Burger King Diageo completed the disposal of Burger King on 13 December 2002.

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 results of operations could suffer and the trading price and liquidity of securities could decline.

In the current global financial crisis and uncertain economic environment, certain risks may gain more prominence either individually or when taken together. The following are examples of ways that any of the risks below may become so exacerbated. Demand for beverage alcohol products, in particular luxury or super premium products, may decrease with a reduction in consumer spending levels. Costs of operations may increase if inflation were to become prevalent in the economic environment, resulting in an increase in the costs of raw materials. These factors may also lead to intensified competition for market share, with consequential potential adverse effects on volumes and prices. The financial and economic situation may have a negative impact on third parties with whom Diageo does, or may do, business. Any of these factors may affect the group's results of operations, financial condition and liquidity.

If there is an extended period of constraint in the capital markets, with debt markets in particular experiencing a lack of liquidity, at a time when cash flows from Diageo's business may be under pressure, this may have an impact on Diageo's ability to maintain current long term strategies, with a consequent effect on the group's growth rate. Such developments may adversely affect shareholder returns or share price. Additionally, continued volatility in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo's reported results. Decreases in the trustees' valuations of Diageo's pension plans may also increase pension funding requirements.

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. Diageo competes with drinks companies across a wide range of consumer drinking occasions. Within a number of categories, consolidation or realignment is still possible. Consolidation is also taking place amongst Diageo's customers in many countries. Increased competition and unanticipated actions by competitors or customers could lead to downward pressure on prices and/or a decline in Diageo's market share in any of these categories, which would adversely affect Diageo's results and hinder its growth potential.

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

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further acquisitions (including associated financing), disposals, joint ventures or partnerships. There can be no guarantee that any such acquisition, disposal, joint venture or partnership would deliver the benefits intended.

Similarly, there can be no assurance that the cost-saving or restructuring programmes implemented by Diageo in order to improve efficiencies and deliver cost-savings will deliver the expected benefits.

Systems change programmes may not deliver the benefits intended and systems failures could lead to business disruption Certain change programmes designed to improve the effectiveness and efficiency of end-to-end operating, administrative and financial systems and processes continue to be undertaken. This includes moving transaction processing from a number of markets to business service centres.

Business description (continued)

There can be no certainty that these programmes will deliver the expected operational benefits. There is likely to be disruption caused to production processes and possibly to administrative and financial systems as further changes to such processes are effected. They could also lead to adverse customer or consumer reaction. Any failure of information systems could adversely impact on Diageo's ability to operate. As with all large systems, Diageo's information systems could be penetrated by outside parties intent on extracting information, corrupting information or disrupting business processes. Such unauthorised access could disrupt Diageo's business and/or lead to loss of assets. The concentration of processes in business service centres also means that any disruption arising from system failure or physical plant issues could impact on a large portion of Diageo's global business.

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

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

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

Diageo is subject to 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, and Diageo is routinely subject to litigation in the ordinary course of its operations. If such litigation resulted in fines, damages or reputational damage to Diageo or its brands, Diageo's business could be materially adversely affected.

Contamination, counterfeiting or other circumstances 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 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. In addition, Diageo may voluntarily recall products in the event of contamination or damage. A significant product liability judgement or a widespread product recall may negatively

Business description (continued)

impact on 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, resulting negative publicity could adversely affect Diageo's reputation with existing and potential customers and its corporate and brand image.

To the extent that third parties sell products which are either counterfeit versions of Diageo brands or inferior brands that look like Diageo brands, consumers of Diageo brands could confuse Diageo products with them. This could cause them to refrain from purchasing Diageo brands in the future and in turn could impair brand equity and adversely affect Diageo's business.

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

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

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

Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for Diageo's products and erosion of its competitive and financial position. Continued economic pressures could lead to consumer selection of products at lower price points, whether Diageo's or those of competitors, which may have an adverse effect on Diageo's profitability.

If the social acceptability of Diageo's products declines, Diageo's sales volume could decrease and the business could be materially adversely affected In recent years, there has been increased social and political attention directed to the beverage alcohol industry. Diageo believes that this attention is the result of public concern over problems related to alcohol abuse, including drink driving, underage drinking and health consequences from the misuse of alcohol. If, as a result, the general social acceptability of beverage alcohol were to decline significantly, sales of Diageo's products could materially decrease.

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

Business description (continued)

deliver its strategy, for example in relation to sales, marketing and innovation capability within markets or in its senior management. The loss of senior management or other key personnel or the inability to identify, attract and retain qualified personnel in the future could make it difficult to manage the business and could adversely affect operations and financial results.

Diageo's operating results may be adversely affected by disruption to production facilities or business service centres Diageo would be affected if there were a catastrophic failure of its major production facilities or business service centres. See 'Business description Premium drinks Production' for details of Diageo's principal production areas. In addition, the maintenance and development of information systems may result in systems failures which may adversely affect business operations.

Diageo has a substantial inventory of aged product categories, principally scotch whisky and Canadian whisky, which mature over periods of up to 30 years. The maturing inventory is stored primarily in Scotland, and the loss through contamination, fire or other natural disaster of all or a portion of the stock of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, Diageo would not be able to meet consumer demand for those products as it arises. There can be no assurance that insurance proceeds would cover the replacement value of Diageo's maturing inventory or other assets, were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third parties. In addition, there is an inherent risk of forecasting error in determining the quantity of maturing stock to lay down in a given year for future consumption. This could lead to an inability to supply future demand or lead to a future surplus of inventory and consequent write down in value of maturing stocks.

