DIAGEO

Annual Report 2018

Our performance 2018

Financial

Volume (equivalent units EU)

2018	EU240.4m
2017	EU242.2m
Reported movement	↓ 0.7%
Organic movement	↑ 2.5%

Net sales[i]

2018	£12,163m
2017	£12,050m
Reported movement	↑ 0.9%
Organic movement	↑ 5.0%

Operating profit

2018	£3,691m
2017	£3,559m
Reported movement	↑ 3.7%
Organic movement	↑ 7.6%

Net cash from operating activities

2018	£3,084m
2017	£3,132m
2018 decrease of £48m	
2018 free cash flow[ii] £2,523m	↓ £140m

Earnings per share (eps)

2018	121.7p
2017	106.0p
Reported movement	↑ 14.8%
Eps before exceptional items movement[ii]	↑ 9.3%

Total recommended dividend per share[iii]

2018	65.3p
2017	62.2p
	↑ 5%

Non-financial

Alcohol in society

2018	225
2017	264

Number of responsible drinking programmes

Health and safety

2018	1.00Δ
2017	1.14

Lost time accident frequency[iv]

Water efficiency[v]

2018	4.94l/lΔ
2017	4.98l/l

(i) Net sales are sales less excise duties.
(ii) See definitions and reconciliations on pages 56-61.
(iii) Includes recommended final dividend of 40.4p.
(iv) Per 1,000 full-time employees.
(v) Data for the year ended 30 June 2017 has been restated in accordance with Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. For further detail and the reporting methodologies, see our Sustainability & Responsibility Performance Addendum 2018.

Performance by region 2018

	North America	Europe and Turkey	Africa	Latin America and Caribbean	Asia Pacific
Volume (equivalent units)	EU48.2m	EU46.3m	EU33.2m	EU22.2m	EU90.5m
Reported	↑ 2%	↑ 4%	↑ 3%	↑ 5%	↓ 7%
Organic	↑ 1%	↑ 4%	↑ 3%	↑ 5%	↑ 2%
Net sales[i]	£4,116m	£2,932m	£1,491m	£1,069m	£2,503m
Reported	↓ 1%	↑ 4%	↓ 4%	↑ 2%	↑ 3%
Organic	↑ 4%	↑ 4%	↑ 3%	↑ 7%	↑ 9%
Operating profit[ii]	£1,882m	£1,028m	£191m	£308m	£568m
Reported	↓ 1%	↑ 10%	↓ 12%	↑ 23%	↑ 17%
Organic	↑ 2%	↑ 8%	↓ 5%	↑ 19%	↑ 19%

Read more p28-29 | Read more p30-31 | Read more p32-33 | Read more p34-35 | Read more p36-37

(i) Excluding corporate net sales of £52 million (2017 – £46 million).
(ii) Excluding exceptional operating charges of £128 million (2017 – £42 million) and net corporate operating costs of £158 million (2017 – £189 million).

Diageo in 2018

Diageo is **a global leader** in beverage alcohol with an **outstanding collection of brands** across spirits and beer.

Our products are sold in more than 180 countries around the world. Our brands include Johnnie Walker, Crown Royal, JεB, Buchanan's and Windsor whiskies, Smirnoff, Cîroc and Ketel One vodkas, Captain Morgan, Baileys, Don Julio, Tanqueray and Guinness.

Our performance ambition is to be one of the best performing, most trusted and respected consumer products companies in the world.

We are proud of the brands we make and the enjoyment they give to millions. We are passionate about alcohol playing a positive role in society as part of a balanced lifestyle. It is central to our purpose to celebrate life, every day, everywhere.

Contents

Cover image: Members of Diageo's Scotch whisky specialist team, Emma Walker and Aimee Gibson, in the Blenders' Room at Diageo's International Supply Technical Centre, Menstrie, Scotland.

For more information about Diageo, our people and our brands, visit **www.diageo.com**.

Visit Diageo's global responsible drinking resource, **www.DRINKiQ.com**, for information, initiatives and ways to share best practice.

In addition to the economic, social and environmental disclosures in this Annual Report, Diageo has prepared a Sustainability & Responsibility Performance Addendum 2018, in line with the Global Reporting Initiative Sustainability Reporting Standards and the United Nation's Global Compact advanced reporting criteria. It is available at **www.diageo.com.**

Diageo is listed on both the London Stock Exchange (DGE) and the New York Stock Exchange (DEO).

This is the Annual Report 2018 of Diageo plc for the year ended 30 June 2018. The Annual Report is made available to all shareholders on Diageo's website (**www.diageo.com**).

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 the terms 'group' and 'Diageo' refer to the company and its consolidated subsidiaries, except as the context otherwise requires.

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

Unless otherwise stated in this document, percentage movements refer to organic movements which are non-GAAP financial measures. For a definition of organic movement and reconciliations of non-GAAP measures to GAAP measures see pages 56-61. Share refers to value share. Percentage figures presented are reflective of a year-on-year comparison, namely 2017-2018, only.

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

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Diageo plc is incorporated and domiciled as a public limited company in England and Wales.

Diageo was incorporated as Arthur Guinness Son and Company Limited on 21 October 1886. The group was formed by the merger of Grand Metropolitan Public Limited Company (GrandMet) and Guinness PLC (the Guinness Group) in December 1997. Diageo plc's principal executive office is located at Lakeside Drive, Park Royal, London NW10 7HQ and its telephone number is +44 (0) 20 8978 6000.

Cautionary statement: this document contains 'forward-looking' statements. For our full cautionary statement, please see page 163.

Our business model

Diageo is a global leader in beverage alcohol with a portfolio of iconic spirits and beer brands.

We have a broad portfolio across categories and price points and our products are available in more than 180 countries. Our portfolio and geographic reach enable us to deliver sustainable performance and create value for our shareholders.

The consumer is at the heart of our business. Using world-class marketing and innovation skills, we aim to build and sustain strong brands that play a positive role in society.

Our organisation is structured in a market-based model. This means we have greater agility and can better apply our strategy in individual countries to meet the diverse needs of our consumers and customers. It also enables us to quickly identify and act on consumer trends to support growth.

We use our local and global market expertise to identify and deliver against the most valuable growth opportunities.

Our global supply capabilities enable us to manufacture and distribute our brands efficiently and effectively. Where it makes sense to do so, we source and produce locally.

We are passionate about our role in society and the responsibility we have to our stakeholders, communities and the environment.

We make

We are the makers of premium spirits and beer, committed to the highest quality and standards.

We innovate

Led by consumer insights, we unlock new opportunities to recruit and re-recruit consumers to our brands. We innovate with new offerings that meet changing consumer demands.

We market

We invest in world-class marketing to responsibly build aspirational brands that resonate with our consumers.

We sell

We extend our sales reach through leading activations and advocacy to ensure our brands are part of consumer celebrations around the world.

Key highlights

Brands
200+

Production sites
150

Employees
30,000

Countries
180

How we operate

Broad portfolio
Each market has the flexibility to select the best portfolio of brands to capture unique consumer opportunities. We then invest in opportunities that we believe offer the most valuable growth.

Markets
The business operates through a market-based structure so that we are able to act on local consumer insights and identify trends quickly to deliver locally relevant solutions.

Global functions, support and governance
Our markets are supported by global functional teams and a broad range of shared services which, together, drive the sharing of best practice, enhance efficiency and help build in-market capabilities. Our standards for governance, compliance and ethics are set globally.

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

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

Our role in society
We are committed to playing a positive role in society. We work to reduce alcohol harm and promote moderation, increase access to opportunities for local communities and reduce our environmental impact.

Our brands
We own two of the world's five largest premium spirits brands, Johnnie Walker and Smirnoff, and 22 of the world's top 100 premium spirits brands.[i]

Our geographic footprint
We have broad reach in the United States and Europe and leading positions in many of the markets that will generate most of the medium-term industry growth.

Brilliant execution
We use cutting-edge consumer insights and marketing, we innovate at scale and we develop winning relationships with our customers through distribution and sales.

Efficient supply and procurement
We work to high-quality manufacturing and environmental standards.

Financial strength
We aim to deliver strong financial returns and consistent performance.

(i) Impact Databank Value Ratings, May 2018.

Our strategy

The global spirits category has shown resilient, long-term growth. This is being driven by population and income growth, and the increasing penetration of spirits around the world.

Our strategy is to support premiumisation in developed and emerging countries. Our broad portfolio means we can access different consumer occasions with our brands, across price points.

In developed markets, we support premiumisation through our premium core and reserve brands. These enable consumers to trade up into luxury categories.

In emerging markets, we aim to grow participation in international premium spirits. To support this, we participate in mainstream spirits so consumers can access our brands at affordable price points. This also enables us to shape responsible drinking trends in markets where international premium spirits is an emerging category.

We have a global beer business, led by our premium brand Guinness. Beer is our second largest category after scotch. We have a large beer business in Africa with a portfolio that reaches across price points.

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

Our strategy is delivered through

Six executional priorities

Our strategy in action **p16-18**

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

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

Continue to win in reserve
We build our reserve brands by ensuring they are available in the most influential outlets. We also build their reputations with the bartenders and consumers who set trends.

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

Build an advantaged route to consumer
Consumers are at the heart of our business. Using insights, we ensure we understand where to invest our resources so that our brands are consistently presented.

Embed productivity to drive out costs and invest in growth
We are focused on every day efficiency, effectiveness and agility to reduce costs and create fuel for our growth.

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

Our strategy in action **p16-18**

Creating a positive role for alcohol in society
We are committed to alcohol playing a positive role in society through our work to promote moderation and tackle alcohol misuse. We remain focused on delivering the five Global Producers' Commitments[i] and our own stretching 2025 targets.

(i) For more information on the Beer, Wine and Spirits Producers' Commitments, visit www.producerscommitments.org.

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

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

Highest standards of governance and ethics
We are constantly looking for ways to strengthen our culture of integrity and help our people make the right choices. For example, we have further enhanced our third-party due diligence programme, *Know Your Business Partner.* The new technology we have adopted globally enables stronger central oversight, ensures a greater impact on risk and is easy to use for us and our partners.

Outcomes of our strategy

1 Efficient growth

2 Consistent value creation

3 Credibility and trust

4 Motivated people

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

Organic net sales growth	1
Organic operating margin improvement	1
Earnings per share before exceptional items	1
Free cash flow	1
Return on average invested capital	2
Total shareholder return	2
Reach and impact of responsible drinking programmes	3 4
Health and safety	3 4
Water efficiency	1 3
Carbon emissions	1 3
Employee engagement index	3 4

Our brands

Our broad portfolio consists of international and local brands. Reaching across categories and price points, it enables us to participate where we believe the consumer opportunity is greatest and support consistent growth.

We own two of the five largest premium spirits brands in the world, Johnnie Walker and Smirnoff, and 22 of the world's top 100 premium spirits brands.(i)

Using local market insights, our teams select the most relevant brands from our global portfolio to meet the consumer opportunity in their market.

A selection of our brands is included in the table below.

Global giants(ii)

Our business is built around our six biggest global brands.

Local stars(iii)

Can be individual to any one market and provide a platform for our business to grow.

Reserve(iv)

Exceptional spirits brands at above-premium price points to capture the global luxury opportunity.

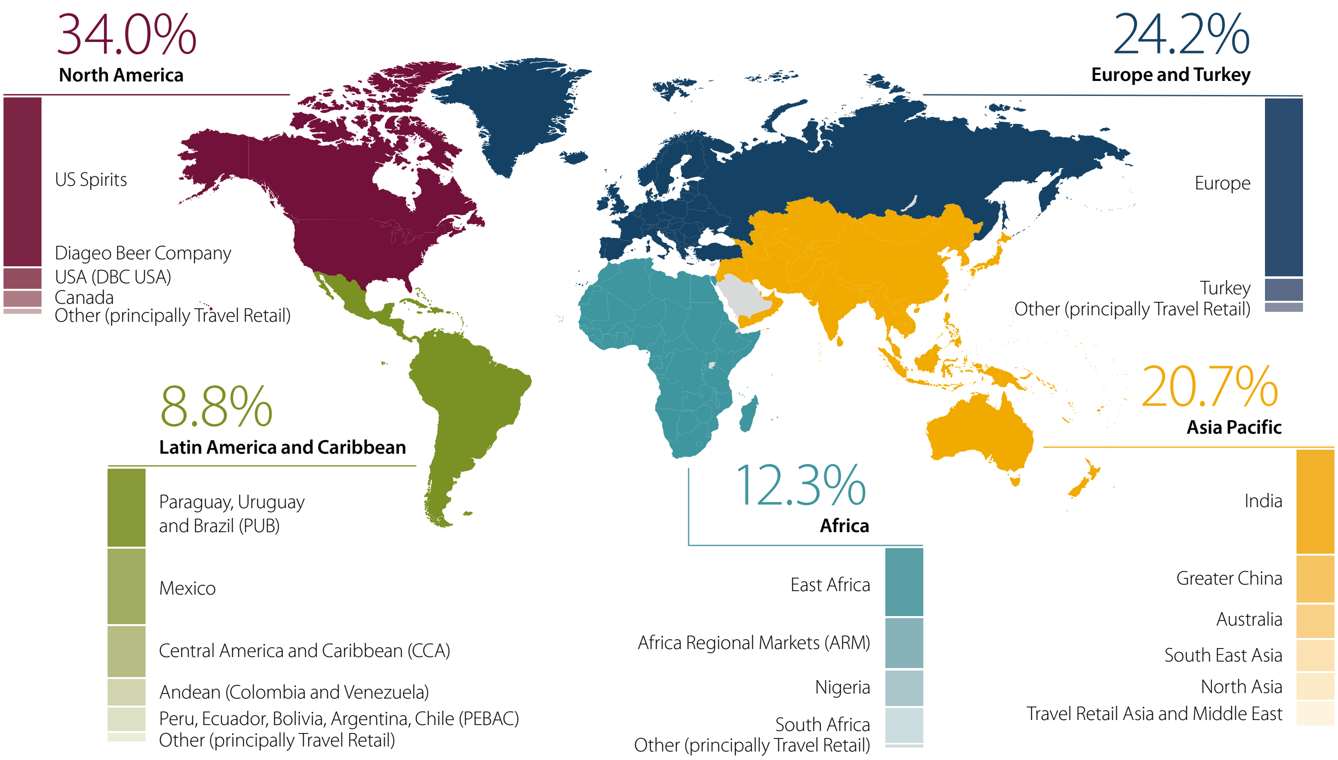
(i) Impact Databank Value Ratings, May 2018.
(ii) Global giants represent 41% of Diageo net sales.
(iii) Local stars represent 20% of Diageo net sales.
(iv) Reserve brands represent 18% of Diageo net sales.

Our global reach

Our regional profile provides us with exposure to the greatest consumer growth opportunities in our sector.

We operate as a market-based business and have a presence in over 180 countries. Each of our markets is accountable for its own performance and for driving growth. We employ 30,000 talented people across our global business.

% share of net sales by region[(i)]



(i) Based on reported net sales for the year ended 30 June 2018. Does not include corporate net sales of £52 million.

% share by region	North America	Europe and Turkey	Africa	Latin America and Caribbean	Asia Pacific
Volume	20.0	19.3	13.8	9.2	37.7
Net sales[(i)]	34.0	24.2	12.3	8.8	20.7
Operating profit before exceptional items[(ii)]	47.3	25.8	4.8	7.7	14.4
Operating profit[(iii)]	48.9	26.7	1.6	8.0	14.8
Number of responsible drinking programmes	28.0	31.0	13.0	10.0	18.0
Water withdrawal	12.0	40.0	38.0	1.4	8.6
Carbon emissions[(iv)]	7.0	45.0	36.0	3.0	7.0
Number of employees[(v)]	8.9	35.2	16.4	9.2	30.3

(i) Excluding corporate net sales of £52 million.
(ii) Excluding exceptional operating charges of £128 million (2017 – £42 million) and net corporate operating costs of £158 million (2017 – £189 million).
(iii) Excluding net corporate operating costs of £158 million (2017 – £189 million).
(iv) Excludes corporate offices which account for <2% of combined impacts.
(v) Employees have been allocated to the region in which they reside.

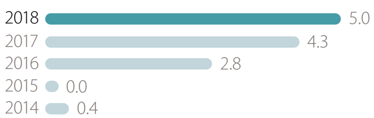
How we measure performance

Key performance indicators

Financial

Organic net sales growth (%)

5.0%



Definition
Sales growth after deducting excise duties, excluding the impact of exchange rate movements, acquisitions and disposals.

Why we measure
This measure reflects our performance as the result of the choices made in terms of category and market participation, and Diageo's ability to build brand equity, increase prices and grow market share.

Performance
Organic net sales grew 5%, driven by 2.5% volume growth and 2.5% positive price/mix.

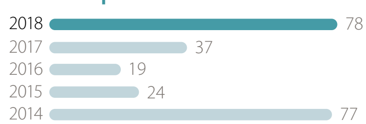
Growth was broad based with all regions delivering both organic volume and net sales growth.

More detail on **p23**

Financial

Organic operating margin improvement (bps)

78bps



Definition
The percentage point movement in operating profit before exceptional items, divided by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.

Why we measure
The movement in operating margin measures the efficiency of the business. Consistent operating margin improvement is a business imperative, driven by investment choices, our focus on driving out costs across the business and improving mix.

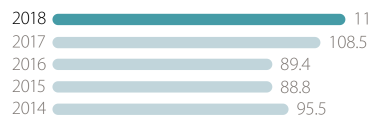
Performance
Organic operating margin improved 78bps driven primarily by our productivity programme partially offset by higher marketing spend.

More detail on **p23**

Financial

Earnings per share before exceptional items (pence)(i)

118.6p



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

Why we measure
Earnings per share reflects the profitability of the business and how effectively we finance our balance sheet. It is a key measure for our shareholders.

Performance
Eps before exceptional items increased 10.1 pence driven by organic operating profit growth and lower finance charges partially offset by the negative impact from exchange and higher tax expense.

More detail on **p24**

Non-Financial

Alcohol in society (number of responsible drinking programmes)

225 programmes

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

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

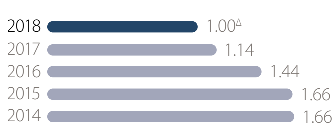
Performance
We continued to concentrate our efforts on those programmes that deliver the biggest impact, thereby supporting fewer programmes. We evaluated the effectiveness of our programmes in 89% of our top 18(ii) countries. We share case studies of how we evaluate our programmes on www.diageo.com. This is the last year we will be reporting on this indicator. During the year, we launched a new alcohol in society strategy, as discussed on page 42. We will report on KPIs against this strategy next year.

More detail on **p42-44**

Non-Financial

Health and safety (lost-time accident frequency per 1,000 full-time employees)

1.00Δ



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

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

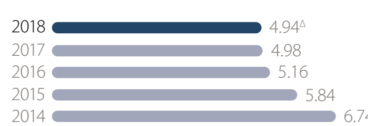
Performance
We achieved a milestone safety performance level of 1.00 lost-time accidents (LTAs) per 1,000 employees, two years ahead of our original 2020 plan. This represents a 12% reduction in LTAs compared with 2017. We continued our focus on markets in particular need of improvement, embedding compliance to our core standards and programmes, while maintaining strong performance in our more established markets.