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

Diageo's business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates Diageo's business is dependent on general economic conditions in the United States, Great Britain and other important markets. A significant deterioration in these conditions, including a reduction in consumer spending levels, customer destocking, the failure of customer, supplier or financial counterparties or a reduction in the availability of, or an increase in the cost of financing to, Diageo, could have a material adverse effect on Diageo's business and results of operations. In addition, Diageo may be adversely affected by political and economic developments or industrial action in any of the countries where Diageo has distribution networks, production facilities or marketing companies. Diageo's operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Political and/or social unrest, potential health issues (including pandemic issues) and terrorist threats and/or acts may also occur in various places around the world, which will have an impact on trade, tourism and travel. These disruptions can affect Diageo's ability to import or export products and to

Business description (continued)

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

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

Diageo may be adversely affected by fluctuations in exchange rates. The results of operations of Diageo are accounted for in pounds sterling. Approximately 37% of sales in the year ended 30 June 2009 were in US dollars, approximately 12% were in sterling and approximately 18% were in euros. Movements in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo's reported results of operations from year to year.

Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense. To partly delay any adverse impact from interest rate movements, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of projected net borrowings, and the overall net borrowings portfolio is managed according to a duration measure. See 'Business review Risk management'.

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

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

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

Business description (continued)

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.

Cautionary statement concerning forward-looking statements

This document contains 'forward-looking statements'. These statements can be identified by the fact that they do not relate only to historical or current facts. In particular, forward-looking statements include all statements that express forecasts, expectations, plans, outlook and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability or cost of financing to Diageo, anticipated cost savings or synergies, the completion of Diageo's strategic transactions and general economic conditions. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo's control.

These factors include, but are not limited to:

- global economic downturn;
- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact on Diageo's market share, increase expenses and hinder growth potential;
- the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergies and/or cost savings;
- Diageo's ability to complete existing or future acquisitions and disposals;
- legal and regulatory developments, including changes in regulations regarding consumption of, or advertising for, beverage alcohol, changes in tax law (including tax rates) or accounting standards, changes in taxation requirements, such as the impact of excise tax increases with respect to the business, and changes in environmental laws, health regulations and laws governing pensions;
- developments in any litigation or other similar proceedings 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;
- developments in the Colombian litigation and Turkish customs litigation or any similar proceedings;
- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues; or contamination, counterfeiting or other circumstances which could harm the integrity of sales of Diageo's brands;

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

changes in economic conditions in countries and markets in which Diageo operates, including changes in levels of consumer spending and failure of customer, supplier and financial counterparties;

Business description (continued)

- levels of marketing, promotional and innovation expenditure by Diageo and its competitors;
- renewal of distribution or licence manufacturing rights on favourable terms when they expire;
- termination of existing distribution or licence manufacturing rights on agency brands;
- systems change programmes, existing or future, and the ability to derive expected benefits from such programmes, and systems failure that could lead to business disruption;
- technological developments that may affect the distribution of products or impede Diageo's ability to protect its intellectual property rights; and
- changes in financial and equity markets, including significant interest rate and foreign currency exchange rate fluctuations and changes in the cost of capital, which may reduce or eliminate Diageo's access to or increase the cost of financing or which may affect Diageo's financial results.

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 those described in 'Business description Risk factors'. 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. All readers, wherever located, should take note of these disclosures.

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

This document includes information about Diageo's 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

Introduction

Information presented Diageo is the world's leading premium drinks business and operates on an international scale selling all types of beverage alcohol. It is one of a small number of premium drinks companies that operate across spirits, beer and wine. Diageo's brands have broad consumer appeal across geographies; as a result, the business is organised under the business areas of North America, Europe, International and Asia Pacific and the business analysis is presented on this basis. The following discussion is based on Diageo's results for the year ended 30 June 2009 compared with the year ended 30 June 2008, and the year ended 30 June 2008 compared with the year ended 30 June 2007.

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

The underlying performance on a constant currency basis and excluding the impact of exceptional items, acquisitions and disposals is referred to as 'organic' performance, and further information on the calculation of organic measures as used in the discussion of the business is included in the organic movements calculation and in the notes to that calculation.

Presentation of information in relation to the business In addition to describing the significant factors impacting on the income statement compared to the prior year for both of the years ended 30 June 2009 and 30 June 2008, additional information is also presented on the operating performance and cash flows of the group.

There are several principal financial key performance indicators (some of which are non-GAAP measures) used by the group's management to assess the performance of the group in addition to income statement measures of performance. These are volume, the organic movements in volume, sales, net sales and operating profit and free cash flow. These key performance indicators are described below:

Volume has been measured on an equivalent units basis to nine litre cases of spirits. An equivalent unit represents one nine litre case of spirits, which is approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer. Therefore, to convert volume of products, other than spirits, to equivalent units, the following guide has been used: beer in hectolitres divide by 0.9, wine in nine litre cases divide by five, ready to drink in nine litre cases divide by 10 and certain pre-mixed products that are classified as ready to drink in nine litre cases divide by five.

Organic movements in volume, sales, net sales, operating profit and operating margin are measures not specifically used in the consolidated financial statements themselves (non-GAAP measures). The performance of the group is discussed using these measures.

In the discussion of the performance of the business, organic information is presented using pounds sterling amounts on a constant currency basis. This retranslates prior period reported numbers at current period exchange rates and enables an understanding of the underlying performance of the

Business review (continued)

market that is most closely influenced by the actions of that market's management. The risk from exchange rate movements is managed centrally and is not a factor over which local managers have any control. Residual exchange impacts are reported within Corporate.