More detail on **p48**

Non-Financial

Water efficiency(iii) (l/l)

4.94l/lΔ



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

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

Performance
Water efficiency improved by 0.8% compared to 2017, and 40.3% versus our 2007 baseline, with particular progress in markets with sites in water-stressed locations.

More detail on **p50-54**

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

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

Relevance to strategy

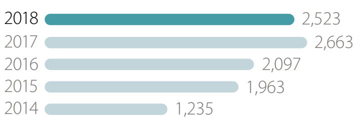
1. Efficient growth
2. Consistent value creation
3. Credibility and trust
4. Motivated people

Financial ® 1

Free cash flow

(£ million)

£2,523m



Definition

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

Why we measure

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

Performance

Free cash flow continued to be strong at £2.5 billion. Operating profit growth was largely offset by increased investment in maturing stock and lower operating working capital improvements year on year.

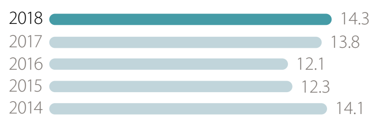
More detail on **p24**

Financial 2

Return on average invested capital

(ROIC) (%)

14.3%



Definition

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

Why we measure

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

Performance

ROIC before exceptional items increased 48bps as organic operating profit growth was partially offset by the impact from acquisitions and disposals and higher underlying tax charges.

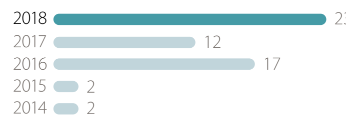
More detail on **p24**

Financial ® 2

Total shareholder return

(%)

23%



Definition

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

Why we measure

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

Performance

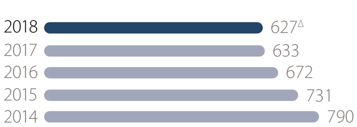
Diageo delivered total shareholder return of 23% as dividends increased, own share buyback programme of £1.5 billion was executed and the share price benefited from underlying business improvements.

Non-Financial 1 3

Carbon emissions(iv)

(1,000 tonnes CO_2e)

627Δ



Definition

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

Why we measure

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

Performance

Carbon emissions reduced by 1.0% in 2018, and by 40.8% against the 2007 baseline despite increased production volumes.

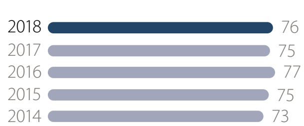
More detail on **p50-54**

Non-Financial 3 4

Employment engagement index

(%)

76%



Definition

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

Why we measure

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

Performance

94% of our people participated in our Values Survey (22,826 of the 24,214 invited). 76% were identified as engaged, an increase of 1% on last year. 90% declared themselves proud to work for Diageo, up 1% on 2017.

More detail on **p49**

Remuneration

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

See our Directors' remuneration report from **p 71** for more detail.

(i) For reward purposes this measure is further adjusted for the impact of exchange rates and other factors not controlled by management, to ensure focus on our underlying performance drivers.
(ii) We now report on our top 18 countries as opposed to 19, as a result of selling our Red Stripe business in Jamaica. Our top countries are identified as those with the highest net sales.
(iii) In accordance with Diageo's environmental reporting methodologies, data for each of the four years in the period ended 30 June 2017 has been restated.
(iv) In accordance with Diageo's environmental reporting methodologies and WRI/WBCSD GHG Protocol, data for each of the four years in the period ended 30 June 2017 has been restated.
Δ Within PwC's limited assurance scope. See page 162 for further details.

Chairman's statement

Recommended final dividend per share

40.4p ↑5%

2017: 38.5p

Total dividend per share[(i)]

65.3p ↑5%

2017: 62.2p

Total shareholder return (%)

23%

2017: 12%

This year's performance demonstrates the consistent and rigorous execution of our strategy and is testimony to the passion and commitment of all our people around the world. My thanks to everyone at Diageo for another year of progress.

Culture

We are seeing the benefits of the transformation of the company under Ivan's leadership. The entrepreneurial spirit, embodied by many of our brands' founders, is very much alive in today's Diageo. Our culture and values will continue to drive performance and help attract and retain the best talent. There is more work to do, but Diageo is an increasingly agile, efficient, consumer-centric business.

Opportunities for growth

We are a global leader with an enviable portfolio of brands and an extensive geographical footprint. We will seize the opportunities presented by demographic change and rising incomes that allow people to choose premium brands. These are trends that make total beverage alcohol a very attractive sector for growth. Spirits continue to take share from wine, premium beer continues to outperform mainstream beer and people want to drink better, not more.

We expect 730 million new consumers[(ii)] will be able to afford international premium spirits over the next 10 years, driving growth in our business and creating long-term value for all our stakeholders.

The global environment

We find combined economic and political challenges around the world, including questions about international trade and future partnerships between countries. Diageo is experienced in navigating volatility. Our broad portfolio, geographic footprint and leadership position in many markets, together with the flexibility of our operating model, enable us to adapt well to change.

We continue to prepare for all scenarios around the United Kingdom's exit from the European Union in 2019 and are taking Brexit in our stride. We look forward to agreement on a final deal that will provide stability for our workforce and business operations in the United Kingdom and the European Union, as well as clarity on existing and future trade deals between countries. As one of the United Kingdom's most important manufacturing export companies, we are working with the UK government to ensure our priorities are well understood.

"The entrepreneurial spirit, embodied by many of our brands' founders, is very much alive in today's Diageo. Our culture and values will continue to drive performance and help attract and retain the best talent. There is more work to do, but Diageo is an increasingly agile, efficient, consumer-centric business."

Javier Ferrán
Chairman

(i) Includes final recommended dividend of 40.4p.
(ii) Euromonitor 2015 and internal analysis.

Creating value

Looking in more detail at the drivers of performance, we have made further good progress toward our medium term guidance and across the four areas in which we measure our performance: efficient growth, value creation, credibility and trust, and motivated people. Our value creation KPIs, return on average invested capital (ROIC) and total shareholder return (TSR) both increased, to 14.3% and 23%, respectively, this year. Progress has also been made across our efficient growth KPIs.

We continue to target dividend cover (the ratio of basic earnings per share before exceptional items to dividend per share) of between 1.8 and 2.2 times. The recommended final dividend is 40.4 pence per share, an increase of 5%. This brings the recommended full year dividend to 65.3 pence per share and dividend cover to 1.8 times. We continue to expect to maintain dividend increases at a mid-single digit rate until our dividend cover is comfortably back in range.

Subject to shareholder approval, the final dividend will be paid to UK shareholders on 4 October 2018. Payment will be made to US ADR holders on 10 October 2018.

Earlier this year, we completed the purchase of 58.9 million shares, returning £1.5 billion to shareholders. Having delivered another year of strong cash flow generation, the Board has approved an additional share buyback programme of up to £2.0 billion during fiscal 2019.

Our role in society

Making a positive contribution to society is central to our purpose. Social philanthropy played a big part in the lives of the founders of many of our brands and we have a long track record of supporting the communities around us through targeted programmes, as well as creating jobs and increasing prosperity.

We believe that promoting a positive role for alcohol in society and fostering inclusive growth through our value chain are fundamental to achieving our long-term performance goals. Ivan outlines in more detail how we have developed our alcohol in society strategy to deliver more. I am proud of the work Diageo continues to do in helping to reduce alcohol harm and I am pleased to see the wholehearted commitment across the company to stretching targets that will deliver even greater impact.

Our broader sustainability and responsibility framework is embedded in our business strategy and focused on targets for non-financial performance, which are included in this report (see pages 40-55).

Diversity and inclusion

We know that for our business to thrive, we depend on diverse talent and thinking with a range of backgrounds, skills and capabilities. Our employees must reflect our broad consumer base. We believe diversity is one of the key enablers that helps our business to grow and I am particularly proud that Diageo has focused on achieving greater diversity at the most senior levels: women currently make up 50% of our Board.

The Executive Committee is a team of highly successful men and women representing six different nationalities, speaking multiple languages and all having lived and worked in countries across the globe. 40% of the Executive Committee are women.

I am pleased that we are also receiving recognition for our diversity. In January 2018, Diageo was recognised by the Bloomberg Gender-Equality Index for our performance and disclosure around gender equality and we ranked fifth in the Thomson Reuters Global Diversity and Inclusion Index. In November 2017, Diageo ranked third in the FTSE 100 for 'women on boards and in leadership' in the Hampton-Alexander Review. And Diageo was named joint first in the FTSE 100 'companies with female executive directors', in the Female FTSE Board Report 2017 from Cranfield University School of Management.

Our intent is to have our senior leadership team 35% female by 2020, with an increase to 40% by 2025. This figure currently stands at 34%.

Celebrating our inclusive and diverse culture is core to Diageo's purpose of 'celebrating life, every day, everywhere'. This purpose is inclusive in nature, valuing everybody irrespective of background, religion, sexuality or ethnicity.

Our commitment to fostering greater inclusion and diversity can also be seen through our brands: Smirnoff's 'We're Open' campaign supports LGBT inclusivity. In May, Diageo also pledged support to the United Nation's Global LGBTI Standards of Conduct for Business.

Board changes

In April 2018, we announced the appointment of Susan Kilsby as a Non-Executive Director. Susan's expertise in finance and M&A make her contributions a valuable addition to the Board's deliberations.

In March, we agreed with Ursula Burns that her appointment as Non-Executive Director would be delayed. The delay is a result of her ongoing commitments at VEON Ltd, where she is currently Executive Chairman on an interim basis. We look forward to welcoming Ursula to the Board in due course.

The future

Diageo is a global leader in a highly attractive industry, in which the increasing number of legal purchasing age consumers continue to trade up. It is also a business with a long cycle, as it takes time to build brands sustainably. The consistent execution of strategy has delivered further progress this year and the Board and Executive leadership remain fully committed to building long-term value.

Javier Ferrán
Chairman

Chief Executive's statement

Volume movement	Organic volume movement
↓ 0.7%	↑ 2.5%
2017: ↓ 1.7%	2017: ↑ 1.1%
Net sales movement	**Organic net sales movement**
↑ 0.9%	↑ 5.0%
2017: ↑ 14.9%	2017: ↑ 4.3%
Operating profit movement	**Organic operating profit movement**
↑ 3.7%	↑ 7.6%
2017: ↑ 25.3%	2017: ↑ 5.6%

I am pleased to report another year of strong and consistent performance. I am proud of our people's passion and engagement, and want to thank all 30,000 colleagues for their commitment to our purpose and values, and for the spirit with which they are making Diageo a stronger business.

Performance

We have become a more efficient, agile company, through the rigorous execution of our strategy and by capitalising on established trends: consumers in developed markets are moving to better quality, more premium brands; those in emerging markets are also trading up into spirits. Of course, while we are one of the largest distillers in the world, beer is also an important part of our business and accounted for 16% of our net sales. It is the second largest category for Diageo after scotch, and Guinness, our premium beer, is growing strongly.

Organic net sales were up 5%, driven by volume growth and strong price/mix. Growth was broad based across categories and regions, including our three focus areas: scotch, US Spirits and India. Organic operating margin expanded by 78bps. We delivered organic operating profit growth of 7.6% and increased investment behind our brands by 7%.

All our regions delivered growth in net sales, as did all categories, with the exception of vodka. Our global giant brands grew 4%, with Johnnie Walker up 5%, Tanqueray up 15%, Guinness up 5%, Baileys up 6% and Captain Morgan up 2%. Smirnoff organic net sales were down 2%, driven predominantly by US Spirits and Europe, as well as competitive pressure in South Africa. Our local stars were up 6% and reserve was up 14%, with particularly strong performances from Chinese white spirits and Don Julio, up 63% and 39%, respectively.

We have a broad portfolio across geographies and categories, which provides a natural hedge against challenging conditions in some countries, such as Cameroon and Ethiopia, this year. In Ethiopia, currency devaluation, changes in the competitive environment and political unrest created a difficult operating environment.

Earnings per share before exceptionals were up significantly again this year, increasing 9.3%. This was primarily driven by organic operating profit growth.

We delivered another year of strong consistent free cash flow performance, delivering £2.5 billion. I am pleased with our continued focus on driving working capital efficiency and the progress we made on average working capital.

"Diageo is becoming a great blend of every day efficiency and reinvestment in our brands. Our results reflect the high performance culture we have created in the company, as well as the ongoing rigorous execution of our strategy. We are more consumer focused and our ability to move swiftly on trends and insights means we are better placed to capture opportunities and deliver sustained growth."

Ivan Menezes
Chief Executive

Our focus areas

Scotch net sales grew 2% and US Spirits and India grew 3% and 9%, respectively. In scotch, Johnnie Walker had another strong year with 5% organic net sales growth. However, we know we have more to do on malts and local stars, Buchanan's and Old Parr.

In US Spirits, share gains were made across all key brands, except vodka. Net sales were down 3% in vodka and although there were early signs of improvement in Ketel One vodka and Cîroc vodka, we know we have more to do. A stronger performance in India reflected a more stable operating environment in the second half, following a year of challenges brought about by regulatory headwinds.

Creating value

We have developed a better understanding of how our consumers celebrate life with our brands. Alongside improved performance, we are creating long-term value by building brands that consumers love. It requires insight, time and investment. The consistency in our execution is supported by a blend of creativity, data and analytics.

Our insights have led to the development of some exciting innovations. In US Spirits, we launched Ketel One Botanicals, in response to increasing interest in natural ingredients. Distilled with real botanicals and infused with natural fruit and botanical essences, Ketel One Botanicals has no artificial flavours and sweeteners and no added sugars. It is made with 100% non-GMO grain and is 30% ABV. In Great Britain, Gordon's Premium Pink Distilled Gin has become the number one new product launch in spirits and the most successful new spirits launch of the last decade.[i] Overall, our brands continue to receive many accolades: at the San Francisco World Spirits Competition, we were awarded 72 medals, including three Best in Class and 12 Double Gold.

Increasingly, we find consumers want a greater and more personal connection to the brands they admire. In response to this, we recently announced plans for a state-of-the-art Johnnie Walker immersive visitor experience in Edinburgh and a new Bulleit Bourbon Visitor Centre in Kentucky.

Diageo in society

A company that wishes to be truly sustainable must strive to have the most positive impact it can on society. For Diageo, this means developing the most talented and engaged employees; investing and innovating to ensure we are environmentally sustainable; creating a positive role for alcohol around the world; and investing in the community with programmes that support job creation, access to clean water and women's empowerment.

We know the misuse of alcohol can harm individuals and communities and we are committed to promoting moderation. This year, we set out a new strategy to drive further progress globally through hard-hitting campaigns to reduce excessive consumption, drink driving and underage drinking. We advocate to establish laws and industry standards, such as minimum legal purchase age or drink driving enforcement, where these are not already in place. We also continue to lead the fight against consumption of illicit and dangerous alcohol in emerging markets.

I am honoured to represent Diageo as Chairman of the CEO Group at the International Alliance for Responsible Drinking (IARD), which brings together the 11 largest alcohol producers to encourage moderation and tackle harm. This year, IARD members have committed to address the use of technology and data in digital marketing, to ensure we are targeting adult consumers in a responsible way.

Our community investment and programmes promote skills and employability, empower women and increase access to clean water. Our Learning for Life programme has reached more than 130,000 people since 2008, with training that opens up permanent and high quality job opportunities in the hospitality sector. Through our leadership of Movement to Work in the United Kingdom, our ambition is to remove barriers to employment with quality work placement opportunities for young people not in education or training.

Our Water of Life programme has reached over 10 million people in 21 countries since 2006, making a real impact on vulnerable communities. And the impact of our gender equality and empowerment programmes for women and girls is amplified across many markets through our global partnership with CARE International.

We have set ourselves stretching environmental targets, supported by capital investment. Over the last decade, we have reduced carbon emissions from our direct operations by 41% and from our entire supply chain by 23%, against our 2007 baseline. We cannot be complacent, however, as we do face challenges and it has taken longer than expected to implement certain environmental projects. We are now focused on investments in renewable energy and water efficiency, as well as our new ambition on plastics.

Outlook

Diageo is becoming a great blend of every day efficiency and reinvestment in our brands. Our results reflect the high performance culture we have created in the company, as well as the ongoing rigorous execution of our strategy. We are more consumer focused and our ability to move swiftly on trends and insights means we are better placed to capture opportunities and deliver sustained growth.

We are on track to deliver our medium term guidance of 175bps of organic operating margin expansion for the three years ending 30 June 2019 and our expectation of mid-single digit net sales growth over this period is unchanged. Diageo is a stronger company and I am confident that we continue to make progress toward our ambition to be one of the best performing, most trusted and respected consumer products companies in the world.

Ivan Menezes
Chief Executive

2018 net sales by category (%)

Scotch	25%	Liqueurs	5%
Vodka	11%	Gin	4%
US Whiskey	2%	Tequila	3%
Canadian Whisky	7%	Beer	16%
Rum	7%	Ready to drink	6%
IMFL Whisky	5%	Other	9%

(i) Based on £RSV in the first 14 weeks since launch in the off-trade only. Data provided from Nielsen Scantrack and dated back to 1 June 2007.

Market dynamics

Consumer behaviour and the occasions on which people choose to drink alcohol are constantly evolving; as are regulatory environments and stakeholder expectations.

We have a strong platform to seize new opportunities and unlock growth in our markets. This is based on our diverse portfolio, geographic footprint, business model and commitment to creating a positive role for alcohol and our business in society.

The global alcohol market: broad based, growing and profitable

500 million
new legal purchase age consumers are expected to come to the market over the next decade.

730 million
more consumers are expected to be able to afford international style spirits over the next decade.

52%
of the global alcohol market by volume, is spirits.

6 billion
equivalent units of alcohol sold each year.

£300 billion
of net sales.

Key trends

Moderate, responsible drinking is part of a balanced lifestyle in many societies around the world, deeply rooted in local rituals and customs. How alcohol is consumed varies as widely as the cultures and conditions in which people live. As society and consumer tastes change, so do alcohol markets. Anticipating, shaping and responding to the trends behind those changes are key to delivering our strategy.

Consumers want to drink better, not more

Consumers in developed markets are seeking to drink better, not more. They are increasingly interested in trying new brands and categories, and are prepared to pay more for products of superior quality, craftsmanship and provenance. Our premium core and reserve portfolios cater to this trend. Brands such as Johnnie Walker offer a ladder to increasing luxury through price, liquid age and provenance.

In emerging markets, increasing wealth means consumers are also seeking to 'trade up' into international spirits brands. This trend provides an opportunity to offer international premium spirits, such as Johnnie Walker Black Label, to consumers.

The world's informal alcohol market accounts for 25% of alcohol sales globally, with emerging markets accounting for a large proportion of this. Informal alcohol poses risks to consumer health and negatively impacts tax revenues. Our mainstream spirits, such as McDowell's No. 1 in India and Smirnoff X1 in Nigeria (more on page 17), provide safer products at affordable price points.

Balanced lifestyles

Consumers across markets are demanding a broader range of products that cater to different occasions and lifestyles. Based on our insights, we are innovating and investing in our brands to ensure we can meet consumer expectations.

This year, in the United States we launched Ketel One Botanicals, which has a 30% ABV, no carbohydrates, no artificial flavours and sweeteners and no added sugars. We also launched Guinness Open Gate Pure Brew in Ireland. Pure Brew is a 0.5% alcohol by volume (ABV) lager. In June, we launched Gordon's Ultra Low Alcohol Gin and Tonic flavoured drink in Great Britain, Spain, Belgium, Sweden and the Netherlands. Gordon's Ultra Low Alcohol has less than 0.5% ABV and 68 calories per serve.

Consumers are socialising differently

Through data and insights, we have identified a shift from late-night drinking to more casual occasions that often include food and an increase in new types of consumption occasions, such as festivals.

The rise of the aperitif occasion also reflects this trend. In 2018, we acquired Belsazar, a premium vermouth aperitif. Belsazar is the first brand to graduate from Distill Ventures (DV), our externally managed accelerator programme. DV builds on our skills and knowledge to support entrepreneurs in the development and financing of new brands. In addition to our own innovation, DV seeks to tap into new and emerging categories.

Continuing geopolitical uncertainty

The global economy continues to be subject to political instability and changes in economic variables.

Our global scale and broad portfolio of brands help provide a natural hedge. Our market-based model also enables us to identify and respond quickly to local dynamics.

Consumers are able to trade up or down depending on the economic environment. As a result, macro-economic trends are key considerations for our risk planning, outlined on pages 20-21.

Earning trust and respect

Earning trust and respect are core elements of our performance ambition and at the heart of our purpose of 'celebrating life, every day, everywhere'. Like our brands, which have been part of communities around the world for hundreds of years, we invest for the long term. Our programmes aim to empower communities and individuals everywhere that we source, produce and sell.

Creating a positive role for alcohol in society, promoting inclusivity and reducing environmental impacts are priorities owned by everyone at Diageo and a source of pride for our employees. All our work is underpinned by a framework of policies that ensures we do business with integrity and respect for human rights (more on page 55).

Alcohol in society

The majority of people who choose to enjoy alcohol do so moderately and responsibly. We are clear that we want to meet the demands of those consumers by offering them opportunities to drink better, not more.

We aim to be a leader in creating a positive role for alcohol in society and in embedding our commitment to promoting moderation and tackling misuse in everything we do. To achieve this, we work in partnership with governments and industry organisations around the world. We do this to increase our impact on reducing harmful drinking, promoting moderation and advocating for industry standards. We focus on the most material issues, where we can have the greatest impact in reducing harm: drink driving, underage drinking and excessive drinking. Our new strategy is in line with the United Nation's and the World Health Organization's (WHO) goals of reducing harmful drinking by 10%. It is described in more detail on page 42.

The beverage alcohol industry is highly regulated. That regulation varies widely between countries and jurisdictions. We comply with all laws and regulations, wherever we operate, as a minimum requirement. We also advocate for laws and industry standards, including minimum legal purchase age laws and maximum blood-alcohol concentration driving limits, in countries where these are not already in place. At the same time, we advocate against measures that are not based on evidence or which could have unintended consequences, such as pushing consumers toward illicit alcohol, which can be a risk to public health.

Climate change and water stress

All businesses, especially those that rely on agricultural raw materials and water, are subject to environmental risks. Climate change, and the linked issue of water risk, can have particularly significant impacts on our wider value chain and associated communities. While not yet having a material impact, we have seen this in Brazil, where sugar cane farming for Ypióca was affected by lower rainfall, and in Cameroon, where the sorghum we use for brewing was needed for food when adverse weather reduced the harvest. This is where our environmental strategy, described in more detail on page 50, is critical to our long-term business. Our programmes reduce carbon emissions and water use throughout our value chain, alongside reductions in waste and packaging and the use of more sustainable packaging materials. We are investing further in water efficiency and carbon reduction in key markets such as Scotland and East Africa, where water stress is particularly acute. We are already integrating management of climate-related issues into our mainstream business operations. We will report more information on this and measures to support resilience in the future, reinforcing our transparency on climate change risks.

Smashed is an award-winning theatre and education programme that informs adolescents about the dangers of alcohol misuse. Smashed has now been rolled out to 15 countries.

Our Water Blueprint defines our approach to water stewardship. It prioritises the water-stressed areas shown in the map below. Along with improving water efficiency, we are replenishing the water used in water-stressed areas, supporting catchment area management to benefit all water users and helping farmers improve water management in agriculture.

Diageo sites located in water-stressed areas

Sites

1 Kenya Brewing, Nairobi
2 East Africa Maltings, Nairobi
3 Seybrew, Seychelles
4 SA Cider, South Africa
5 Phelindaba Brewery, South Africa
6 Butterworth Brewery, South Africa
7 Khangela Brewery, South Africa
8 Isithebe, South Africa
9 Tlokwe, South Africa
10 Isipingo, South Africa
11 Moshi, Tanzania
12 Dar es Salaam, Tanzania
13 Mwanza, Tanzania
14 UBL, Kampala, Uganda
15 IDU, Kampala, Uganda
16 Accra, Achimota, Ghana
17 Kumasi, Kaasi, Ghana
18 Ogba, Lagos, Nigeria
19 Paraipaba, Ceará, Brazil
20 Agricultural lands, Ceará, Brazil
21 Messejana, Brazil
22 Maracanaú, Brazil
23 Meta Abo, Ethiopia
24 Marracuene, Mozambique

India
25 Alwar, Rajasthan
26 Aurangabad, Maharashtra
27 Baddi, Himachal Pradesh
28 Baramati, Maharashtra
29 Four Seasons Winery, Maharashtra
30 Hospet, Karnataka
31 Kumbalgodu, Karnataka
32 Malkajgiri, Telangana
33 Meerut, Uttar Pradesh
34 Nacharam, Telangana
35 Pathankot, Punjab
36 Pioneer, Maharashtra
37 Rosa, Uttar Pradesh
38 Serampore, West Bengal
39 Sovereign, Karnataka
40 Tern, Andhra Pradesh
41 Udaipur, Rajasthan

Our strategy in action

These case studies demonstrate how we are putting our strategy into action at a market and global level. They also show how our approach to sustainability and responsibility supports everything we do.

Drive innovation at scale

Flushed with success: launch of Gordon's Premium Pink Distilled Gin driven by speed and scale

Gordon's Premium Pink Distilled Gin launched in summer 2017.

Gordon's Premium Pink Distilled Gin (Gordon's Pink) has become the most successful new spirits product development in Great Britain in the last decade[(i)]. This is thanks to its consumer appeal and improvements in the way we launch our innovations.

Inspired by an original Gordon's recipe from the 1880s, Gordon's Pink balances the refreshing taste of Gordon's gin with the natural sweetness of raspberries and strawberries and the tang of redcurrant.

Launched in Iberia in May 2017, Gordon's Pink was launched in Great Britain just 10 weeks later, supported by national media, digital and social media content.

In the past, this kind of launch would have taken around six months. Agile work in our supply chain and brand teams, combined with a 'hothouse' approach to cooperation between departments, cut months from the launch process. In September 2017, we launched in Ireland, Italy, Germany, Austria, Switzerland, Benelux and Denmark. Most recently, we have launched in North America and Australia.

In Great Britain, Gordon's Pink was voted 'Product of the Year' for the Alcohol category, in a Kantar TNS survey of 10,637 people. It also received The Grocer's 'Top Launch of the Year' in the Alcohol: Spirits category.

Gordon's Pink removed plastic straws from all promotional materials at the end of 2017 and is now only using paper straws. More broadly, Diageo announced a commitment to phase out the use of all plastic straws and stirrers from all marketing globally and announced new plastics reduction and recycling targets.

(i) Based on £RSV in the first 14 weeks since launch in the off-trade only. Data provided from Nielsen Scantrack and dated back to 1 June 2007.

Continue to win in Reserve

Driving personal luxury with Johnnie Walker

The nature of luxury has continued to evolve: from the traditional western notion, driven by behaviours and visual cues, into a more modern luxury driven by experiences, and global and local influences. Today, luxury can be for everyone.

Mass luxury is key to our reserve growth opportunity. One of the ways we are delivering is through the gifting and personalisation of Johnnie Walker Reserve variants.

In 2018, we offered consumers an accessible luxury gift beyond traditional beauty care and fragrances. During the festive season, our team in Peru launched a Johnnie Walker Blue Label pop-up store. Consumers were treated to Johnnie Walker Blue Label mentoring and were able to engrave their Johnnie Walker bottle with a personal message.

In May, we also launched Johnnie Walker My Edition in Great Britain and Spain. This pilot programme aims to offer consumers a cutting-edge, online whisky personalisation experience. Through the website, consumers are able to purchase exclusive whiskies based on personal flavour preferences, personalise the label and engrave the bottle to create a truly unique gift.

Net sales of Johnnie Walker Reserve variants were up 8% in 2018. Overall, scotch net sales grew 2%, but there is more to do.

Keep premium core vibrant

Proof in the pudding: Baileys' treats making new connections

In 2018, Baileys grew 6% globally. In North America, net sales were up 11% in 2018, following our new indulgent treat campaign. So what is the secret to its success? Our insights told us that people around the world claimed to love Baileys more than any other spirit, but there were simply fewer occasions on which to drink it. To address this, we repositioned Baileys from liqueur to 'premium adult treat' and have activated a groundbreaking marketing and consumer engagement campaign to support this growing occasion.

Our work is underpinned by a deep understanding of occasions, so we are reaching consumers in a range of trend-leading ways. We have created recipe videos for our digital channels showcasing the versatility of Baileys. We have partnered with restaurants, bars and cafe chains to place Baileys on the menu as an indulgent end to a meal – over ice, over ice-cream or in coffee. In supermarkets and retail stores, we have increased displays and cross-promoted Baileys with key coffee and dessert brands. Innovations, such as Baileys Almande, are also recruiting new consumers and creating new occasions on which to enjoy Baileys.

Altogether, our advertising, increased digital presence and food partnerships mean millions of consumers are not only enjoying Baileys but are engaging with and sharing our content too.


Baileys has partnered with restaurants, bars and cafes to put Baileys on the menu.

Build an advantaged route to consumer: China

Premium scotch brands leading the way to consumers in South China

We are setting minimum activation standards for our premium scotch brands in Guangdong and Fujian, China.

We want spirits consumers in China to choose our premium and super premium scotch brands. To achieve this, we identified two provinces in China, Guangdong and Fujian, to further build our route to consumer capabilities in liquor stores.

Guangdong and Fujian have the highest penetration of foreign spirits consumption in China. Focusing on Johnnie Walker Blue Label, The Singleton and our malts portfolio, we trained our sales team and worked with local distributors and liquor outlets to set minimum activation standards for our premium scotch brands. Using data and insights, the sales team is now able to make real-time decisions to ensure we are reaching the right consumers with the right products and that our brands are presented at their best at point of sale. During sales calls, our team is able to take images of displays. Our system logs the images and our central team is able to evaluate and better determine the best sales drivers.

Additionally, during occasions such as the Mid-Autumn Festival and Chinese New Year, we are recruiting and re-recruiting Johnnie Walker Blue Label customers through personalisation and gifting.

This year, we have seen sales of scotch in mainland China grow strong double digit driven by Johnnie Walker and The Singleton.

Embed productivity to drive out costs and invest in growth

New insights, new approach: transforming net revenue management in India

Getting the best value we can from our promotions and trade spend – what is known as net revenue management (NRM) – is common sense. But achieving a step-change improvement in NRM has meant transforming our processes, systems, data and our people's capabilities.

NRM is a key element of our productivity programme, which is focused on every day efficiency and driving out cost across our business. Our overall productivity goal is to deliver £700 million in savings, two thirds of which will be reinvested in the business, and 175bps in operating margin improvement over the three years ending 30 June 2019.

Our NRM work in India is a great example. With 29 separate states, each with distinct sets of regulations for alcohol sales and promotion, India presents a complex picture on both spend and value. This amount of price regulation underscores the importance of getting our trade promotion spend right.

Using customised dashboards, we are ensuring that our data and analytics are cutting edge and give us insight into where we can improve effectiveness. To date, we have implemented our NRM programme in 11 of our clusters in India. We have trained over 100 people in the sales teams and equipped them with the data they need to best focus their spend on brands and locations.

Our NRM programme has been rolled out to 11 of our clusters in India.

We are just at the beginning of our NRM journey and are continuing to embed this culture across our business.

Increase participation in mainstream spirits

Smirnoff X1: showing inclusive ambition in Nigeria

Consumers in Nigeria demand high quality drinks and value for money. We aim to meet this demand through global and local brands at accessible price points, supported by local sourcing and production. Building on Guinness Nigeria's reputation for quality and innovation, and the route to consumer network of our beer business, we are reaching consumers who choose to drink, through mainstream spirits. These grew double digit in Nigeria this year, underpinned by innovation launches and new formats.

Launched in fiscal 2017, Smirnoff X1 is a great example of how we are increasing spirits participation by leveraging our international trademarks. Over the past 18 months, our sales teams in Nigeria have been working with local outlets to introduce consumers to the vodka category. Currently, Smirnoff X1 is available in more than 30,000 on-trade outlets and we have sampled our perfect serve with lemonade in 1,700 outlets. Smirnoff X1 Intense Chocolate vodka, the lead variant, is proving popular and won a Silver Medal for Quality Recognition at the San Francisco World Spirits Competition in 2018.

Smirnoff has also extended its 'We're Open' platform in Nigeria. 'We're Open' aims to promote inclusivity and bring people together using experiences, great drinks and music to break down barriers and stereotypes.

Creating a positive role for alcohol in society: global

Promoting moderation and tackling misuse: Drink Positive

We are proud of producing some of the world's best alcoholic drinks – and of the fact that millions of people enjoy our brands responsibly and in moderation. At the same time, we know that harmful drinking causes individuals and communities significant problems – so creating a positive role for alcohol in society has always been vitally important to everyone in our business.

We have consistently invested in global programmes which encourage responsible drinking, reduce drink driving, and seek to create a positive role for alcohol in society. This year we launched a new strategy to create even greater impact through our programmes, as described on pages 42-44.

At the same time, we have never lost sight of the vital role that our employees play in promoting moderation and tackling misuse – as ambassadors for our brands, and within their own work and home communities.

In October 2017 we launched our new Drink Positive campaign, aimed at highlighting the role that everyone at Diageo can play through their work. Drink Positive communicates how employees are promoting moderation and tackling misuse, and includes training resources such as DRINKiQ, our alcohol education tool, to help engage employees and to support them to engage others.

The creative, integrated campaign involves social media, 'office takeovers', global and local 'Lunch and Learn' events, online training, leaders from the business sharing their commitment to help people to Drink Positive, and much more. Through Drink Positive, we've reached all of our employees (nearly 30,000) with the facts, information and inspiration that will help them become Drink Positive ambassadors within our business and beyond – and our Values Survey showed that 93% of employees agreed that Diageo is effective in promoting a balanced role for alcohol in society.

Building thriving communities: Cameroon

Finding inclusive ways to grow: working with farmers in Cameroon

Working with the farmers who grow our ingredients is a vital part of ensuring we have a resilient, sustainable supply chain. It's also an opportunity to support the communities around us – through inclusive programmes that promote the aims of the UN Sustainable Development Goals and strengthen our business.

As part of our local sourcing programme, we are working through partners with over 4,500 sorghum farmers in Cameroon to help them increase their yields through improved farming practices and irrigation. At the same time, we are helping to improve community access to drinkable water, increase awareness of good sanitation, build local management of water, and enhance people's skills, with a particular emphasis on women's empowerment.

In North Cameroon, our partnership with the Sahel Espoir co-operative in the two villages of Mindjil and Garey has led to a new irrigation system and new boreholes to provide access to water for 10,000 people. In the village of Fotouni in West Cameroon, we are working with the NGO, ANDP Environment, to improve access to safe water

and sanitation, particularly for women and children, installing two new water pumps to serve 6,500 people. An additional 150 women are benefiting from water-related economic activities, including gardening and selling water and ginger drinks. In both programmes, training and empowering local people to manage and maintain their community assets are key elements.

We want our programmes to have real impact, increasing the resilience of our communities and supply chains.

Reducing our environmental impact: India

Saving water, saving costs: water recycling in India

Water is essential to our business – and to the people and ecosystems around us. That means responsible water stewardship is a strategic priority – especially in areas of water stress, where factors such as drought and climate change have their greatest impact.

In India, an acutely water-stressed region, we've developed a comprehensive local strategy to conserve water. This supports our global targets for 2020 of reducing the amount of water we use, returning wastewater safely to the environment and replenishing the total water used in our final product.

A recent programme of investments in our distilleries in Maharashtra state has driven further improvements. We have installed new water-recycling equipment, including ultra-filtration followed by reverse osmosis systems at our Nasik, Aurangabad and Pioneer sites. This has enabled us to re-use up to 500,000 cubic metres of water a year – enough to fill 200 Olympic swimming pools.

This water reuse has led to a 35% reduction in water extraction, which is good for the long-term sustainability of our business and the local water catchment and community. It has also had immediate fiscal benefits, by saving more than £1 million in costs resulting from a new state water tariff.

How we protect our business

Risk management and principal risks

Our Performance Ambition calls on us to be bold and to act like owners. Well managed risk taking lies at the heart of this. Great risk management drives better commercial decisions, creating a growing, resilient and sustainable business.

Monitor and report

Quality reporting enables great discussion, which is at the heart of our risk management approach

Continuous review

Continually utilise our information to drive insightful discussion and effective decision making

Identify

Identifying the risks our business faces is the first step in effective risk management

Mitigate

Taking actions to manage our key risks

Assess

Assessing the likelihood and impact of risks to drive effective, prioritised mitigations

Viability statement

In accordance with the UK Corporate Governance Code, the Directors have assessed the viability of the group over the three years to 30 June 2021, considering our current position and prospects, our strategy, the Board's risk appetite and our principal risks as set out on pages 20 to 21 in the Strategic report.

Although the prospects of the company are considered over a longer period the Directors believe that a three-year assessment is most appropriate as it aligns with our normal three-year strategic business planning processes.

The three-year business plan is based on our current strategy. This plan has been stress tested by modelling severe but plausible downside scenarios, and combinations of scenarios, linked to our principal risks. Key scenarios considered include:

- severe marketing and/or route to market restrictions or fiscal changes introduced by local governments,
- material negative changes in the macro-economic environment that could impact both developed and emerging markets,
- unfavourable exchange movements in foreign currencies, mainly the euro and US dollar against sterling,
- a failure to adapt to or participate fully in critical industry developments, and
- increased potential tax rate due to changes in the international tax environment.

The principal risks considered in the most likely combination of downside scenarios are identified with the symbol 'V' on page 20 to 21.