Acquisitions, disposals and exceptional items also impact on the reported performance and therefore the reported movement in any period in which they arise. Management adjusts for the impact of such transactions in assessing the performance of the underlying business.

The underlying performance on a constant currency basis and excluding the impact of exceptional items, acquisitions and disposals is referred to as 'organic' performance. Organic movement calculations enable the reader to focus on the performance of the business which is common to both periods.

Diageo's strategic planning and budgeting process is based on organic movements in volume, sales, net sales and operating profit, and these measures closely reflect the way in which operating targets are defined and performance is monitored by the group's management.

These measures are chosen for planning, budgeting, reporting and incentive purposes since they represent those measures which local managers are most directly able to influence and they enable consideration of the underlying business performance without the distortion caused by fluctuating exchange rates, exceptional items and acquisitions and disposals.

The group's management believes these measures provide valuable additional information for users of the financial statements in understanding the group's performance since they provide information on those elements of performance which local managers are most directly able to influence and they focus on that element of the core brand portfolio which is common to both periods. They should be viewed as complementary to, and not replacements for, the comparable GAAP measures and reported movements therein.

Free cash flow is a non-GAAP measure that comprises the net cash flow from operating activities as well as the net purchase and disposal of investments and property, plant and equipment that form part of net cash flow from investing activities. The group's management believes the measure assists users of the financial statements in understanding the group's cash generating performance as it comprises items which arise from the running of the ongoing business.

The remaining components of net cash flow from investing activities that do not form part of free cash flow, as defined by the group's management, are in respect of the purchase and disposal of subsidiaries, associates and businesses. The group's management regards the purchase and disposal of property, plant and equipment as ultimately non-discretionary since ongoing investment in plant and machinery is required to support the day-to-day operations, whereas acquisitions and disposals of businesses are discretionary. However, free cash flow does not necessarily reflect all amounts which the group either has a constructive or legal obligation to incur. Where appropriate, separate discussion is given for the impacts of acquisitions and disposals of businesses, equity dividends paid and the purchase of own shares, each of which arises from decisions that are independent from the running of the ongoing underlying business.

The free cash flow measure is used by management for their own planning, budgeting, reporting and incentive purposes since it provides information on those elements of performance which local managers are most directly able to influence.

Business review (continued)

Operating results 2009 compared with 2008

Summary consolidated income statement

	Year ended 30 June	
	2009	**2008**
	£ million	**£ million**
Sales	**12,283**	10,643
Excise duties	**(2,972)**	(2,553)
Net sales	**9,311**	8,090
Operating costs	**(6,698)**	(5,786)
Operating profit before exceptional items	**2,613**	2,304
Exceptional items	**(170)**	(78)
Operating profit	**2,443**	2,226
Sale of businesses		9
Net finance charges	**(592)**	(319)
Share of associates' profits after tax	**164**	177
Profit before taxation	**2,015**	2,093
Taxation	**(292)**	(522)
Profit from continuing operations	**1,723**	1,571
Discontinued operations	**2**	26
Profit for the year	**1,725**	1,597
Attributable to:		
Equity shareholders	**1,621**	1,521
Minority interests	**104**	76
	1,725	1,597

Sales and net sales On a reported basis, sales increased by £1,640 million from £10,643 million in the year ended 30 June 2008 to £12,283 million in the year ended 30 June 2009. On a reported basis net sales increased by £1,221 million from £8,090 million in the year ended 30 June 2008 to £9,311 million in the year ended 30 June 2009. Exchange rate movements increased reported sales by £1,362 million and reported net sales by £1,095 million. Acquisitions increased reported sales by £160 million and reported net sales by £151 million for the year.

Operating costs before exceptional items On a reported basis, operating costs before exceptional items increased by £912 million in the year ended 30 June 2009 due to an increase in cost of sales of £623 million, from £3,245 million to £3,868 million, an increase in marketing expenses of £73 million, from £1,239 million to £1,312 million, and an increase in other operating expenses of £216 million, from £1,302 million to £1,518 million. The impact of exchange rate movements increased total operating costs before exceptional items by £928 million.

Exceptional items Exceptional items are those that, in management's judgement, need to be disclosed by virtue of their size or incidence in order for the user to obtain a proper understanding of the financial information.

Business review (continued)

Exceptional costs totalling £170 million, being £166 million in respect of the global restructuring programme and £4 million in respect of the restructuring of Irish brewing operations are included within operating costs for the year ended 30 June 2009. Exceptional costs of £78 million in respect of the restructuring of Irish brewing operations were included within operating costs in the year ended 30 June 2008.

Post employment plans Post employment costs for the year ended 30 June 2009 were £63 million (2008 £53 million) of which £65 million (2008 £99 million) was included in operating costs and income of £2 million (2008 £46 million) was included in net finance charges. Exceptional pension curtailment gains were £32 million for the year ended 30 June 2009.

The deficit before taxation in respect of post employment plans increased by £975 million from £408 million at 30 June 2008 to £1,383 million at 30 June 2009. The increase in the deficit is primarily a result of a reduction in the value of the assets held by the plans, and a lower discount rate, partly offset by a lower inflation rate.

Operating profit Reported operating profit for the year ended 30 June 2009 increased by £217 million to £2,443 million from £2,226 million in the prior year. Exchange rate movements increased operating profit for the year ended 30 June 2009 by £154 million. Excluding exceptional costs, operating profit for the year ended 30 June 2009 increased by £309 million to £2,613 million from £2,304 million in the prior year. Exchange rate movements increased operating profit before exceptional items by £167 million.