None of these scenarios individually threaten the viability of Diageo, therefore the combined impact of these scenarios has been evaluated as the most severe stress scenario.

We have considered the risks presented by Brexit and at this stage do not perceive any material risk to the company's viability. We will keep this under review as exit negotiations progress.

Stress testing considers the effectiveness of mitigation actions and internal control systems, makes certain assumptions about temporary reductions in discretionary spending including capital expenditure and dividend payments and considers whether additional financing facilities would be required.

Based on the results of this analysis the Directors confirm they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period to 30 June 2021.

Our approach

Our risk management framework is simple. We believe that great risk management starts with the right conversations to drive better business decisions. We embed accountability for managing risk into our business management structures. Each market and function undertakes an annual risk assessment, establishes mitigation plans and monitors their risks. Our Executive Audit and Risk Committee regularly receives reports on the risks faced by the business and the effectiveness of risk management efforts. Our Executive updates the group's risk assessment annually, and this is independently reviewed by the Board. We ensure that significant business risks are considered and escalated where appropriate to our Executive and Board and we establish cross-functional working groups, and leverage experts to ensure significant risks are effectively managed.

Further details about the group's risk management approach are described in the Corporate Governance Report on page 64 and in the Report of the Audit Committee on page 68.

Focus in the year

The Diageo Executive and Board considered the risks described here as the group's principal risks for this financial year, and also reviewed our risk appetite, which is the level of risk we wish to take to achieve our strategic objectives.

Our principal risks continue to respond to a challenging external environment and, although the majority of our risks remain consistent with last year, there are two notable changes. We have removed the Business Acquisitions risk as this was largely focused on the acquisition of United Spirits Limited (USL). It has been more than three years since completion of this transaction and we are comfortable that USL has been integrated and that legacy risks are being appropriately managed (please refer to pages 143-146 for further information on legacy risks). We have replaced this with a risk relating to product contamination; while this is not a new risk to Diageo, we have re-evaluated that the potential reputational impact of this risk warrants its inclusion within the principal risks.

Protectionism and local trade and regulatory policies have continued to lead to excise tax increases and restrictive regulations, and the attention being given to data privacy is heightened with the recent implementation of GDPR legislation. We continue to develop our risk planning work around Brexit while retaining agility to changing political situations. Despite this challenging environment, we remain deeply committed to operating in the right way in everything we do.

1 Efficient growth 2 Consistent value creation 3 Credibility and trust 4 Motivated people V Risk included in viability assessment

Risk	Impact	How we mitigate	Developments in 2018
1. Market restrictions and indirect tax Fiscal pressures and/or failure to address perceived growth in anti-alcohol sentiment. V 1 2 3	• Regulators in major markets impose indirect tax increases, trade barriers, and/or restrictions on marketing and availability. • Damage to our corporate reputation.	• Comprehensive multi-year public policy plans in priority markets, regulatory policy risk tracking and evaluation, and economic modelling of tax, trade and regulatory scenarios. • Company rollout of a new Alcohol in Society strategy supported by a fully operational global industry platform to promote responsible drinking. • Proactive, evidence-based engagement to build trust and deepen our relationship and reputation with governments, industry and other stakeholders. • Dedicated training and capability building curriculum on indirect tax, trade and regulatory affairs, alcohol policy, campaigning and scenario planning.	• The risks associated with protectionism and uncertainty in the international trading environment have increased, adding pressure on tariffs, indirect taxation and regulation. We believe we are well placed to manage these risks. This year we have successfully mitigated threats and built momentum in our engagement with governments around the world to shape more balanced public policy outcomes. • We have refined our public policy plans along with our ability to monitor and evaluate the external environment and strengthened capability across the business in public affairs and alcohol policy. • We have moved with pace in delivering our Alcohol in Society programmes around the world.
2. Economic change Significant local volatility or upheaval, uncertainty or failure to react quickly enough to increasing volatility, including the UK's exit from the EU. V 1 2	• Social unrest, liquidity issues, generalised downturn, currency instability, inflationary pressures, possible changes to customs duties and tariffs and/or eroded consumer confidence, impacting business forecasting and/or performance.	• Local and global market monitoring of key business drivers to prepare for rapid changes in external environment. • Strategic business reviews by CEO and other senior executives to review local strategies. • Multi-country investment and capacity expansion strategy, and local sourcing strategy (e.g. to minimise currency risk). • Cross-functional steering group to monitor the risks of Brexit.	• Volatility, particularly in emerging markets, has been mainly driven by political or legislative issues, rather than GDP or economic volatility. While the macro environment is arguably currently more uncertain, we believe this risk remains stable as we continue to embed scenario planning at local and global levels to assess the potential impact of economic change to strengthen our mitigation responses. • We are making better use of data to improve performance prediction, using statistical techniques. • Ongoing risk identification and mitigation planning to respond to the risks associated with Brexit and the potential impact of any trade wars. We have particular focus on identifying critical decision points to ensure potential operational disruption is effectively mitigated.
3. Critical industry developments Failure to shape or participate in critical consumer, customer or competitor developments. V 1 2 3	• Consumers move away from our brands to alternative products. • Suboptimal routes to consumers and customers. • Less efficient business model compared to key competitors.	• Highly diversified portfolio of brands to ensure coverage of consumer occasions and price points. • Rigorous processes of strategy and innovation development at corporate and market level. • Systematic review of emerging consumer and route-to-consumer trends including potential disruptive technologies. • Continuous assessment and optimisation of business efficiencies and investments.	• The pace of industry developments and consumer trends continues to speed up, increasing the risk that we fail to respond quickly enough; despite this, we believe the management of this risk remains strong. • We focus innovation on our strategic priorities through global brand extensions and new to world products, leveraging partnerships such as Distill Ventures. • We continue to build capabilities and business structures that enable us to be agile in responding to rapidly shifting consumer trends, for example in digital commerce and marketing by investing in technology and tech partnerships.
4. Non-compliance with laws and regulations Non-compliance with local laws or regulations, or breach of our internal global policies and standards and/or significant internal control breakdown. 1 2 3 4	• Severe damage to our corporate reputation and/or significant financial penalty.	• Code of Business Conduct and supporting framework of policies and standards set out compliance requirements. • Regular training, communications and engagement activities to embed employee understanding. • Risk based control assurance programme, with local management accountability.	• We continue to see new regulations come into force in a number of countries in which we operate; however, this risk remains stable as we manage these increasing requirements within our existing structures. • We have a programme of global e-Learning Code and policy training and engagement for all employees with integrated compliance certification, and conduct face to face events for employees with no computer access. • Further embedding of enhanced technology globally to support third party compliance processes, leveraging our shared service centre operations. • Robust programme of control assurance and refresher training for all Finance Directors on effective risk based control assurance.
5. Sustainability and responsibility Failure to manage key sustainability risks or meet key sustainability goals. 1 2 3 4	• Harm to future growth either directly; or • Indirectly via reputational impact reducing trust amongst consumers and other stakeholders.	• Sustainable Development strategy credible with stakeholders and set up to deliver against 2020 targets. • Partnerships with Non Governmental Organisations (i.e. CARE, WaterAid) in place. • Resource scarcity issues identified and mitigated, agriculture programme delivered with greater consistency. • Manufacturing standards programme including environmental performance, with future activity on community water around production sites.	• Our continued progress in achieving key environmental metrics, and a strong position maintained with external stakeholders and benchmarking leads us to believe this risk remains stable. • Human rights assessment programme extended to Colombia, Guatemala, India, Tanzania and UK. • Strengthening of our diversity and inclusion agenda within the business and in the wider value chain. • 'Brands with Purpose' activity with key global brands, aligning sustainable development and alcohol in society strategies with brand strategies. • Development of Climate Change Risk Reporting. • Water Blueprint adoption in Ghana, India and Kenya to support water security.

Risk	Impact	How we mitigate	Developments in 2018
6. Cyber threat Theft, loss and misappropriation of our most important digital assets. 1 2 3 4	• Financial loss, operational disruption and reputational damage.	• Focus on insider threat by tightening 'privileged access' to critical applications. • Mandatory e-Learning and regular phishing exercises to global workforce. • Experts perform intelligence-led, proactive hunting and monitoring of threats. • Advanced malware detection and blocking. • High risk market cyber stress tests addresses security gaps used by sophisticated hackers. • Regular Red Team exercises to improve surveillance monitoring and response.	• Despite the increasing frequency of cyber attacks (including phishing, ransomware and potential disruptions to production operations), we believe, from regular benchmarking of our mitigation actions against peers, that our approach to managing this risk is consistent with industry practice . • We are accelerating our investment in intelligence led threat analysis to better predict and proactively manage the most serious threats, and continually improve our control environment, including hiring a skilled cyber threat team. • We take a programmatic approach to deal with increased cyber threat risks and continue to deliver employee awareness campaigns and training to help identify appropriate responses to cyber risks.
7. Political instability and terrorism Impacts from political instability and security threats including terrorism. 1 3 4	• Diageo employees, sites or supply chain threatened and/or harmed. • Our ability to operate in key markets is disrupted.	• In-country security managers overseeing people and physical security and above market subject matter experts. • Monitoring of local security situations. • Diageo's global Business Continuity and Crisis Management Framework. • Global travel security programme for all Diageo travellers. • Global and market liaison with government, academia, and industry on evolving threats and responding to incidents.	• Political violence risks are increasing globally, due to geopolitical tensions, a weakening of liberal democratic governance, and the repercussive effects of chronic conflicts around the globe. Terrorism risks are more diversified and impact more countries in which we operate. • To manage this risk we undertake terrorism crisis simulation exercises across various markets and have established quarterly cross-functional threat reviews. • Implementation of Diageo Incident Management Database to monitor security incidents and trends. • Increased intelligence capacity through extra internal resource and third party threat monitoring.
8. Data privacy Breach of data protection laws or regulations. 1 2 3 4	• Harm to our reputation with consumers, customers and/or our people. • Non-compliance with data protection regulation. • Significant financial penalty of up to 4% of global turnover.	• Global Data Privacy programme with global data privacy policy, training and communication. • Briefings to Board, Executive and other senior leadership on our General Data Protection Regulation (GDPR) Readiness Programme. • Use of Privacy Impact Assessments in key risk areas of the business concerning the proper use of data. • Risk assurance at a market and global functions level.	• The introduction of GDPR in the EU on 25 May 2018 has heightened awareness and scrutiny over the data privacy risk generally, which potentially increases the level of subject access requests being made to organisations that hold personal data, as well as the risk of complaints to regulators. • We have a programme to enable us to implement processes to get to and maintain compliance with GDPR led by Diageo's Global Data Privacy Office; this causes us to believe that this risk is stable. • We have embedded a global incident response process to identify, investigate, risk assess and respond effectively to any personal information security incidents.
9. International tax Significant changes to the international tax environment such as the OECD Base Erosion and Profit Shifting initiative and EU anti-tax abuse measures alter our operating position. 1 2 3	• Increase in the cost of doing business arising from an increase in our effective and cash tax rates. • Changing tax laws and audit activity lead to additional tax exposures and uncertainty.	• Ongoing review of how our tax policy applies to our business in light of changing rules and stakeholder expectations. • Monitoring and, where appropriate, expressing views on the formulation of tax laws either directly or through trade associations or similar bodies. • End-to-end review of our tax processes to continually improve our tax control and governance environment.	• The international tax environment has been subject to increased scrutiny and change in recent years, increasing the overall levels of risk to business. • Investment by governments in the 'digitisation of tax administration' will facilitate enhanced access to and analysis of our data, which is likely to increase audit activity. • In common with other multi-nationals, we face continued scrutiny from certain authorities into tax matters, as referred to in our contingency liability note. See also Note 18 to the Financial Statements on the current position with the notices previously received from HM Revenue & Customs. • We have submitted our Country-by-Country Report to the necessary tax authorities. • We have updated our Global Tax Policy to clarify our strategy and approach to the management of taxes and tax risks globally.
10. Product quality Contamination of raw materials or finished product, or unsafe counterfeit product is supplied to the market. 2 3	• Harm to consumers and/or • Our corporate and brand reputation is damaged.	• Food Safety System 22000 Certification in place for owned brewing and packaging sites, and third party site audit programme in place. • Physical security standards (including access control, CCTV and guarding) and vetting procedures in place across our production sites. • Anti-counterfeiting measures embedded into our packaging to ensure it cannot be reused. • Application of unique lot-codes on all products for product recall requirements, assured by Diageo Quality standards.	• This risk has been brought into our principal risks this year. However, this is not a new risk and we believe that our approach to ensuring compliance with all necessary food safety requirements and minimising the risk of malicious tampering of our products while under our control are robust. • Strong programme of food safety controls, standards and assurance activity. Global Food Safety Initiative assurance strategy being rolled out across wholly owned breweries, packaging sites and key third party production sites. • Food fraud risk assessments (i.e. the risk of ingredient substitution that creates a product quality risk) regularly undertaken. • Brand protection and anti-counterfeit activities focussed on high risk markets and technology to assist with product verification.

Group financial review

We have delivered another year of strong consistent results with progress on all our measures of value creation and efficient growth. Organic net sales growth of 5% was broad based across regions and categories and delivered through both volume growth and positive price mix. Our productivity programme, which is now embedded in the fabric of the organisation, provides the firepower to increase investment behind our brands to fuel future growth as well as expand margins. Marketing spend increased 7%, ahead of net sales, and organic operating margin expanded 78bps. Our discipline in converting profit to cash and improving working capital continued with free cash flow of £2.5 billion and operating cash conversion sustained above 100%. With the changes we have made in the business and the high performance culture we have created we are well positioned to continue to deliver consistent growth.

Kathryn Mikells, Chief Financial Officer

Reported net sales were up

0.9%

as organic growth was partially offset by adverse exchange

Reported operating profit was up

3.7%

driven by organic growth partially offset by adverse exchange

Organic results improved with volume growth of

2.5%

Organic net sales growth of

5%

Organic operating profit grew

7.6%

Free cash flow continued to be strong at

£2.5bn

Net cash from operating activities was

£3.1bn

Basic eps of

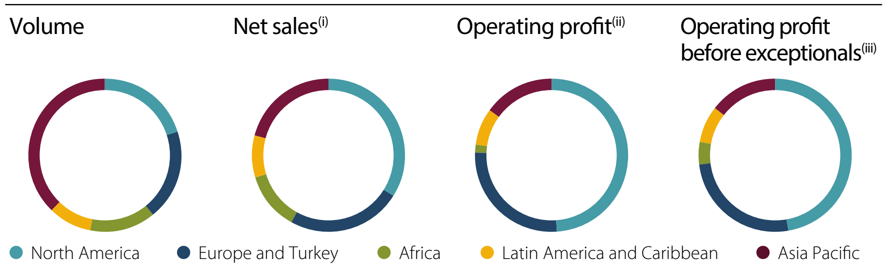
121.7 pence

was up 14.8%

Eps before exceptional items increased

9%

to 118.6 pence



(i) Excluding corporate net sales of £52 million (2017 – £46 million).
(ii) Excluding net corporate cost of £158 million (2017 – £189 million).
(iii) Excluding exceptional operating charges of £128 million (2017 – £42 million) and net corporate operating costs of £158 million (2017 – £189 million).

Summary financial information		2018	2017
Volume	EUm	**240.4**	242.2
Net sales	£ million	**12,163**	12,050
Marketing	£ million	**1,882**	1,798
Operating profit before exceptional items	£ million	**3,819**	3,601
Exceptional operating items(i)	£ million	**(128)**	(42)
Operating profit	£ million	**3,691**	3,559
Share of associates and joint ventures profit after tax	£ million	**309**	309
Exceptional non-operating gain(i)	£ million	**–**	20
Net finance charges	£ million	**260**	329
Exceptional taxation credit(i)	£ million	**203**	4
Tax rate including exceptional items	%	**15.9**	20.6
Tax rate before exceptional items	%	**20.7**	20.6
Discontinued operations (after tax)(i)	£ million	**–**	(55)
Profit attributable to parent company's shareholders	£ million	**3,022**	2,662
Basic earnings per share	pence	**121.7**	106.0
Earnings per share before exceptional items	pence	**118.6**	108.5
Recommended full year dividend	pence	**65.3**	62.2

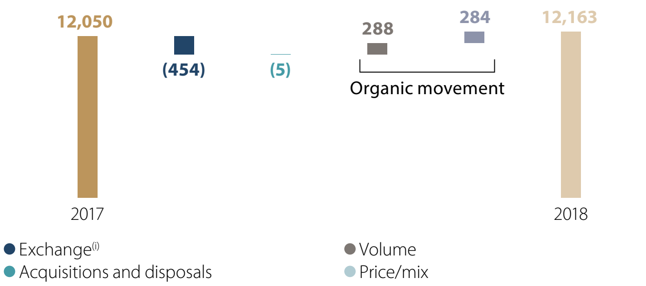
(i) For further details of exceptional items see pages 114 to 116, and discontinued operations items see page 121.

	Volume %	Net sales %	Marketing %	Operating profit(i) %
North America	2	(1)	3	(1)
Europe and Turkey	4	4	7	10
Africa	3	(4)	(5)	(12)
Latin America and Caribbean	5	2	1	23
Asia Pacific	(7)	3	13	17
Diageo – reported growth by region(ii)	(1)	1	5	6
North America	1	4	6	2
Europe and Turkey	4	4	6	8
Africa	3	3	2	(5)
Latin America and Caribbean	5	7	4	19
Asia Pacific	2	9	15	19
Diageo – Organic growth by region(ii)	2	5	7	8

(i) Before operating exceptional items.
(ii) Includes Corporate. In the year ended 30 June 2018 corporate net sales were £52 million (2017 – £46 million). Net corporate operating costs were £158 million (2017 – £189 million).

Net sales (£ million)

Reported net sales up 0.9% with organic growth partially offset by unfavourable exchange
Organic net sales growth of 5.0% with 2.5% volume growth and 2.5% positive price/mix



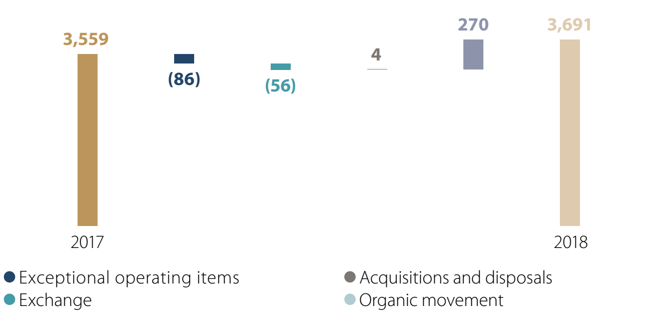
(i) Exchange rate movements reflect the translation of prior year reported results at current year exchange rates.

Reported net sales grew 0.9%, driven by organic growth which was partially offset by unfavourable exchange.

Organic volume growth of 2.5% and 2.5% of positive price/mix drove 5% organic net sales growth with organic growth delivered across all regions.

Operating profit (£ million)

Reported operating profit grew 3.7%
Organic operating profit grew 7.6%



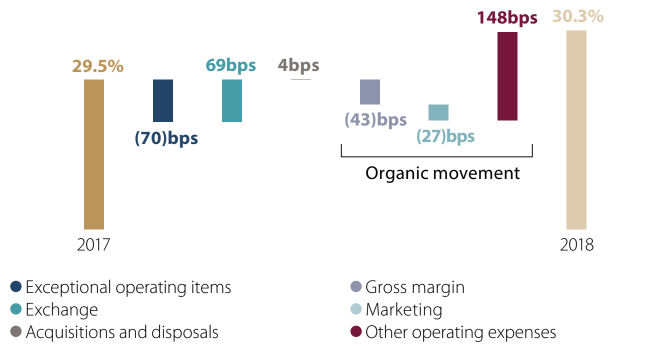
Reported operating profit was up 3.7% with organic growth partially offset by exceptional operating items and adverse exchange. Organic operating profit grew ahead of net sales at 7.6%.

Acquisitions and disposals

The impact of acquisitions and disposals on the reported figures was primarily attributable to the acquisition of the Casamigos brand which was completed on 15 August 2017 and to the prior year change to a franchise model for some popular segment brands in India.

Operating margin (%)

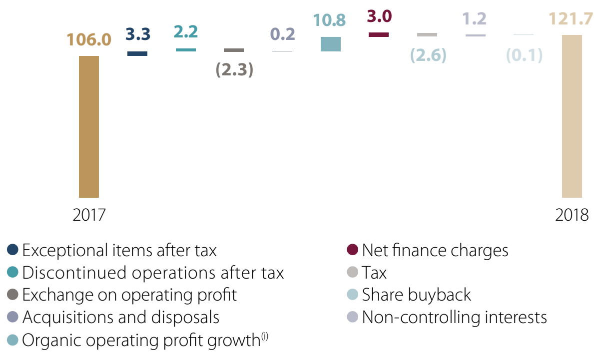
Reported operating margin increased 81bps
Organic operating margin increased 78bps



Reported operating margin increased 81bps driven by organic operating margin improvement and the positive impact on operating margin from exchange, due to the stronger negative impact of exchange on net sales relative to operating profit, which more than offset the impact from exceptional operating items. Organic operating margin improved 78bps driven primarily by our productivity programme partially offset by higher marketing spend.

Basic earnings per share (pence)

Basic eps increased 14.8% from 106 pence to 121.7 pence
Eps before exceptional items increased 9.3% from 108.5 pence to 118.6 pence



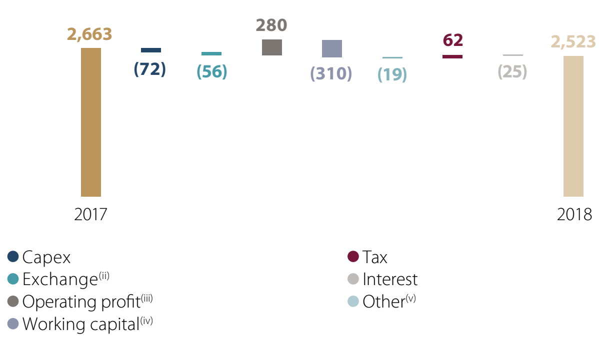
(i) Excluding exchange.

Eps before exceptional items increased 10.1 pence driven by organic operating profit growth and lower finance charges partially offset by the negative impact from exchange and higher tax expense.

Basic eps increased by 14.8% being impacted by a benefit of exceptional items after tax and the lapping of discontinued losses in the year ended 30 June 2017. The net exceptional credit was due to the balance sheet re-measurement of our deferred tax liabilities in the US as a result of the headline rate reduction. This was partially offset by the tax charge as a result of the transfer pricing agreement reached with HMRC on the UK tax assessment and the impairment of certain of our assets in Africa Regional Markets.

Free cash flow (£ million)

Net cash from operating activities[i] was £3,084 million, a decrease of £48 million compared to the same period last year. Free cash flow was £2,523 million, a decrease of £140 million

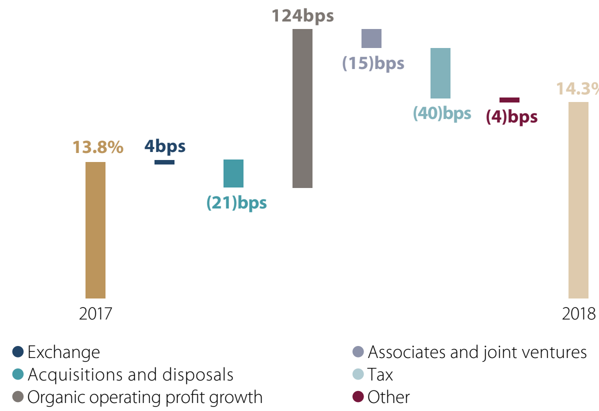


(i) Net cash from operating activities excludes net capex, movements in loans and other investments ((£561) million in 2018 – (£469) million in 2017).
(ii) Exchange on operating profit before exceptional items.
(iii) Operating profit excluding exchange, depreciation and amortisation, post employment charges and non-cash items but including operating exceptional items.
(iv) Working capital movement includes maturing inventory.
(v) Other items include post employment payments, dividends received from associates and joint ventures, loans and other investments.

Free cash flow continued to be strong at £2.5 billion. Operating profit growth was largely offset by increased investment in maturing stock and capex as well as lower operating working capital improvements year on year. Operating working capital improved but the benefits on free cash flow were lower than in the prior year.

Return on average invested capital (%)[i]

ROIC improved 48bps



(i) ROIC calculation excludes exceptional items.

ROIC before exceptional items increased 48bps as organic operating profit growth was partially offset by the impact from acquisitions and disposals and higher underlying tax charges.

Income statement

	2017 £ million	Exchange (a) £ million	Acquisitions and disposals (b) £ million	Organic movement(ii) £ million	2018 £ million
Sales	18,114	(724)	(147)	1,189	18,432
Excise duties	(6,064)	270	142	(617)	(6,269)
Net sales	12,050	(454)	(5)	572	12,163
Cost of sales	(4,680)	286	29	(269)	(4,634)
Gross profit	7,370	(168)	24	303	7,529
Marketing	(1,798)	44	(8)	(120)	(1,882)
Other operating expenses(i)	(1,971)	68	(12)	87	(1,828)
Operating profit before exceptional items	3,601	(56)	4	270	3,819
Exceptional operating items (c)	(42)				(128)
Operating profit	3,559				3,691
Non-operating items (c)	20				–
Net finance charges	(329)				(260)
Share of after tax results of associates and joint ventures	309				309
Profit before taxation	3,559				3,740
Taxation (d)	(732)				(596)
Profit from continuing operations	2,827				3,144
Discontinued operations (c)	(55)				–
Profit for the year	2,772				3,144

(i) Before exceptional operating items, see note (c) below.
(ii) For the definition of organic movement see page 56.

(a) Exchange

The impact of movements in exchange rates on reported figures is principally in respect of strengthening of sterling against the US dollar, the Turkish lira and the Kenyan shilling, partially offset by weakening of sterling against the euro.

The effect of movements in exchange rates and other movements on profit before exceptional items and taxation for the year ended 30 June 2018 is set out in the table below.

	Gains/ (losses) £ million
Translation impact	(117)
Transaction impact	61
Operating profit before exceptional items	(56)
Net finance charges – translation impact	1
Impact of IAS 21 and IFRS 9 on net other finance charges	(8)
Net finance charges	(7)
Associates – translation impact	8
Profit before exceptional items and taxation	(55)

	Year ended 30 June 2018	Year ended 30 June 2017
Exchange rates		
Translation £1 =	$1.35	$1.27
Transaction £1 =	$1.36	$1.45
Translation £1 =	€1.13	€1.16
Transaction £1 =	€1.16	€1.22

(b) Acquisitions and disposals

The impact of acquisitions and disposals on the reported figures was primarily attributable to the acquisition of the Casamigos brand which was completed on 15 August 2017 and to the prior year move to a franchise model for some popular segment brands in India.

(c) Exceptional items

Exceptional operating charges in the year ended 30 June 2018 were £128 million before tax, an increase of £86 million against last year.

In the year ended 30 June 2018, an impairment charge of £128 million in respect of the Meta brand, Ethiopian tangible fixed assets, associated spare parts included in inventories and goodwill allocated to the Africa Regional Markets cash-generating unit has been recognised in other operating exceptional expenses. The £115 million net exceptional charge includes the reversal of deferred tax liabilities of £13 million. Forecast cash flow assumptions were reduced principally due to the devaluation of the Ethiopian birr increasing costs of imported raw materials and products, an increased competitive environment and political unrest in Ethiopia.

Operating items of £42 million in the year ended 30 June 2017 comprised:

- a loss of £33 million in respect of a Turkish Competition Authority investigation into certain of Mey İçki's trading practices in Turkey.
- a loss of £32 million in respect of a customer claim in India.
- a gain of £23 million in respect of a settlement with Dr Vijay Mallya.

There were no ***non-operating items*** in the year ended 30 June 2018.

Non-operating items in the year ended 30 June 2017 comprised a net gain of £20 million in respect of the sale of Diageo's wines interests in the United States and its UK based Percy Fox business.

See page 56 for the definition of exceptional items.

Discontinued operations in the year ended 30 June 2017 comprised £55 million (net of deferred tax of £9 million) of additional amounts payable to the UK Thalidomide Trust.

(d) Taxation

The reported tax rate for the year ended 30 June 2018 was 15.9% compared with 20.6% for the year ended 30 June 2017. The tax rate before exceptional items for the year ended 30 June 2018 was 20.7% compared with 20.6% in the prior year.

Included in the tax charge of £596 million is a net exceptional tax credit of £203 million comprising the favourable impact of applying the Tax Cuts and Jobs Act, enacted on 22 December 2017, in the United States of £354 million, which was partially offset by the additional exceptional tax charge in respect of the transfer pricing agreement in the United Kingdom of £143 million and other net exceptional charges of £8 million.

In its interim announcement for the six months ended 31 December 2017, Diageo reported that discussions were being held with HMRC to seek clarity on Diageo's transfer pricing and related issues, and that a preliminary assessment for diverted profits tax notice had been issued. Final charging notices were issued in August 2017 and Diageo paid £107 million in respect of the two years ended 30 June 2016. Diageo agreed in June 2018 with HMRC that diverted profits tax does not apply and at the same time has reached resolution on the transfer pricing issues being discussed. The agreement in respect of transfer pricing covers the period from 1 July 2014 to 30 June 2017 and has resulted in an additional UK tax charge of £143 million. In the year ended 30 June 2018 an additional tax charge of £47 million has been recognised in current tax which is based on the approach agreed with HMRC.

As for most multinationals the current tax environment is creating increased levels of uncertainty. The current expectation is that the tax rate before exceptional items for the year ending 30 June 2019 will be approximately 21% to 22%.

(e) Dividend

The group aims to increase the dividend each year and the decision in respect of the dividend increase is made with reference to dividend cover as well as current performance trends including sales and profit after tax together with cash generation. Diageo targets dividend cover (the ratio of basic earnings per share before exceptional items to dividend per share) within the range of 1.8-2.2 times. For the year ended 30 June 2017 dividend cover was 1.7 times. The recommended final dividend for the year ended 30 June 2018 is 40.4 pence, an increase of 5% consistent with the interim dividend increase. This brings the full year dividend to 65.3 pence per share and dividend cover to 1.8 times. It is expected that a mid-single digit increase in the dividend will be maintained until the cover is comfortably back in the policy range.

Subject to approval by shareholders, the final dividend will be paid to holders of ordinary shares and ADRs on the register as of 10 August 2018. The ex-dividend date both for the holders of the ordinary shares and for US ADR holders is 9 August 2018. The final dividend will be paid to shareholders on 4 October 2018. Payment to US ADR holders will be made on 10 October 2018. A dividend reinvestment plan is available to holders of ordinary shares in respect of the final dividend and the plan notice date is 13 September 2018.

(f) Share buybacks

In the year ended 30 June 2018 the group completed a share buyback programme and repurchased and cancelled 58.9 million ordinary shares (representing 2.1% of the issued ordinary share capital) at an average price of £25.43 per share, and an aggregate cost of £1,507 million (including £9 million of transaction costs).

On 25 July 2018 the Board resolved to delegate to a committee of the Board a decision in respect of a potential share buyback programme of up to £2 billion in the year ending 30 June 2019. It is anticipated that the committee will make a decision on the matter at a meeting to be held on 26 July 2018.

Movement in net borrowings and equity

Movement in net borrowings	2018 £ million	2017 £ million
Net borrowings at the beginning of the year	(7,892)	(8,635)
Free cash flow (a)	2,523	2,663
Acquisition and sale of businesses (b)	(590)	(83)
Share buyback programme	(1,507)	–
Proceeds from issue of share capital	1	1
Net sale/(purchase) of own shares for share schemes (c)	8	(41)
Dividends paid to non-controlling interests	(80)	(83)
Rights issue proceeds from non-controlling interests of subsidiary company	26	–
Net movements in bonds (d)	1,041	(1,234)
Net movements in other borrowings	(26)	414
Equity dividends paid	(1,581)	(1,515)
Net (decrease)/increase in cash and cash equivalents	(185)	122
Net (increase)/decrease in bonds and other borrowings	(1,015)	820
Exchange differences (e)	80	(205)
Other non-cash items	(79)	6
Net borrowings at the end of the year	(9,091)	(7,892)

(a) See page 24 for the analysis of free cash flow.

(b) In the year ended 30 June 2018 acquisitions and sale of businesses included $706 million (£549 million) in respect of the acquisition of Casamigos. In addition, the group is expected to pay contingent consideration of $300 million (£233 million) in tranches over the next ten years subject to Casamigos achieving certain performance targets.

In the year ended 30 June 2017 acquisitions and sale of businesses included part of the settlement of the guarantee in respect of the US wines disposal partially offset by the working capital settlement received from Treasury Wine Estates.

(c) Net purchase of own shares comprised purchase of treasury shares for the future settlement of obligations under the employee share option schemes of £68 million (2017 – £102 million) less receipts from employees on the exercise of share options of £76 million (2017 – £61 million).

(d) In the year ended 30 June 2018, the group issued bonds of €1,275 million (£1,136 million) and $2,000 million (£1,476 million) and repaid bonds of $2,100 million (£1,571 million). In the comparable period the group repaid bonds of $1,600 million (£1,234 million).

(e) Decrease in net borrowings of £80 million is primarily driven by the favourable exchange differences on US dollar denominated borrowings and foreign exchange swaps and forwards.

Movement in equity	2018 £ million	2017 £ million
Equity at the beginning of the year	12,028	10,180
Profit for the year	3,144	2,772
Exchange adjustments (a)	(609)	36
Remeasurement of post employment plans net of taxation	368	522
Rights issue proceeds from non-controlling interests of subsidiary company (b)	26	–
Dividends to non-controlling interests	(101)	(83)
Equity dividends paid	(1,581)	(1,515)
Share buyback programme	(1,507)	–
Other reserve movements	(55)	116
Equity at the end of the year	11,713	12,028

(a) Movement in the year ended 30 June 2018 primarily arose from exchange losses in respect of the Indian rupee and the Turkish lira partially offset by gains on the US dollar.

(b) In the year ended 30 June 2018 a rights issue was completed by Guinness Nigeria (GN) where Diageo's controlling equity share in GN increased from 54.32% to 58.02%. The transaction resulted in a credit of £31 million to non-controlling interests and a charge of £5 million to reserves.

Post employment plans

The net position of the group's post employment benefit plans improved by £554 million from a deficit of £491 million at 30 June 2017 to a surplus of £63 million at 30 June 2018. The change primarily arose due to an increase in the market value of the assets held by the post employment schemes, the contributions paid into the post employment plans being in excess of the income statement charge and an increase in returns from 'AA' rated corporate bonds used to calculate the discount rates on the liabilities of the post employment plans.

The operating profit charge decreased by £25 million from £109 million for the year ended 30 June 2017 to £84 million for the year ended 30 June 2018 primarily due to changes in pension obligations to members of the UK and Ireland pension plans. Total cash contributions by the group to all post employment plans in the year ending 30 June 2019 are estimated to be approximately £200 million.

North America

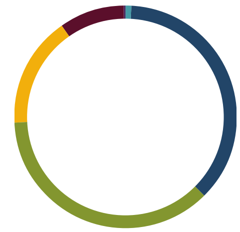
North America, the largest market for premium drinks in the world, represents about a third of our net sales and around half of operating profit. Our consumer is at the heart of everything we do, and we are focused on sustainable growth through our strategy of getting the right brands in the right occasions at the right price. In the year, we completed the acquisition of Casamigos to further strengthen our participation in the fast growing tequila category.

Net sales by markets
(%)

(i) excluding RTDs

Net sales by categories
(%)

Net sales by price points
(%)



Key financials

	2017 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2018 £ million	Reported movement %
Net sales	4,161	(228)	(8)	49	142	4,116	(1)
Marketing	642	(21)	(2)	8	35	662	3
Operating profit	1,899	(60)	(4)	4	43	1,882	(1)

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions.

Our markets

The North America business, headquartered in Norwalk, Connecticut, is comprised of US Spirits and Diageo Beer Company USA (DBC USA) and also Diageo Canada, headquartered in Toronto.

Supply operations

With 10 domestic production facilities across the United States, Canada and the US Virgin Islands, Diageo North America's economic impact is significant. We have made major investments in innovation and sustainability. In addition to opening a brand new Bulleit Frontier Whiskey distillery in Shelbyville, Kentucky in 2017 we opened our new Guinness Open Gate Brewery & Barrel House in the summer of 2018, in Relay, Maryland.

Route to consumer

The route to consumer in the United States is through the three-tier system and we distribute our products through approximately 40 spirits distributors and brokers, and more than 400 beer distributors. Our United States spirits business has approximately 2,500 dedicated distributor sales people focused only on Diageo and Moët Hennessy spirits brands. We have consolidated our US Spirits business into single distributors or brokers in 41 states and the District of Columbia, representing more than 80% of our US Spirits volume.

The US Spirits business operates through three divisions in open states where we sell to distributors who then sell to retailers, and through one division covering control states where we sell to the state, which in turn sells to state or agency stores and on premise retailers. DBC USA sells and markets brands including Guinness and Smirnoff Ice. Beer distribution generally follows the three-tier open state regulations across the United States. Diageo Canada distributes our portfolio of spirits and beer brands across all Canadian provinces, which generally operate through a provincial control system. Diageo Canada operates through a single broker with a dedicated sales force handling our brands in the country. National brand strategy, strategic accounts marketing and corporate functions are managed at the North America level.

Sustainability and responsibility

In 2017, the Caribbean faced an unprecedented hurricane season. The US Virgin Islands, home to our distillery on St. Croix and many of our employees, were one of the many areas affected. In response we've provided over $1 million to date to fund relief efforts, including provision of water, food and temporary power.