Acquisitions Brand additions made in the year ended 30 June 2008, principally Ketel One vodka, Rosenblum Cellars wine and the distribution rights for Zacapa rum, contributed £151 million to net sales and £43 million to operating profit in the year ended 30 June 2009 in addition to the organic element.

Sale of businesses In the year ended 30 June 2008, a gain of £9 million arose from the sale of businesses.

Net finance charges Net finance charges increased from £319 million in the year ended 30 June 2008 to £592 million in the year ended 30 June 2009.

The net interest charge for the year ended 30 June 2009 increased by £175 million to £516 million from £341 million in the prior year. This increase resulted principally from the increase in net borrowings in the year, adverse exchange rate movements of £64 million and an increase in the adverse impact of the revaluation to year end market rates of interest rate swaps under IAS 39 of £8 million.

Net other finance charges for the year ended 30 June 2009 were £76 million (2008 net other finance income of £22 million). There was a reduction of £44 million in income in respect of the group's post employment plans from £46 million in the year ended 30 June 2008 to £2 million in the year ended 30 June 2009. Other finance charges also include £33 million (2008 £5 million income) in respect of exchange rate translation differences on inter-company funding arrangements that do not meet the accounting criteria for recognition in equity, £11 million (2008 £6 million) in respect of exchange movements on net borrowings not in a hedge relationship and therefore recognised in the income statement, £21 million (2008 £17 million) on unwinding of discounts on liabilities and £13 million (2008 £6 million) in respect of other finance charges.

Associates The group's share of associates' profits after interest and tax was £164 million for the year ended 30 June 2009 compared to £177 million in the prior year. Diageo's 34% equity interest in Moët

Business review (continued)

Hennessy contributed £151 million (2008   £161 million) to share of associates' profits after interest and tax.

Profit before taxation   Profit before taxation decreased by £78 million from £2,093 million to £2,015 million in the year ended 30 June 2009.

Taxation   The reported tax rate for the year ended 30 June 2009 is 14.5% compared with 24.9% for the year ended 30 June 2008. Factors that reduced the reported tax rate in the year included settlements agreed with tax authorities that gave rise to changes in the value of deferred tax assets and tax provisions.

Discontinued operations   In connection with the past disposal of the Pillsbury business, Diageo guaranteed debt of a third party until November 2009 and profit after tax from discontinued operations in the year ended 30 June 2009 of £2 million (2008   £2 million) represents a provision release in respect of this. In the year ended 30 June 2008 there was a £24 million tax credit relating to the disposal of the Pillsbury business.

Exchange rate movements   For the year ending 30 June 2010 at current exchange rates (US$/£1.65, €/£1.15) foreign exchange movements (excluding the exchange impacts of IAS 21 and IAS 39) are estimated to increase operating profit by £80 million and decrease the interest charge by £10 million.

Dividend   The directors recommend a final dividend of 22.20 pence per share, an increase of 5% on last year's final dividend. The full dividend would therefore be 36.10 pence per share, an increase of 5.1% from the year ended 30 June 2008. Subject to approval by shareholders, the final dividend will be paid on 19 October 2009 to shareholders on the register on 11 September 2009. Payment to US ADR holders will be made on 23 October 2009. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 28 September 2009.

Analysis by business area and brand

In order to assist the reader of the financial statements, the following comparison of 2009 with 2008 includes tables which present the exchange, acquisitions and disposals and organic components of the year on year movement for each of volume, sales, net sales and operating profit. Organic movements in the tables below are calculated as follows:

(a)   The organic movement percentage is the amount in the column headed Organic movement in the tables below expressed as a percentage of the aggregate of the column headed 2008 Reported, the column headed Exchange and the amounts, if any, in respect of disposals and transfers included in the column headed Acquisitions, disposals and transfers. The inclusion of the column headed Exchange in the organic movement calculation reflects the adjustment to recalculate the prior period results as if they had been generated at the current period's exchange rates.

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

Business review (continued)

overheads included in disposals are only those directly attributable to the businesses disposed of, and do not result from subjective judgements of management. For acquisitions, a similar adjustment is made in the organic movement calculations. For acquisitions subsequent to the end of the equivalent prior period, the post acquisition results in the current period are excluded from the organic movement calculations. For acquisitions in the prior period, post acquisition results are included in full in the prior period but are only included from the anniversary of the acquisition date in the current period.

The organic movement calculations for volume, sales, net sales and operating profit before exceptional items for the year ended 30 June 2009 were as follows:

	2008 Reported units million	Acquisitions, disposals and transfers units million	Organic movement units million	2009 Reported units million	Organic movement %
Volume					
North America	51.1	1.8	**0.1**	**53.0**	
Europe	41.6		**(2.6)**	**39.0**	**(6)**
International	39.1		**(1.6)**	**37.5**	**(4)**
Asia Pacific	13.2		**(1.4)**	**11.8**	**(11)**
Total volume	145.0	1.8	**(5.5)**	**141.3**	**(4)**

	2008 Reported £ million	Exchange £ million	Acquisitions, disposals and transfers £ million	Organic movement £ million	2009 Reported £ million	Organic movement %
Sales						
North America	2,965	715	149	**29**	**3,858**	**1**
Europe	4,046	353	7	**(127)**	**4,279**	**(3)**
International	2,376	192	3	**232**	**2,803**	**9**
Asia Pacific	1,168	99	1		**1,268**	
Corporate	88	3		**(16)**	**75**	**(18)**
Total sales	10,643	1,362	160	**118**	**12,283**	**1**

Business review (continued)