We remain leaders in responsible drinking, building on programmes promoting moderation and reducing alcohol-related harm. Our drunk driving virtual experience, 'Decisions', gained over 14 million views with 73% of viewers more likely to stop others from drinking and driving. 'Decisions: Party's Over', launched in April 2018 and focuses on the dangers of binge drinking.

Since 2007, North America has cumulatively reduced greenhouse gas emissions by 80% and improved water use efficiency by 16% versus the baseline. Driving further improvements in water efficiency is a key priority for F19. While hurricane-related disruption prevented us from meeting waste reduction targets, we have taken remedial action and are confident of improvement next year.

As we continue our commitment to safety, North America celebrated zero lost time accidents for the first time in the market's history.

North America delivered net sales growth of 4% with US Spirits growing 3% and continued growth in both Diageo Beer Company USA (DBC USA) and Canada. In US Spirits, category share gains were achieved for all key brands except in vodka. Crown Royal grew 3% with Crown Royal Deluxe and Crown Royal Regal Apple growth accelerating, partially offset by Crown Royal Vanilla lapping its launch last year. Bulleit continued its double digit growth, up 10%. Scotch grew 4% with Johnnie Walker up 6%, driven by Johnnie Walker Black Label growing 5% and double digit growth in reserve variants. Baileys growth accelerated while Captain Morgan growth moderated as it cycled a strong performance last year. Vodka net sales, while declining 3%, showed some improvement versus last year driven by Ketel One vodka and Cîroc vodka. Smirnoff net sales were down 2%. Don Julio growth accelerated with net sales growing 37%. DBC USA net sales grew 5% with ready to drink growing 14% and beer declining 2%. Net sales in Canada were up 1%. Marketing in North America increased 6% and grew ahead of net sales as investment was up-weighted. Operating margin declined 58bps as the impact of increased marketing, hurricane remediation costs and logistics inflation more than offset the benefits from productivity initiatives.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
North America	1	2	4	(1)
US Spirits	1	2	3	(1)
DBC USA	5	5	5	(1)
Canada	–	–	1	(1)
Spirits	1	2	3	–
Beer	(2)	(2)	(1)	(6)
Ready to drink	11	11	12	6

Global giants, local stars and reserve[(i)]:	Organic volume movement[(ii)] %	Organic net sales movement %	Reported net sales movement %
Crown Royal	2	3	(3)
Smirnoff	(1)	(2)	(8)
Captain Morgan	–	(1)	(7)
Johnnie Walker	5	8	6
Ketel One vodka[(iii)]	3	(2)	(7)
Cîroc vodka	(1)	(4)	(10)
Baileys	9	11	6
Guinness	(1)	–	(5)
Tanqueray	4	3	(3)
Don Julio	36	37	30
Bulleit	8	10	4
Buchanan's	2	–	(5)

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except Johnnie Walker 7%, Baileys 10% and Buchanan's 3% due to the reallocation of the Travel Retail operations.
(iii) Ketel One vodka includes Ketel One Botanicals.

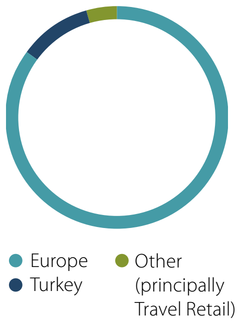
Key highlights

- Net sales in **US Spirits** were up 3%. Net sales were broadly in line with depletions. Crown Royal and Bulleit continued share gains in the Canadian whisky and US whiskey categories, respectively. The Generosity platform is working for Crown Royal, driving gains in equity and category share. Crown Royal net sales grew 3% with acceleration in Crown Royal Deluxe and Crown Royal Regal Apple growth partially offset by Crown Royal Vanilla cycling its launch last year. Johnnie Walker grew 6% with the successful 'Keep Walking America' platform being followed up by a new campaign 'Step Right up', scaled up 'liquid on lips' and continued focus on Johnnie Walker Blue Label in the gifting occasion. Buchanan's net sales were broadly flat with depletion performance improving in the second half and category share gains continuing. Vodka while declining, showed some improvement versus last year. Ketel One vodka benefitted from the execution of improved plans, as did the trademark from the launch of Ketel One Botanicals. Cîroc vodka saw some improvement in performance with the focus on core variants. Smirnoff net sales declined 2% with brand equity scores improving as it continued to remind consumers that it is a quality vodka at a great price. The 'Live like a Captain' campaign continues to resonate with consumers, driving category share and equity gains for Captain Morgan. Baileys growth accelerated versus last year as it reminded consumers of its indulgent treat positioning over the holidays. Don Julio net sales grew 37% with growth and category share gains accelerating versus last year.
- **DBC USA** net sales increased 5% with ready to drink growing 14%. Ready to drink growth was driven by continued growth of Smirnoff Ice and Smirnoff Spiked Sparkling Seltzer, and the launch of Smirnoff Ice Smash. Beer declined 2% with Guinness declining 1%.
- Net sales in **Canada** grew 1% driven by growth in Johnnie Walker, Baileys, Guinness and ready to drink. Johnnie Walker benefitted from a focus on Johnnie Walker Black Label highlighting its credentials to consumers through mentoring events, media and in-store activation. Guinness benefitted from the growth in the on-trade and the launch of Hop House 13 Lager.
- **Marketing** grew 6% with the upweighting of marketing investment funded largely from productivity initiatives.

Europe and Turkey

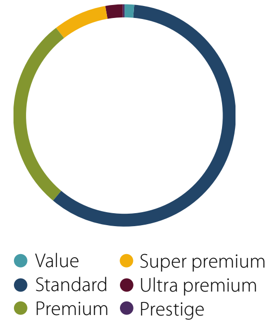
Within the geography of Europe there are two markets: Europe and Turkey. In Europe consumer marketing programmes are developed at a market level to drive consistency, efficiency and scale across all countries. In Turkey we use our local business's route to consumer to drive growth in international premium spirits. We are focused on the rigorous execution of our strategy through continued investment behind our brands. In the year, we completed the acquisition of Belsazar GmbH to strengthen our participation in the aperitif occasion, to respond to new consumer trends shifting towards more casual occasions.

Net sales by markets
(%)



Net sales by categories
(%)

Net sales by price points
(%)



(i) excluding RTDs

Key financials

	2017 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2018 £ million	Reported movement %
Net sales	2,824	(15)	16	(3)	110	2,932	4
Marketing	443	2	1	–	28	474	7
Operating profit before exceptional items	936	7	11	–	74	1,028	10
Exceptional operating items(ii)	(33)					–	
Operating profit	903					1,028	14

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions.
(ii) For further details of exceptional operating items see pages 114 to 116.

Our markets

Europe comprises Great Britain, Ireland, France, Continental Europe (including Northern Europe, Central Europe, Iberia, the Mediterranean and the Europe Partner Markets distribution businesses) and Russia, whilst Turkey is a standalone market. Europe is managed as a single market with country teams focusing on sales and customer marketing execution.

Supply operations

A number of Diageo's International Supply Centre (ISC) operations are located in Europe including sites in the United Kingdom, Ireland and Italy. The group owns 29 distilleries in Scotland, a Dublin based brewery and maturation and packaging facilities in Scotland, England, Ireland and Italy. The ISC leads all supply chain activities for Europe and manufactures whisky, vodka, gin, rum, beer, wine, cream liqueurs, and other spirit-based drinks which are distributed in over 180 countries. Over the next three years a £150 million investment will transform our Scotch whisky visitor experiences through investment in our 12 malt whisky distillery visitor centres with a focus on the 'Four Corners distilleries', Glenkinchie, Caol Ila, Clynelish and Cardhu, celebrating the important role these single malts play in the flavours of Johnnie Walker. Raki, vodka and wine are produced at a number of sites in Turkey and Smirnov vodka and other local brands are produced in Russia.

Route to consumer

In Great Britain we sell and market our products through Diageo GB (spirits, beer and ready to drink) and Justerini & Brooks Fine Wines (wines private clients). Products are distributed through independent wholesalers and directly to retailers. In the on-trade, products are sold through major brewers, multiple retail groups and smaller regional independent brewers and wholesalers. In the Republic of Ireland and Northern Ireland, Diageo sells and distributes directly to the on-trade and the off-trade as well as wholesalers. In France our products are sold through a joint venture arrangement with Moët Hennessy. In Continental Europe, we distribute our spirits brands primarily through our own distribution companies. Europe Partner Markets distributes our beer brands in mainland Europe, focusing on Germany, Russia and France, our largest mainland European beer markets. In Russia we operate through a wholly owned subsidiary.

In Turkey, we sell our products via the distribution network of Mey İçki, our wholly owned subsidiary. Mey İçki distributes both local brands (raki, other spirits and wine) and Diageo's global spirits brands.

Sustainability and responsibility

We see our work to promote moderation and reduce alcohol-related harm as both a responsibility and a key strength. Our Smashed theatre-based education programme, for example, which began in Great Britain and is now global, visits schools to discourage underage drinking. We also launched our 'Stay Yourself' moderation campaign in university campuses across Europe, with a goal of reaching five million students in 13 countries by the end of the 2018 calendar year.

We bring the same focus on impact to other areas of our strategy. We published research into our Learning for Life (L4L) skills programme, which told us that graduates felt increased self-efficacy, self-esteem and self-confidence; 77% of participants felt that they had become more responsible drinkers. We will use insights from this study to guide future programme design.

We have also strengthened the sustainability of our agricultural supply chain through our work with Scottish Quality Crops to agree standards through their certification system. In Marketing and Sales functions around Europe, we more than halved our lost time accidents from the prior year through a renewed focus on core safety programs, including Office Safety Standards.

The region delivered 4% net sales growth, reflecting another year of consistent performance in Europe where net sales were up 4% and a strong performance in Turkey growing net sales by 11%. Europe growth was largely driven by Great Britain, Ireland and Continental Europe, with continued share gains in spirits, up 50bps across Western Europe. Performance was led by strong growth in gin, where Tanqueray gained share in the fastest growing category and Gordon's benefitted from the launch of its Pink variant. Guinness was up 6% driven by a good performance for Guinness Draught supported by double digit growth in Hop House 13 Lager. Net sales of Captain Morgan grew 7%. Johnnie Walker grew 2% despite lapping a strong performance last year. Smirnoff declined 4% driven by Iberia and Great Britain, in line with the vodka category. In Turkey net sales were up 11% driven by volume growth of 5% and price increases across all categories. Operating margin improved 126bps as up-weighting in marketing investment was more than offset by ongoing productivity initiatives and lapping other one-off operating costs.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Europe and Turkey	4	4	4	4
Europe(i)	5	7	4	8
Turkey	5	5	11	(7)
Spirits	4	4	4	4
Beer	4	4	4	6
Ready to drink	12	12	11	11

Global giants and local stars(ii):	Organic volume movement(iii) %	Organic net sales movement %	Reported net sales movement %
Guinness	5	6	8
Johnnie Walker	2	–	8
Smirnoff	(4)	(4)	(4)
Baileys	8	6	7
Yenì Raki	–	10	(9)
Captain Morgan	5	6	10
J&B	(5)	(10)	(7)
Tanqueray	18	18	22

(i) Following a change in management responsibilities the Europe market, from 1 July 2017, includes Russia and the Algeria, Iraq, Jordan, Lebanon and Morocco markets.
(ii) Spirits brands excluding ready to drink.
(iii) Organic equals reported volume movement except Johnnie Walker 5% due to the reallocation of the Travel Retail operations.

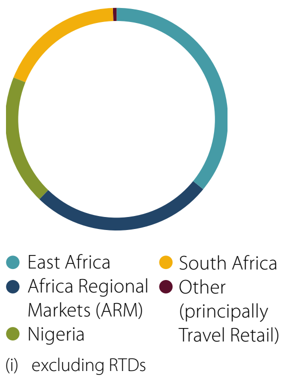
Key highlights

- In **Europe**, net sales were up 4%:
  - In **Great Britain**, net sales grew 8%. Tanqueray delivered strong double digit net sales growth and gained 30bps share in the fastest growing category across Western Europe and Gordon's benefitted from the successful launch of its Pink variant. Guinness net sales increased 8% and gained 30bps of share in the beer category, driven by a strong performance in Guinness Draught and Hop House 13 Lager. Scotch net sales were up 6% mainly driven by scotch malts and Johnnie Walker supported by incremental media activation, 'liquid on lips' and additional off trade visibility. Smirnoff declined 2% in line with the vodka category. Reserve brands continued to deliver double digit growth, with strong performance led by our scotch portfolio.
  - Net sales in **Ireland were up by 3%**. Guinness grew 2% driven by the continued success of Hop House 13 Lager and the launch of the 'Behind every town' campaign across the country. In spirits, net sales were up 14% largely driven by strong performance in Gordon's and Tanqueray.
  - In **Continental Europe**, net sales were up 1%:
  - **Iberia** net sales declined 6% due to J&B driven by category decline and an increased competitive pricing environment.
  - In **Central Europe**, net sales declined 1%. Double digit growth in Tanqueray and good performance from Johnnie Walker in Poland were offset by a soft performance in Baileys as it lapped a strong performance in the prior year, a weaker performance of Captain Morgan and Smirnoff.
  - In **Northern Europe** net sales were flat as net sales growth in the Nordics was offset by a decline in Benelux as the spirits category slowly began to recover following a prior year excise increase.
  - In the **Mediterranean Hub**, net sales were up 4% largely driven by Italy with broad growth across the spirits categories.
  - **Europe Partner Markets** grew net sales 8% driven by strong activations, innovation and performance improvement in Johnnie Walker and Guinness.
  - **Russia** net sales grew 14% with 5pps of positive price/mix driven by price increases in the previous year. Growth was largely driven by scotch led by Johnnie Walker and strong growth in Captain Morgan.
  - In **France**, net sales were up 1%. Continued strong performance in Captain Morgan and Zacapa was partially offset by weakness in J&B.
- In **Turkey**, net sales grew 11% with volume growth of 5% and excise led price increases as well as good raki and vodka performance.
- **Marketing** investment increased 6% focused on key growth opportunities for the region in Guinness, Johnnie Walker, reserve brands and gin. Productivity initiatives continued to improve the efficiency and effectiveness of the investment.

Africa

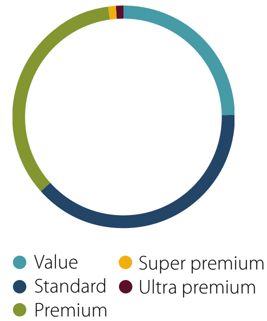
In Africa our strategy is to grow Diageo's leadership across beer and spirits by providing brand choice across a broad range of consumer motivations, profiles, price points and occasions. We are focused on growing beer fast and accelerating the growth of spirits through continued investment in infrastructure and brands to realise the potential of the region. Local sourcing is a key element of our strategy in Africa as it directly supports our commercial operations, while indirectly supporting our position by bringing wider benefits to society as a whole.

Net sales by markets
(%)



Net sales by categories
(%)

Net sales by price points
(%)



(i) excluding RTDs

Key financials

	2017 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2018 £ million	Reported movement %
Net sales	1,556	(105)	1	–	39	1,491	(4)
Marketing	166	(11)	–	–	3	158	(5)
Operating profit before exceptional items	218	(20)	2	–	(9)	191	(12)
Exceptional operating items(ii)	–					(128)	
Operating profit	218					63	(71)

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions and the results of North African countries which were formerly reported in the Africa geographical regions now being included in Europe and Turkey.
(ii) For further details of exceptional operating items see pages 114 to 116.

Our markets
The region comprises East Africa (Kenya, Tanzania, Uganda, Burundi, Rwanda and South Sudan), Africa Regional Markets (including Ghana, Cameroon, Ethiopia, Angola and a sorghum beer business in South Africa), Nigeria and South Africa (including the Republic of South Africa and Mozambique).

Supply operations
We operate 12 breweries in Africa, three sites that produce sorghum beer in South Africa, one cider plant and five facilities which provide blending and malting services. In addition, our beer and spirits brands are produced under licence by third-parties in 16 African countries. We are also investing in the future of our beer business by building a new brewery in Kenya with an estimated cost of £100 million, in order to increase our capacity in an attractive market.

Route to consumer
In Nigeria we own 58.02% of a listed company whose principal brands are Guinness, Malta Guinness, Satzenbrau and Dubic, and in East Africa, where we own 50.03% of East African Breweries Limited (EABL). EABL produces and distributes beer and spirits brands to a range of consumers in Kenya and Uganda, and also owns 51% of Serengeti Breweries Limited located in Tanzania. Within Africa Regional Markets, we have wholly owned subsidiaries in Cameroon, Ethiopia and Reunion and majority owned subsidiaries in Ghana and the Seychelles. Angola is supplied via a third party distributor. In South Africa we sell spirits and ready to drink products through our wholly owned subsidiary. Diageo has agreements with the Castel Group who license, brew and distribute Guinness in several countries across Africa Regional Markets. Diageo sells spirits through distributors in the majority of other sub-Saharan countries.

Sustainability and responsibility
Our operations and supply chain give us opportunities to create value beyond our contribution as an African employer, manufacturer and taxpayer. For example, we work with around 80,000 small farmers, helping improve yields, livelihoods and environmental and labour standards, and in 2018 78% of our agricultural raw materials were sourced and grown locally. Our Sourcing for Growth programme in Ethiopia, which now works with 6,400 smallholder farmers, won the New Vision for Development Award from the World Economic Forum. We also conducted research in partnership with CARE International on female farmers in our barley supply chain in Ethiopia, as part of our commitment to furthering women's empowerment.

Water stewardship and resilience to climate change-related water scarcity are vital issues for Diageo; 20 of our production sites in Africa are in water-stressed areas and drought has already affected some supply chains. We focus on managing water efficiently while enhancing access to clean water for communities through our Water of Life programme, which reached over 178,000 people this year. Our reforestation programmes around Lake Victoria and Mount Kenya are also helping to replenish key watersheds.

Promoting moderation and reducing alcohol-related harm remain key priorities, and we are implementing our global commitment to preventing drink driving through programmes such as 'Drive Dry' in South Africa. In March 2018 we announced the launch of 'Smashed' in Nigeria and Ethiopia, a global programme run by our partner Collingwood Learning, which combats underage drinking and is targeting an initial 30 schools in Lagos state and 30,000 students in 30 schools in Addis Ababa.