	2008 Reported £ million	Exchange £ million	Acquisitions, disposals and transfers £ million	Organic movement £ million	2009 Reported £ million	Organic movement %
Net sales						
North America	2,523	602	142	**23**	**3,290**	**1**
Europe	2,630	260	6	**(146)**	**2,750**	**(5)**
International	1,971	156	2	**157**	**2,286**	**7**
Asia Pacific	877	74	1	**(42)**	**910**	**(4)**
Corporate	89	3		**(17)**	**75**	**(18)**
Total net sales	8,090	1,095	151	**(25)**	**9,311**	
Excise duties	2,553				**2,972**	
Total sales	10,643				**12,283**	
Operating profit						
North America	907	206	45	**(2)**	**1,156**	
Europe	798	66	(2)	**(6)**	**856**	**(1)**
International	593	(5)		**57**	**645**	**10**
Asia Pacific	170	(6)			**164**	
Corporate	(164)	(94)		**50**	**(208)**	
Total operating profit before exceptional items	2,304	167	43	**99**	**2,613**	**4**
Exceptional items	(78)				**(170)**	
Total operating profit	2,226				**2,443**	

Notes

(1) The exchange adjustments for sales, net sales and operating profit are primarily the retranslation of prior period reported results at current period exchange rates and are principally in respect of the US dollar and the euro.

(2) The impacts of acquisitions, disposals and transfers are excluded from the organic movement percentages. Transfers represent the movement between operating units of certain activities. In the year ended 30 June 2009:

a. Acquisitions in the year ended 30 June 2008 that affected volume, sales, net sales and operating profit were the acquisitions of Ketel One Worldwide BV, Rosenblum Cellars and the distribution rights for Zacapa rum

b. There were no disposals

c. There were no transfers

(3) Operating exceptional items in the year ended 30 June 2009 comprised charges of £166 million in respect of the global restructuring programme and £4 million in respect of the restructuring of Irish brewing operations. Operating exceptional items in the year ended

30 June 2008 comprised restructuring costs for Irish brewing operations of £78 million.

Business review (continued)

Key brand performance

	Volume movement*	Organic net sales movement	Reported net sales movement
	%	%	%
Smirnoff	(2)	2	17
Johnnie Walker	(11)	(6)	4
Captain Morgan	3	7	29
Baileys	(10)	(9)	3
JεB	(13)	(12)	
José Cuervo	2	3	27
Tanqueray	(10)	(8)	12
Crown Royal North America	(1)	(1)	23
Buchanan's International	(15)	2	18
Windsor Asia Pacific	3	22	17
Guinness	(3)	4	16
Total key brands**	(5)	(1)	13

* Volume movement is both reported and organic.

** Spirits brand performance excludes ready to drink.

Smirnoff vodka: strong net sales growth in North America, International and Australia offset weakness in Europe. The performance of Smirnoff Black in all its markets along with price increases which were taken in the majority of markets delivered 4 percentage points of price/mix.

Johnnie Walker: the global economic environment had a significant impact on Johnnie Walker as it is the most global premium drinks brand. De-stocking, the reduction in travel which led to a decline in sales through travel retail outlets and a reduction in business entertaining and consumption in traditional on-trade outlets in Asia Pacific have led to a reduction in net sales.

Captain Morgan: strong performance mainly driven by share gains in North America which accounts for almost 90% of net sales. The successful introduction of the brand into markets in Europe and International has continued. Innovation with the launch of Captain Morgan 100 in North America, together with price increases drove overall price/mix improvement.

Baileys: weakness in Spain and de-stocking in many markets was partially offset by growth in Great Britain.

JεB: the weakness of the Spanish scotch category was the primary driver of the decline in JεB.

José Cuervo: share gains on José Cuervo Gold plus a successful launch of José Cuervo Silver in North America led to volume and net sales growth.

Tanqueray: weakness in North America drove overall performance although the brand grew in Europe and Asia Pacific.

Crown Royal: volume reduction on the higher priced Reserve and Cask 16 variants led to a small decline in volume and net sales despite growth in Crown Royal.

Business review (continued)

Buchanan's: growth in the key markets of Venezuela, Mexico and Colombia was offset by the decline in the Caribbean and other Latin American markets. The brand continued to grow in North America and gained share. Price increases drove net sales growth.

Windsor: growth in Korea following the return to Diageo's normal route to market. The brand's share grew in Korea benefiting from a bottle re-design and also grew in China following its recent launch.

Guinness: strong growth in Africa with net sales up 18%. Its performance in Asia Pacific continued to improve and sales stabilised in Ireland. Out-performance in the declining Great Britain beer category delivered further share gains in that market.

Category summary

	Organic volume movement	**Organic net sales movement**	**Reported volume movement**	**Reported net sales movement**
	%	**%**	**%**	**%**
Global priority brands	(5)	(2)	(5)	11
Local priority brands*	(1)	1	5	24
Category brands*	(2)	4	(1)	17
Spirits**	(4)		(3)	16
Beer		5		16
Wine	1	(5)	2	12
Ready to drink	(11)	(8)	(11)	5

* Ketel One vodka and Rosenblum Cellars wine are included in local priority brands in North America and in category brands in other regions while Zacapa rum is reported in category brands globally.

** Spirits brand performance excludes ready to drink.

Spirits: Vodka net sales up 8% and rum net sales up 6% were the strongest categories in spirits. Scotch net sales declined 3% mainly as a result of de-stocking. The liqueurs category was weak as a result of de-stocking and declining consumer demand and net sales declined by 9%.

Beer: The strong performance of Diageo's beer brands in Africa was the key driver of the overall performance of beer. There was continued growth in Asia Pacific and while beer net sales declined in Ireland by 4% and in Great Britain by 1%, this performance was significantly stronger than that of the beer category in both countries.

Wine: The weakness of the higher priced wine segment in the US was the biggest contributor to the 5% overall decline in wine as the US accounts for over half of Diageo's total wine net sales. In contrast wine performed strongly in Great Britain and net sales grew 6%.

Ready to drink: The 2008 excise duty increase on ready to drink products in Australia drove much of the weakness in performance. While in International the segment continued to grow strongly, the planned de-stock of ready to drink brands in the US, together with weakness in the segment there and in Europe, contributed to the overall decline.

Business review (continued)

Corporate revenue and costs Net sales decreased by £14 million in the year ended 30 June 2009 to £75 million, from £89 million in the prior year. Net operating costs before exceptional items increased by £44 million in the year ended 30 June 2009 to £208 million, from £164 million in the prior year.

Diageo undertakes the majority of its currency transaction hedging centrally and therefore £86 million of negative year on year transaction impact was taken to Corporate. In addition there was a negative year on year translation impact of £8 million in Corporate. The regions are reported using forecast transaction exchange rates with the difference between forecast and achieved rates being included in Corporate. This amounted to a benefit of £38 million in the year. There was a £12 million reduction in underlying Corporate net costs.

North America

Key highlights

Despite the difficult economic environment, North America delivered net sales growth

Total spirits volume grew 1% with 3 percentage points of price/mix. Smirnoff vodka, Captain Morgan and José Cuervo positioned in the more resilient premium segment contributed most to net sales growth

Vodka remained the largest and most resilient of the major categories in the United States. Diageo out-performed the category as a whole, growing net sales 16% led by Smirnoff in the premium segment and Cîroc and Ketel One vodka at higher price points

Stock levels of beer and malt based ready to drink brands were reduced adversely impacting mix

Stock levels of spirits have reduced across the supply chain

Innovation launches contributed significantly to overall performance as the focus on premium spirits line extensions and pre-mixed cocktails capitalised on consumer shifts

Ketel One vodka performed ahead of expectations

Marketing spend decreased as a result of media efficiencies and a refocus away from beer and ready to drink, however Diageo's share of voice in spirits improved

Net sales growth of 7% in Canada was led by strong performances of Captain Morgan rum of 19% and Smirnoff vodka of 10%

Key measures	2009	2008	Reported movement	Organic movement
	£ million	£ million	%	%
Volume			**4**	
Net sales	**3,290**	2,523	**30**	**1**
Marketing spend	**429**	366	**17**	**(9)**
Operating profit before exceptional items	**1,156**	907	**27**	

Operating profit	**1,131**	907	**25**

Reported performance Net sales increased by £767 million in the year ended 30 June 2009 to £3,290 million, from £2,523 million in the prior year. Reported operating profit before exceptional items increased by £249 million in the year ended 30 June 2009 to £1,156 million, from £907 million in the prior year. Operating profit increased by £224 million in the year ended 30 June 2009 to £1,131 million, from £907 million in the prior year.

Business review (continued)

Organic performance The weighted average exchange rate used to translate US dollar sales and profit moved from £1 = $2.01 in the year ended 30 June 2008 to £1 = $1.60 in the year ended 30 June 2009. Exchange rate impacts increased net sales by £602 million, acquisitions increased net sales by £142 million and there was an organic increase in net sales of £23 million. Exchange rate impacts increased operating profit by £206 million, acquisitions increased operating profit by £45 million and there was an organic decrease in operating profit before exceptional items of £2 million.

Despite the economic climate, the total beverage alcohol market in North America grew in both volume and value. Within spirits, there has been a trend for consumers to trade out of the super and ultra premium segments and down to lower price segments; however the premium segment, where Diageo is most represented, has proved the most resilient and has gained share of the overall spirits category. As consumer demand slowed stock levels reduced in aggregate across the whole supply chain. Spirits stocks with distributors at the end of June 2009 were higher when compared to June 2008, although there has been a significant reduction in absolute levels since December. Stock levels held by retailers are down year on year. The planned beer and ready to drink stock reduction was completed successfully resulting in net sales declines of 6% in beer and 8% in ready to drink. The slowdown of the wine category, especially at price points above $25 per bottle has led to a decline in Diageo wine net sales of 7%. Overall price/mix of 1 percentage point was achieved by strong price increases in the first half on premium brands partially offset by negative mix driven by volume declines in the higher net sales per case scotch category and ready to drink segment.

Smirnoff vodka grew as a result of higher marketing spend and price increases on Smirnoff Red. Marketing spend increased 2% behind core growth drivers reinforcing the quality message combined with investment behind innovation launches on the Smirnoff Flavours range.

Johnnie Walker was impacted by the economic climate that led to the total scotch category declining 3% in value with weaker performance in the deluxe segment. Johnnie Walker Red Label net sales declined 2% and Black Label declined 7% but both gained share of their segments while maintaining price premiums. In the super deluxe segment, Johnnie Walker Blue Label experienced double digit declines and marketing spend was re-directed towards Johnnie Walker Black Label.