Africa net sales grew 3% with growth in Nigeria and with East Africa recovering from the first half impact of the uncertainty following the presidential election in Kenya. This was partially offset by weakness in Africa Regional Markets due to challenging conditions in Cameroon and Ethiopia, and a competitive environment in South Africa. Across Africa, beer net sales were up 5%, with strong growth of Dubic in Nigeria and the successful launch of Serengeti Lite in Tanzania. Guinness and Malta Guinness grew 7% and 4% respectively, while Senator Keg declined in Kenya. Mainstream spirits saw continued double digit growth in East Africa and Nigeria partially offset by soft performance of Smirnoff 1818 and primary scotch whiskies in South Africa. Scotch net sales declined 6%. Operating margin declined by 96bps driven by input cost inflation, adverse mix and one-off charges, partially offset by productivity savings in supply, lower indirect spend as well as organisational effectiveness benefits.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Africa	3	3	3	(4)
East Africa	7	7	4	(2)
Africa Regional Markets	(5)	(5)	(2)	(7)
Nigeria	10	10	13	(4)
South Africa	(1)	(1)	(3)	(4)
Spirits	10	10	2	(1)
Beer	–	–	5	(4)
Ready to drink	(2)	(2)	(1)	(7)

Global giants and local stars[(i)]:	Organic volume movement[(ii)] %	Organic net sales movement %	Reported net sales movement %
Guinness	2	7	–
Johnnie Walker	(5)	(4)	(5)
Smirnoff	–	(10)	(12)
Other beer:			
Malta Guinness	(4)	4	(10)
Tusker	1	–	(6)
Senator	(12)	(12)	(17)
Satzenbrau	(28)	(22)	(34)

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except Johnnie Walker (4)% due to the reallocation of the Travel Retail operations.

Key highlights

- In **East Africa**, net sales grew 4% with a stronger second half performance, with conditions normalising after the political uncertainty in the first half. Beer net sales grew 4% as a decline in Senator Keg in Kenya was more than offset by the successful launch of Serengeti Lite in Tanzania and Guinness net sales growing 8%. Mainstream spirits continued to deliver strong performance driven by improved distribution, consumer promotions and new launches.
- In **Africa Regional Markets**, net sales declined 2% with growth in Ghana more than offset by weakness in Cameroon, due to third party distributor challenges in the first half and social unrest, and in Ethiopia due to political instability, high inflation driven by currency devaluation and competitive pressures. This resulted in a double digit decline in scotch. Beer net sales were flat with double digit growth in Malta Guinness offset by a decline in Guinness in Cameroon. In Ghana net sales increased 7% with net sales growth in Malta Guinness and Guinness offsetting decline in ready to drink where Orijin faced increased competitive pressure.
- Net sales in **South Africa** declined 3% largely driven by decline in mainstream spirits, Smirnoff 1818 and primary scotch whiskies, which were impacted by price increases and an increased competitive environment.
- In **Nigeria**, net sales grew 13%. Beer grew 15% with continued strong growth from Dubic post-launch in the prior year and Guinness, up 24%, as it benefitted from the on premise activation against football, leveraging the English Premier League and the football World Cup. In spirits, net sales were up 28% as a result of strong double digit growth in mainstream spirits driven by innovation launches and new formats.
- **Marketing** investment increased 2%. In Nigeria, marketing was focused on key campaigns including Malta Guinness 'Fuel Your Greatness' and Satz 'Smart Choice'. In East Africa, the focus of marketing investment was on the Guinness campaign 'Meet The Legend', the Tusker 'Here is to Us' campaign and the launch of Serengeti Lite.

Latin America and Caribbean

In Latin America and Caribbean the strategic priority is continued leadership in scotch, while broadening our category range through vodka, rum, liqueurs and tequila. We continue to invest in routes to market and in the breadth and depth of our portfolio of leading brands to enable the business to provide the emerging middle class with the premium brands they aspire to. In this region's changing regulatory landscape, our presence is supported by our reputation as a trusted and respected business, based on our stance on responsible drinking, and community development programmes.

Net sales by markets
(%)

- PUB
- Mexico
- CCA
- Andean
- PEBAC
- Other (principally Travel Retail)

Net sales by categories
(%)

- Spirits[i]
- Beer
- Ready to drink
- Other

Net sales by price points
(%)

- Value
- Standard
- Premium
- Super premium
- Ultra premium
- Prestige

(i) excluding RTDs

Key financials

	2017 £ million	Exchange £ million	Reclassification[i] £ million	Acquisitions and disposals £ million	**Organic movement £ million**	**2018 £ million**	**Reported movement %**
Net sales	1,044	(43)	2	–	66	1,069	2
Marketing	195	(8)	1	–	8	196	1
Operating profit	250	10	(1)	–	49	308	23

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions.

Our markets
Our Latin America and Caribbean (LAC) business comprises five markets: PUB (Paraguay, Uruguay and Brazil), Mexico, CCA (Central America and Caribbean), Andean (Colombia and Venezuela) and PEBAC (Peru, Ecuador, Bolivia, Argentina and Chile).

Supply operations
The majority of brands sold in the region are manufactured by our International Supply Centre in Europe. In recent years, we have acquired a number of supply operations and expanded our co-packer network across the region. We have manufacturing facilities in Mexico to produce tequila, in Brazil to produce cachaça and in Guatemala to produce Zacapa rum.

Route to consumer
We drive an efficient route to consumer through differentiated models tailored to each markets' size and needs. In Mexico and Peru our in-market companies sell directly to retailers and wholesalers. In Brazil we distribute the majority of Ypióca (a cachaça) through a reseller network in Ceará state, and serve the rest of the country and brands via distributors, wholesalers and multiple retail groups. In Andean we partner with geographically exclusive distributors, but in Colombia a subsidiary sells to the key accounts directly. In most of CCA and Argentina we partner with distributors in each country who are responsible for the execution of the sales and marketing programmes.

Sustainability and responsibility
Our Learning for Life (L4L) programme originated in this region and trained over 5,300 people this year. By providing skills in areas such as hospitality and entrepreneurship, it continues to be an important way for us to create value. This year, we celebrated the success of a former L4L graduate, who won the World Class Bartender of the Year competition in Colombia.

Our work to tackle underage drinking continues. Through the Ministry of Education, the 'Ask, Listen and Learn' programme trained children in Grenada and St. Lucia on healthy lifestyle choices and the dangers of underage drinking.

In Guatemala, Zacapa Warehousing have implemented a new rainwater catchment system, saving over 20,000 litres in the first two months. Some of the water saved has been used to support a new Ecological Gardens community initiative.

Finally, our Glass Is Good recycling initiative in Brazil reached a milestone, collecting 20,000 tonnes of glass.

In Latin America and Caribbean net sales grew 7% with strong performances in Mexico, PUB, and PEBAC partially offset by weakness in the export channels and declines in the domestic markets of Caribbean and Central America. Growth in the region was broad based across categories. In scotch, net sales were up 3% with continued strong performance of Black & White in Brazil, Mexico and Colombia and Johnnie Walker was up 3% across the region. This was partially offset by a decline in Old Parr in Colombia and the export channels and in Buchanan's in Mexico. Don Julio delivered double digit growth. Gin also performed strongly with Tanqueray more than doubling its net sales with strong growth across the region driven by Brazil and Mexico. Smirnoff grew double digit driven by Argentina, Mexico and Brazil. Operating margin in the region increased 299bps as organisational effectiveness benefits, productivity savings and the lapping of one-off tax charges more than offset adverse mix.

Key highlights

- In **PUB (Paraguay, Uruguay and Brazil)** net sales increased 11%. In Brazil growth was broad based across spirits categories. Scotch net sales were up 11% driven by Black & White. In gin, Tanqueray net sales more than doubled through increased activation and distribution. Smirnoff net sales increased 4% through new formats to increase accessibility and the amplification of the cocktail culture through sponsorship of 'The Best Caipiroska in Brazil' event. In Paraguay net sales increased double digit driven by scotch, Tanqueray and Cîroc underpinned by domestic market growth.
- In **Mexico** net sales increased 12%. Growth was broad based but led by Don Julio which gained 1.8pps of share of the tequila category with increasing premiumisation from new innovations, Barricas and Reposado Claro. Scotch was flat with growth in Black & White offset by declines in Buchanan's whose performance was impacted by price increases. Smirnoff returned to growth, with improved performance on Smirnoff 21 and the launch of Smirnoff X1.
- In **CCA (Caribbean and Central America)** net sales declined 4%. Hurricanes Irma and Maria impacted performance in the domestic markets where net sales declined 3%. Export channels net sales declined 5% as market conditions remained challenging with continuing currency weakness against the US dollar.

Markets:	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Latin America and Caribbean	5	5	7	2
PUB	6	6	11	3
Mexico	8	8	12	9
CCA	(1)	(1)	(4)	(3)
Andean	(5)	(6)	(2)	(14)
PEBAC	24	24	15	12
Spirits	6	5	7	1
Beer	3	3	4	5
Ready to drink	(15)	(15)	(4)	(12)

Global giants and local stars(i):	Organic volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Johnnie Walker	3	3	(3)
Buchanan's	(5)	(4)	(8)
Smirnoff	15	16	5
Old Parr	(4)	(11)	(12)
Baileys	(3)	(4)	(9)
Ypióca	2	2	(6)
Black & White	38	56	47

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except for Johnnie Walker 2%, Baileys (5)% and Old Parr (5)% due to the reallocation of the Travel Retail operations.

- In **Andean (Colombia and Venezuela)** net sales declined 2% primarily driven by Colombia as last year's tax regulations resulted in higher retail selling prices for premium imported whisky, impacting the performance of Old Parr. As consumers traded down, Black & White was the biggest beneficiary supported by up-weighted media campaigns. In Venezuela volume declined 18% driven by locally produced brands as economic conditions continued to deteriorate.
- **PEBAC (Peru, Ecuador, Bolivia, Argentina and Chile)** delivered net sales growth of 15% driven by Argentina and Chile as well as Ecuador where economic conditions improved. Growth was driven by scotch which gained share, and by increased distribution of Smirnoff.
- **Marketing** investment increased by 4%, driven by up weighted investment across the scotch portfolio focused on Johnnie Walker and Black & White.

Asia Pacific

Our strategy in Asia Pacific, which encompasses both developed and emerging markets, is to operate across categories in international spirits, local spirits, ready to drink formats and beer. We focus on the highest growth categories and consumer opportunities, driving continued development of super and ultra premium scotch, and leveraging the emerging middle class opportunity.

Our markets
Asia Pacific comprises India, Greater China (China, Taiwan, Hong Kong and Macau), Australia (including New Zealand), South East Asia (Vietnam, Thailand, Philippines, Indonesia, Malaysia, Singapore, Cambodia, Laos, Myanmar, Nepal and Sri Lanka), North Asia (Korea and Japan) and Travel Retail Asia and Middle East.

Supply operations
We have distilleries at Chengdu, in China that produce Chinese white spirit and in Bundaberg, Australia that produces rum. United Spirits Limited (USL) operates 20 owned manufacturing units in India. In addition, USL and Diageo brands are produced under licence by third parties. We also have bottling plants in Korea, Thailand, Indonesia and Australia with ready to drink manufacturing capabilities.

Route to consumer
In South East Asia, spirits and beer are sold through a combination of Diageo companies, joint venture arrangements, and third party distributors. In Thailand, Malaysia and

Net sales by markets
(%)

Net sales by categories
(%)

Net sales by price points
(%)

(i) excluding RTDs

Key financials

	2017 £ million	Exchange £ million	Reclassification(i) £ million	Acquisitions and disposals £ million	Organic movement £ million	2018 £ million	Reported movement %
Net sales	2,419	(64)	(11)	(51)	210	2,503	3
Marketing	343	(5)	–	–	50	388	13
Operating profit before exceptional items	487	1	(8)	(1)	89	568	17
Exceptional operating items(ii)	(9)					–	
Operating profit	478					568	19

(i) Reclassification comprises changes to a reallocation of the results of the Travel Retail operations to the geographical regions.
(ii) For further details of exceptional operating items see pages 114 to 116.

Singapore, we have joint venture arrangements with Moët Hennessy, sharing administrative and distribution costs. Diageo operates wholly owned subsidiaries in the Philippines and Vietnam. In Vietnam we own a 45.57% equity stake in Hanoi Liquor Joint Stock Company. In Indonesia, Guinness is brewed by, and distributed through third party arrangements.

In Greater China our market presence is established through our investment in Sichuan Shuijingfang Company Limited for Baiju, our wholly owned entity Diageo China Limited, other subsidiaries and through a joint venture arrangement with Moët Hennessy. Diageo operates a wholly owned subsidiary in Taiwan.

In India, we manufacture, market and sell Indian whisky, rum, brandy and other spirits through our 54.78% shareholding in USL. Diageo also sells its own brands through USL.

In Australia, we manufacture, market and sell the Diageo products and in New Zealand we operate through third party distributors. In North Asia, we have our own distribution company in South Korea, whilst in Japan, the majority of sales are through joint venture agreements with Moët Hennessy and Kirin. Airport shops and airline operators are serviced through a dedicated Diageo sales and marketing organisation. In the Middle East, we sell our products through third party distributors.

Sustainability and responsibility
Promoting road safety is a regional priority. Our partnership with the United Nations Institute for Training and Research gathers experts, government officials, educators and business leaders to create change in the countries with the highest road traffic fatalities. In 2018 the partnership held an event in Thailand – where we also run our 'Smashed' educational programme, which raises awareness of the dangers of underage drinking.

Overall, lost time accident rates have improved by 23% in the region. Our focus on safety in USL is paying dividends, as well as the continued improvement in more established markets like Australia, which had zero lost time accidents.

This year we carried out a Human Rights Impact Assessment across our value chain in India. Our 'Road to Safety' programme also trained over 5,000 police officers and we gathered 3.6 million pledges against drunk driving. We have provided safe drinking water for 70,000 people through community water projects, and we continued to tackle illicit alcohol and harmful drinking, while promoting women's empowerment.

In Asia Pacific net sales grew by 9% with strong growth in Greater China, India, and Travel Retail Asia and Middle East. This was partially offset by the continued contraction of the scotch category in Korea. Growth was broad based across the majority of spirits categories. Chinese white spirits continued to grow strong double digit. Net sales in India grew by 9% with strong second half growth as the impact of the Supreme Court ruling prohibiting the sale of alcohol in certain outlets near state highways was lapped. In scotch, net sales were up 4% as strong performance of Johnnie Walker in Travel Retail Asia and Middle East, South East Asia, and China Mainland was partially offset by the decline of Windsor in Korea. Net sales of reserve brands were up 29% driven by Chinese white spirits and Johnnie Walker Super Deluxe in Travel Retail Asia and Middle East and premium scotch in South East Asia. Operating margin in the region improved by 181bps as savings from both indirect spend and organisational effectiveness programmes more than offset the up-weighted marketing investment.

Markets:	Organic volume movement[i] %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
Asia Pacific	2	(7)	9	3
India	1	(9)	9	(1)
Greater China	15	15	27	25
Australia	(2)	(2)	–	(4)
South East Asia	10	8	5	2
North Asia	1	1	(6)	(9)
Travel Retail Asia and Middle East	11	5	22	20
Spirits	2	(7)	10	5
Beer	4	4	3	(1)
Ready to drink	(5)	(5)	(4)	(6)

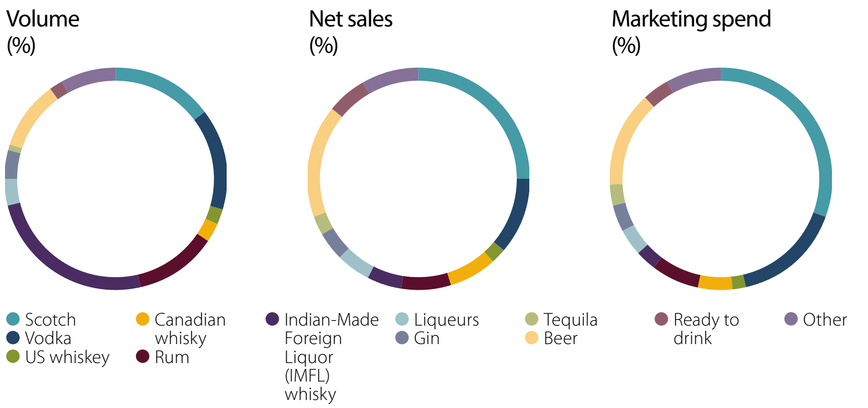
Global giants and local stars[ii]:	Organic volume movement[iii] %	Organic net sales movement %	Reported net sales movement %
Johnnie Walker	7	12	11
McDowell's	–	8	(3)
Windsor	(12)	(19)	(20)
Smirnoff	6	2	1
Guinness	5	4	–
Bundaberg	(3)	(4)	(7)
Shui Jing Fang[iv]	50	63	61

(i) Difference between organic and reported volume for Asia Pacific is driven by the move to a franchise model for some popular segment brands in India.
(ii) Spirits brands excluding ready to drink.
(iii) Organic equals reported volume movement except for Johnnie Walker 5% and McDowell's (9)% due to the reallocation of the Travel Retail operations, the change from an owned to a franchise model for some popular segment brands in India and the disposal of a subsidiary in Nepal.
(iv) Organic growth figures represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

Key highlights

- In **India** net sales increased 9% reflecting a strong acceleration in the second half as the business lapped the implementation of the Supreme Court ruling prohibiting the sale of alcohol in certain outlets near state highways. Prestige and above net sales grew 12% driven by McDowell's No. 1 supported by the launch of its 'Never Drink and Drive' campaign, Royal Challenge which leveraged a partnership with T20 cricket through Royal Challengers Bangalore and celebrity endorsement of Signature. Scotch net sales were up 11% supported by up-weighted marketing investment. Rum net sales were up 3% driven by the national launch of Captain Morgan. The popular brand segment recovered in the second half following a focus on key states and brands, resulting in full year net sales growth of 4%.
- In **Greater China** net sales increased 27% driven by Chinese white spirits which grew strong double digit through improved execution, expanded distribution and increased marketing investment. Scotch net sales declined 5% as strong double digit growth in mainland China in Johnnie Walker and The Singleton was more than offset by declines in Taiwan where scotch net sales declined by 15% as a result of commercial challenges and category contraction.
- Net sales in **Australia** were flat. Growth in Guinness and Tanqueray, with the latter gaining 1.1pps of share, was offset by declines in Smirnoff and Bundaberg in the ready to drink category.
- In **South East Asia** net sales increased 5% driven by double digit growth in Key Accounts where Johnnie Walker was supported by continued focus on route to consumer and seasonal gifting. Scotch net sales grew 11% with growth in all markets except Vietnam and Thailand.
- In **North Asia** net sales declined 6% as scotch led growth in Japan driven by Johnnie Walker was more than offset by continued weakness in Korea. In Korea net sales declined 11% driven by Windsor as the scotch category continued to contract as consumers switched to lower alcohol content alternatives. This was partially offset by growth in the W range by Windsor, in the lower ABV segment, and Guinness, which both delivered double digit net sales gains.
- **Travel Retail Asia and Middle East** net sales grew 22% with growth driven by scotch, particularly Johnnie Walker, as the Middle East lapped weak performance in the prior year along with expanded distribution and improved commercial activations.
- **Marketing** investment increased 15% driven by investment in China and India.