Business review (continued)

Investment behind the 'Strides' marketing campaign and driving loyalty through relationship marketing have led to strong improvements across key brand equity measures.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	(2)	(2)	(2)	22
Local priority brands*	1		19	47
Category brands*	6	11	6	36
Total		1	4	30
Key brands:**				
Smirnoff	1	6	1	30
Johnnie Walker	(6)	(8)	(6)	14
Captain Morgan	3	7	3	32
Baileys	(5)	(5)	(5)	16
José Cuervo	3	4	3	30
Tanqueray	(12)	(12)	(12)	10
Crown Royal	(1)	(1)	(1)	23
Guinness	(11)	(6)	(11)	15
Ready to drink	(10)	(8)	(10)	14

* Brand additions in the year ended 30 June 2008 Ketel One vodka and Rosenblum Cellars wine are included in local priority brands while Zacapa rum is included in category brands.

** Spirits brands excluding ready to drink.

Captain Morgan had a strong year, delivering volume and net sales growth and share gains. Four percentage points of positive price/mix was delivered through price increases on Original Spiced Rum and the launch of the higher priced Captain Morgan 100. Increased marketing spend behind the 'Got a little Captain in you' television campaign led to share gains in the rum category and improved brand equity scores.

The liqueur category has been among the hardest hit in the current economic environment and Baileys net sales declined but share was maintained. The decline of Original Irish Cream was partially offset by the successful launch of Baileys with a hint of Coffee.

José Cuervo grew volume 3% and net sales 4%. Share gains on José Cuervo Gold driven by an increase in distribution points and the launch of José Cuervo Silver more than offset weakness in the on-trade.

Tanqueray net sales declined 12% in line with volumes as price increases on the core London Dry variant were offset by faster declines on the higher priced variants Tanqueray No.10 and Rangpur. Marketing investment was reduced as spend was re-directed to fund proven growth drivers on other brands.

Crown Royal volume and net sales declined 1%. Positive net sales growth on the core variant was more than offset by the poor economic conditions impacting the higher priced Reserve and Cask 16 variants. Crown Royal in Canada under-performed the United States, as price increases were not followed by the competition leading to price gaps at retail that impacted volume.

Business review (continued)

Guinness net sales declined 6% as a result of three factors: the planned stock reduction, consumers trading out of the higher priced imported beer segment and into domestic beer, and overall weakness in the on-trade which particularly impacted keg volume. Price increases on both keg and packaged Guinness contributed 5 percentage points of price/mix.

Local priority brands grew volume 1% and held net sales flat driven by the organic contribution of Ketel One vodka and sales of Seagram's 7. This was offset by the decline in US wines, in particular on Chalone wines, as consumers traded down from higher price points. To offset this, Diageo wines increased promotional activity in the second half and launched a number of new products at price-points of $10 and below.

Category brand volume grew 6% and net sales grew 11% reflecting the opportunities presented by Diageo's broad brand range. Cîroc vodka continued its strong growth trajectory, as a result of the combination of Diageo, Sean Combs and the brand itself, and grew volume 137% and net sales 159%. At the other end of the pricing spectrum and capitalising on the consumer shift towards value brands were Gordon's gin with net sales up 9%, Gordon's vodka up 11% and Popov vodka up 14%.

Ready to drink net sales declined 8% as a result of segment decline and the planned stock reduction. Diageo continued to innovate in this segment with the launch of several new Smirnoff Ice flavours and a range of ready to serve Smirnoff Cocktails, reflecting the trend for increased at-home consumption.

Marketing spend for the year decreased 9% due to a reduction of investment behind those brands and segments most impacted by the current economic climate and media rate deflation. While investment behind ready to drink, beer and Tanqueray decreased, proven growth drivers elsewhere in the brand range were fully supported, in particular on Captain Morgan, Cîroc vodka and innovation launches. Overall, Diageo's share of voice of total spirits advertising spend increased 4 percentage points.

Canada has also been affected by the global economic slowdown but it has not experienced contractions on the scale of the United States. Price increases on core spirits together with increased marketing spend behind Smirnoff and Captain Morgan delivered 7% net sales growth.

Gross margin was adversely affected by input cost increases, the negative mix effect of consumers trading down within brands and the volume decline of higher gross margin segments and categories such as ready to drink, scotch and liqueurs. Price increases on core variants taken in the first half plus reductions in overall marketing spend combined to deliver constant operating profit for the year.

Europe

Key highlights

- The region was severely impacted by the economic downturn, with conditions in Spain and Ireland deteriorating significantly
- Great Britain out-performed a declining total beverage alcohol market, growing net sales despite the difficult trading environment
- Russia net sales grew 1% following a strong first half although the worsening economic conditions in the second half led to consumers trading down, driving negative mix. In response to this trend, smaller bottle sizes at lower price points were introduced

Business review (continued)

In a declining beer category, Guinness performed well with flat net sales across the region and grew share in the on-trade in Great Britain and Ireland supported by the 250th Anniversary and 'Alive Inside' campaigns

Key measures	2009 £ million	2008 £ million	Reported movement %	Organic movement %
Volume			**(6)**	**(6)**
Net sales	**2,750**	2,630	**5**	**(5)**
Marketing spend	**419**	438	**(4)**	**(14)**
Operating profit before exceptional items	**856**	798	**7**	**(1)**
Operating profit	**790**	720	**10**	**(1)**

Reported performance Net sales increased by £120 million in the year ended 30 June 2009 to £2,750 million, from £2,630 million in the prior year. Reported operating profit before exceptional items increased by £58 million in the year ended 30 June 2009 to £856 million, from £798 million in the prior year. Operating profit increased by £70 million in the year ended 30 June 2009 to £790 million, from £720 million in the prior year.

Organic performance The weighted average exchange rate used to translate euro sales and profit moved from £1 = €1.36 in the year ended 30 June 2008 to £1 = €1.17 in the year ended 30 June 2009. Exchange rate impacts increased net sales by £260 million, acquisitions increased net sales by £6 million and there was an organic decrease in net sales of £146 million. Exchange rate impacts increased operating profit by £66 million, acquisitions decreased operating profit by £2 million and there was an organic decrease in operating profit before exceptional items of £6 million.

In Great Britain net sales were up 2% driven by strong spirits and wine performance and Diageo gained share of beer in the on-trade and of spirits and wine in the off-trade. Bell's and Baileys performed strongly with both brands gaining share in the on-trade and off-trade following a robust Christmas. Smirnoff vodka net sales declined 3% as the brand came under increased pressure from heavily promoted competitor brands.

The performance in Ireland was impacted by the continued decline of the total beverage alcohol market where volume declined by 4% and value by 3%. Against this, Guinness net sales were flat as Diageo maintained investment behind the brand with the 250th Anniversary and the 'Alive inside' campaigns. For the second consecutive year Guinness grew share in the key Republic of Ireland and Northern Ireland on-trade channels.

In Spain volume was down 21% and net sales were down 20% in line with market trends following the steep decline in the economy from mid-November onwards. Rising unemployment, lower consumer confidence and spending power reduced demand across consumer categories and led to a shift from on-trade to off-trade impacting spirits consumption. Significant de-stocking occurred as limited credit availability in the market led to some wholesalers being unable to fund their stock.

In Russia volume was up 2% and net sales were up 1% following a strong first half performance. Johnnie Walker remained the key brand and accounted for almost 50% of net sales. Price/mix was down 1 percentage point as consumers traded down from deluxe to standard scotch and both Johnnie Walker Red Label and White Horse grew share. In many markets in Eastern Europe Diageo's key brands gained share.

Business review (continued)

Smirnoff vodka net sales were down 6% with declines in Great Britain and Spain partially offset by net sales growth in Continental Europe. Smirnoff continued to be the number one premium spirit in Great Britain and grew share in Ireland.

Brand performance	Organic volume movement	Organic net sales movement	Reported volume movement	Reported net sales movement
	%	%	%	%
Global priority brands	(8)	(6)	(8)	4
Local priority brands	(6)	(6)	(6)	4
Category brands*	(1)	(2)	(1)	8
Total	(6)	(5)	(6)	5
Key brands:**				
Smirnoff	(8)	(6)	(8)	
Johnnie Walker	(5)	(4)	(5)	7
Baileys	(9)	(10)	(9)	
JεB	(13)	(13)	(13)	
Guinness	(6)		(6)	8
Ready to drink	(17)	(11)	(17)	(2)

* Brand additions in the year ended 30 June 2008 Ketel One vodka, Rosenblum Cellars wine and Zacapa rum are included in category brands.

** Spirits brands excluding ready to drink.

Johnnie Walker net sales decreased by 4% mainly driven by the performance in Spain and Russia. The brand continued to perform well in Greece where Johnnie Walker Black Label grew net sales by 14% following the successful launch of the anniversary pack supported by the 'Strides' and 'Crossroads' campaigns. The brand benefited from price increases in all markets leading to positive price/mix in the region.

Baileys net sales were down 10%. The overall decline of the brand was mainly due to performance in Iberia, where net sales declined in line with the category. In Great Britain both Baileys Original and the Baileys Flavours variants grew volume and net sales with positive price/mix following the successful launch of Baileys Coffee.

JεB volume and net sales were down 13%, principally due to performance in Iberia where the economic environment has driven a significant decline in consumption and customer stock levels.

In Great Britain Guinness has now delivered 30 consecutive months of volume share growth in the on-trade and therefore despite the difficult on-trade beer segment, net sales of Guinness declined only 1%. In the second half net sales were flat, while the beer market continued to decline driven by the switch from on-trade to off-trade and the increase in beer duty. This share gain was driven by the execution of a new strategy to focus on less frequent purchasers, investment behind the 250th Anniversary and the '17:59' and 'Alive inside' campaigns. In Ireland net sales were also flat and Guinness grew share in key on-trade channels.

Local priority brand net sales were down 6% driven by Cacique and Cardhu in Iberia and the agency beer brands in Ireland partially offset by Harp, which benefited from the continued rollout of Harp Ice Cold. Bell's had good net sales and volume growth in Great Britain, driven by the launch of

Business review (continued)

Bell's Original supported by a marketing programme called 'The Spirit of Arthur Bell' which included television, newspaper and direct mail advertising.

Category brand volume was down 1% and net sales were down 2% with declines in most markets offset by growth in Blossom Hill in Great Britain and growth of White Horse scotch in Russia.

Ready to drink volume was down 17% as the segment continued to decline. Smirnoff Ice volume was down 20% in Great Britain although the brand grew share in the on-trade.

Marketing spend was down 14% across the region particularly driven by Spain and Ireland, countries where the economic conditions were harder and the beverage alcohol consumption declined more significantly.

International

Key highlights

- Volume growth in Africa and price increases in both Africa and Latin America drove net sales growth of 7%
- Volume and net sales growth in Venezuela, Mexico and Brazil, the three largest markets in Latin America offset declines in the duty free channel in Latin America and in the Caribbean
- Strong growth in beer with volume up 5% and net sales up 17%
- Pressure on the Global Travel business due to declining passenger numbers and customer de-stocking
- Marketing spend efficiencies in Latin America and the transition of spend on ready to drink, cider and beer brands into the new South Africa joint venture offset increases on beer and ready to drink elsewhere in Africa

Key measures	2009 £ million	2008	Reported movement	Organic movement