Category review



Key categories	Organic volume movement[iv] %	Organic net sales movement %	Reported net sales movement %
Spirits[i]	3	5	2
Scotch	3	2	1
Vodka[ii][iii]	1	(1)	(6)
US whiskey	2	7	1
Canadian whisky	–	2	(4)
Rum[ii]	(3)	1	(4)
Indian-Made Foreign Liquor (IMFL)	4	8	(1)
Liqueurs	6	6	4
Gin[ii]	17	16	14
Tequila	35	40	56
Beer	1	4	(1)
Ready to drink	2	4	–

(i) Spirits brands excluding ready to drink.
(ii) Vodka, rum, gin including IMFL brands.
(iii) Vodka includes Ketel One Botanicals.
(iv) Organic equals reported volume movement except for spirits (1)%, rum (10)%, IMFL whisky (3)%, vodka flat, tequila 58% and gin 12%. IMFL whisky was impacted by the move from an owned to a franchise model for some popular segment brands in certain states in India and the disposal of a subsidiary in Nepal, Tequila reported volume benefits from the Casamigos acquisition and other categories were impacted by the reallocation of the Travel Retail operations.

- **Scotch** represents 25% of Diageo's net sales and was up 2% with growth in North America, Asia Pacific and Latin America and Caribbean partially offset by decline in Africa and Europe. Scotch growth was driven by Johnnie Walker, which delivered a strong performance with net sales up 5%, and primary scotch brands net sales increased 7% largely driven by Black & White in Latin America and Caribbean and Asia Pacific. Africa was impacted by South Africa's decline in primary scotch and the soft economic environment in Cameroon. In Europe performance was impacted by weakness in J&B. Elsewhere Windsor net sales were down double digit as it continued to suffer from the category decline in Korea and Old Parr performance was impacted by tax changes in Colombia. Net sales in scotch malts were up 1% with growth primarily in Great Britain and China Mainland partially offset by weakness of The Singleton in Taiwan.
- **Vodka** represents 11% of Diageo's net sales and declined 1%, an improvement against the 4% decline last year. The net sales decline was driven predominantly by Smirnoff in US Spirits and Europe as well as Smirnoff 1818 in South Africa which continued to be impacted by the competitive pressure in the mainstream segment. This more than offset the good performance of Smirnoff in Latin America and Caribbean. Cîroc vodka and Ketel One vodka also declined with growth in Europe and Latin America and Caribbean more than offset by declines in US Spirits despite improved performance on both brands compared to last year.
- **US whiskey** represents 2% of Diageo's net sales and grew 7% largely driven by Bulleit continuing to win share in the US whiskey category.
- **Canadian whisky** represents 7% of Diageo's net sales and grew 2%. Net sales in Crown Royal grew 3% and continued to gain share in the Canadian whisky category of the US market.
- **Rum** represents 7% of Diageo's net sales and grew 1% with broad based growth across all regions except North America where we continue to gain share despite category headwinds. Rum overall performance was largely driven by Captain Morgan, up 2%, as well as Zacapa that grew 8%. Captain Morgan and Zacapa performance more than offset declines in Parrot Bay, Bundaberg and Cacique.
- **IMFL whisky** represents 5% of Diageo's net sales and grew 8% driven by strong performance of McDowell's No.1 and Royal Challenge.
- **Liqueurs** represents 5% of Diageo's net sales and grew 6% driven by double digit growth of Baileys in US Spirits as the brand benefited from a new media campaign and 'liquid on lips' sampling activations and good performance in Europe due to Baileys Original, up 2%, strong recruitment via Baileys Almande and launch of time limited flavour Baileys Strawberries and Cream.
- **Gin** represents 4% of Diageo's net sales and grew 16% with broad based growth across all regions. Tanqueray and Gordon's in Europe were the largest contributors to growth as both brands grew double digit.
- **Tequila** represents 3% of Diageo's net sales and grew 40%. The performance was driven by strong double digit growth of Don Julio in US Spirits and Mexico.

- **Beer** represents 16% of Diageo's net sales and grew 4%. Growth was largely driven by Guinness, Dubic and Serengeti Lite. Guinness net sales were up 5% with strong performance in Europe driven by Hop House 13 Lager and Guinness Draught. Nigeria also had a strong performance with Guinness growing 24%. In East Africa, performance of Senator was impacted by excise driven price increase and political instability.
- **Ready to drink** represents 6% of Diageo's net sales and grew 4% driven by good performance in North America and Europe.
- **Global giants** represent 41% of Diageo's net sales and grew 4%. Growth was broad based across all brands with the exception of Smirnoff whose net sales declined 2%.
- **Local stars** represent 20% of Diageo's net sales and grew 6%, largely driven by strong growth of Chinese white spirits, IMFL whisky, Crown Royal in US Spirits and Black & White in Latin America and Caribbean. This was partially offset by declines of Windsor in Korea, J&B in Iberia and Old Parr in Colombia.
- **Reserve brands** represent 18% of Diageo's net sales and grew 14% largely driven by strong double digit growth in Chinese white spirits and Don Julio. Net sales of Johnnie Walker reserve variants were up 8%. Double-digit growth in Tanqueray No. TEN and Bulleit more than offset declines in Ketel One vodka and Cîroc vodka.

Global giants, local stars and reserve(i):	Organic volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Global giants			
Johnnie Walker	3	5	5
Smirnoff	–	(2)	(5)
Baileys	6	6	5
Captain Morgan	6	2	(1)
Tanqueray	14	15	12
Guinness	3	5	2
Local stars			
Crown Royal	1	3	(3)
Yenì Raki	–	10	(9)
Buchanan's	(3)	(2)	(6)
J&B	(5)	(9)	(7)
Windsor	(13)	(19)	(20)
Old Parr	(3)	(9)	(10)
Bundaberg	(3)	(4)	(7)
Black & White	26	33	28
Ypióca	2	2	(7)
McDowell's	–	8	(3)
Shui Jing Fang(iii)	50	63	61
Reserve			
Scotch malts	1	1	4
Cîroc	1	(2)	(6)
Ketel One vodka	3	(1)	(7)
Don Julio	34	39	32
Bulleit	9	11	5

(i) Spirits brands excluding ready to drink.
(ii) Organic equals reported volume movement except for McDowell's (9)% and Scotch malts 2% which were impacted by the move from an owned to a franchise model in India.
(iii) Organic growth figures represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

Our role in society

Sustainability & Responsibility review

Our business and brands connect us to millions of people, and to the natural resources we share with them and which we all depend upon. This is an enormous opportunity, and one we will use to safeguard the future of our business while helping to address some of the biggest challenges facing society and the environment; from harmful drinking to climate change, and from women's empowerment to water scarcity.

Our sustainability and responsibility strategy uses the capabilities of our entire business to make a positive contribution to society and promote inclusive growth by:

Creating a positive role for alcohol in society

Read detail on **page 42**

Building thriving communities

Read detail on **page 45**

Reducing our environmental impact

Read detail on **page 50**

As a global leader in premium alcohol, we have a clear opportunity – and responsibility – to be leaders in ensuring alcohol has a positive role in society. We want the millions of people who choose to enjoy our brands to 'drink better, not more', and we're committed to tackling alcohol misuse across the world.

Our community initiatives emphasise empowering women; promoting entrepreneurship, employability and skills; building sustainable supply chains; and improving access to clean water and sanitation. There is of course a crossover with our aim to deliver the highest standards of environmental performance; improving water stewardship and reducing carbon emissions, thus helping to address climate change. In fact, all the areas we prioritise are interconnected – because people are interconnected. A supplier may also be a member of the local community and a consumer; so too may an employee. Our holistic approach is underpinned by a commitment to acting as a good corporate citizen, with exemplary governance and respect for human rights.

Impact within and beyond our operations

We want to build on our brands' connections with consumers to achieve greater positive social impacts, such as promoting moderate drinking and encouraging inclusivity. We also want to enhance the direct economic value our products already create – this year alone, for example, we employed c. 30,000 people, and paid £7.4 billion in taxes and other duties to governments. And we want to ensure we can achieve all this while reducing the environmental impacts involved in making the brands we're so proud of.

But we also look beyond our brands and operations. Throughout our value chain we have strong relationships: with the farming communities where our ingredients are grown, with our many suppliers and contractors, and with the distributors and retailers who bring our products to consumers.

Progress, challenges – and setting new goals

In 2015, we set ourselves targets to reach by 2020, with metrics to measure our impact and help us co-ordinate our efforts.

Our targets are ambitious; designed to drive performance that achieves real impact while making our business more resilient, including to the effects of climate change. Many of our environmental targets, for example, commit us to achieving absolute reductions in our impact, rather than relative reductions.

Our alcohol in society targets have helped to drive performance across our programmes. This year we updated our targets for 2025 and are outlining a new strategy to maximise our impact as leaders in creating a positive role for alcohol in society.

After many years of cumulative progress in areas such as carbon emissions reduction and water efficiency improvements, progress against some of our environmental targets slowed in 2018. In part this is because, as we get closer to 2020, delivering further improvements becomes more complex, and in some markets it has taken longer to implement projects than we expected. Nonetheless, we are committed to the targets, which are driving the right approach, and we have identified future environmental investments that will help us progress toward 2020.

Highlights of our community targets include meeting our safety target two years early – this year we achieved our goal of less than one lost-time accident per 1,000 employees, and no work-related fatalities. We also made good progress with our human rights impact assessments, bringing our total to 12 countries assessed since 2015.

We remain committed to achieving our 2020 targets, and report against each in the following pages, with supporting detail in our submissions to CDP, and in our Sustainability & Responsibility Performance Addendum, which reports against GRI and the UN Global Compact (UNGC), and includes our response to the Sustainability Accounting Standards Board.

We are also looking beyond 2020, with longer-term objectives to enhance the value we create and our contribution to the SDGs for 2030. These build on our increasing understanding of our risks and opportunities, including those highlighted by our work on implementing the recommendations of the Task Force on Climate-related Financial Disclosure (TCFD), discussed further on page 50.

Creating a positive role for alcohol in society

We're proud of producing some of the world's best alcoholic drinks – and we want them to be enjoyed responsibly, as part of our purpose of celebrating life, every day, everywhere. Our goal is for people to drink better, not more – which is why we are committed to promoting moderation and tackling misuse, while respecting the fact that many people choose not to drink alcohol at all.

Millions of people enjoy our brands, and the vast majority do so sensibly and in moderation. They know that balance is important, and that drinking too much of any kind of alcohol can lead to serious problems. At the same time, we know that harmful drinking causes significant problems for individuals and for society. Tackling alcohol misuse and encouraging moderation are critically important to everyone at Diageo, because we all want to ensure our brands have a positive impact on the people around us.

Far from being in conflict with our commercial interests, these goals align with Diageo's values and business aims. Harmful drinking can damage our reputation and make it harder for us to create value. On the other hand, our focus on the taste, authenticity and heritage of our brands means we benefit when consumers choose to trade up to higher-quality, better-tasting drinks. That's what we mean by 'drink better, not more'.

New strategic approach to maximise our impact

We support the World Health Organization's goal of reducing harmful drinking by 10% across the world by 2025 through a wide range of approaches and programmes, often working alongside industry peers and external partners. This year, we are outlining a new strategy to make sure we're maximising our impact as leaders in creating a positive role for alcohol in society.

We already take a clear stand on key issues – such as being the first to put nutritional information and alcohol content onto our labels – and aim to be the first choice industry partner for governments. We also want to put our support behind the most effective programmes around the world, reducing harm and changing behaviour. As a global business, we've focused our efforts on three core pillars: campaigning to reduce harmful drinking, promoting moderation, and improving laws and industry standards.

Industry collaboration

Collaboration with our peers in the alcohol industry is a vital part of achieving greater impact, whether through campaigns or by setting industry standards. From global businesses like ours, to local producers in individual markets, we believe everyone needs to play their part – and where possible, we aim to be a catalyst for change.

From 2013, for example, we worked with our peers to implement the Global Beer, Wine and Spirits Producers' Commitments to Reduce Harmful Drinking. We are proud of our achievements over the five years of those Commitments and, although these ended in December 2017, the signatory companies remain committed to the spirit of the five Commitments and the ten action areas. A final progress report will be issued in September 2018 and can be found at www.producerscommitments.org.

We will continue to work with our peers in this area. In 2017 our CEO became Chairman of the CEO Group at the International Alliance for Responsible Drinking. The CEO Group met in September 2017 and announced a commitment to enhance standards for digital marketing by applying new tools, technology and data to digital marketing to ensure it is responsibly targeting adult consumers.

Responsible marketing

The Diageo Marketing Code and Digital Code are our mandatory minimum standards for responsible marketing, and we review them at least every two years to ensure they represent best practice.

Across many of our markets, advertising monitoring and industry bodies publicly report breaches of self-regulatory alcohol marketing codes.

This year, the UK's Advertising Standards Agency (ASA) upheld a complaint relating to a Snapchat lens advertising our Captain Morgan brand, on the grounds that the lens was of particular appeal to people under 18 and was directed at people under 18. The demographic data supplied to Diageo by Snapchat showed that over 75% of users were

continued on page 44

Complaints about advertising upheld by industry bodies that report publicly[(i)]

Country	Body	Industry complaints upheld	Complaints upheld about Diageo brands
Australia	Alcohol Beverage Code	14	0
Ireland	Advertising Standards Authority for Ireland (ASAI)	1	0
United Kingdom	The Portman Group	5	0
	Advertising Standards Authority (ASA)	4	1
United States	Distilled Spirits Council of the United States (DISCUS)	9	4

(i) From 1 July 2017 to 30 June 2018.

Pillar 1

Campaigning to reduce harmful drinking

Our long experience of running campaigns to reduce harm, raise awareness and shift attitudes has taught us that the best results are achieved through proven, high-impact programmes, delivered at scale.

As a result, we're directing all our resources at global programmes focused on our priorities for reducing harmful drinking:

- **Tackling heavy episodic (or binge) drinking** through brand campaigns and pilot projects to develop a blueprint for a flourishing, safe night-time economy in cities, working with partners to reduce alcohol-related problems in entertainment districts. This year we launched pilots in Durban and Toronto.
- **Preventing drink driving** through our global #JoinThePact programme, we have already met our target to encourage five million people to sign a pact never to drink and drive, and the programme continues. We are also developing partnerships with police, local authorities and other agencies that support enforcement, to provide education for drivers and law enforcers, and to provide safe rides and public transportation.
- **Addressing underage drinking** through the global expansion of our hard-hitting, theatre-based programme. 'Smashed' has reached almost half a million school children since its launch in the UK in 2005. The programme has a proven track record: on average, attendees report a 44% increase in awareness of the risks associated with underage drinking and a 32% increase in awareness of where to get help over alcohol issues. As part of our ambition to harness innovation and technology to reach and inform more young people than ever before, we released an online version of 'Smashed' in the United Kingdom.

Partnerships are essential to delivering impact for many of our programmes. Our two-year partnership with the UN Institute for Training and Research (UNITAR), for example, aims to reduce death and injuries from traffic accidents in more than 60 countries, with a focus on those with the highest road traffic death rates. As part of the partnership, we are running multi-stakeholder conferences and training in 15 countries across Asia, Africa and Latin and Central America.

Pillar 2

Promoting moderation

For most people who drink, drinking responsibly is common sense. They know that balance is important, and that drinking too much can lead to serious problems. We want to reinforce that common sense understanding of moderation in everything we do, using the full reach of our brands and global business.

That means using our brands to carry a strong moderation message and combat heavy episodic drinking – for example, our Haig Club, Crown Royal and Captain Morgan brands have all launched campaigns this year with engaging messages to reinforce moderation. It also means exploring other channels for providing consumers with information, tools and resources to make informed choices. For example, our dedicated responsible drinking website, DRINKiQ.com, is available in 18 languages and offers consumers access to a wide range of training and resources on the effects of drinking. It includes an online tool with interactive learning and tests to help people gain insights on how drinking affects the body. Launched in March 2017, this tool is now available in 25 countries. DRINKiQ.com also hosts powerful resources such as our virtual reality films that simulate the potentially life-changing consequences of harmful drinking.

Our employees are passionate about alcohol's positive role in society too, and are at the heart of promoting moderation. Our Drink Positive initiative, launched in November 2017 and described in our case study on page 18, celebrated some of the most inspiring activities and commitments led by employees, and showcased innovative initiatives for reaching people with positive messages about moderation. Results from this year's Values Survey demonstrate the impact of this initiative, with 93% of employees agreeing that Diageo is effective in promoting a balanced role for alcohol in society.

Labels and packaging also help us provide information to consumers to reinforce the importance of moderation. Our Diageo Consumer Information Standards define mandatory minimum information for labels on and packaging of all our brands, wherever such information is legally permitted. Our labels and packaging must include alcohol content and nutrition information per serve, alcohol content by volume (ABV), at least one responsible drinking symbol, a reference to DRINKiQ.com, a list of allergens, and recycling and sustainability information.

Pillar 3

Improving laws and industry standards

Working with regulators and policy-makers is an important part of our strategy and is critical to the impact of our programmes. We comply with all laws and regulations, wherever we operate, but we also advocate sensible new regulation, including campaigning for legal purchasing age laws and blood-alcohol volume driving limits in countries where these do not exist.

We also campaign for effective policies to reduce the misuse of all forms of alcohol – whether beer, wine or spirits – and have worked with industry partners and others to establish minimum standards for responsible marketing. For example, this year we supported a stakeholder conference on self-regulation of marketing in Ghana in an effort to improve standards for responsible marketing to adults. We also work with governments and others to combat illicit alcohol.

Beyond our 2020 targets

In 2015, we set ourselves targets for reducing alcohol-related harm in key areas, which have driven performance across our programmes. This year, we updated our targets for 2025, which will help us go even further to deliver impact where it is needed. We will begin reporting against our 2025 targets next year.

Focus area	2020 target	KPI	Progress
Industry collaboration	Implement global alcohol industry commitments to expand and increase efforts on: • reducing underage drinking • strengthening and expanding market codes of practice • providing consumer information and responsible product innovation • reducing drink driving • enlisting the support of retailers to reduce harmful drinking.	Concluded	The current set of Global Producers' Commitments concluded in December 2017. Reports on progress against the commitments can be found at www.producerscommitments.org. In September 2017, the CEOs of the leading beer, wine and spirits producers, including Diageo, announced a commitment to develop, in collaboration with others, new robust responsible marketing standards for digital channels that represent best practice.
Impactful programmes	Going beyond industry commitments, we will work in partnership to support programmes to address harmful drinking in our top 18 countries. We will evaluate these initiatives for efficacy and impact and report on the results.	Number of countries that evaluate responsible drinking programmes	This year, 16 of our top 18[(i)] countries assessed the effectiveness of their programmes, measuring increases in awareness or shifts in attitudes or behaviour. (i) This number changed from 19 to 18 as a result of the sale of our Red Stripe business in Jamaica.
Training	Reach one million adults with training materials that will enable them to become responsible drinking (RD) ambassadors.	Number of adults, above legal purchasing age, who have completed interactive training (face-to-face or online) on responsible drinking, which can also include training on responsible serving, selling and marketing.	By September 2017, we had trained one million adults around the world with the knowledge they need to champion responsible drinking. This year alone we trained 800,239 adults as RD ambassadors in 23 countries through training programmes including DRINKiQ, Learning for Life, Diageo Bar Academy and Plan W.

By 2025

Educate
5m
young people, parents and teachers about the dangers of underage drinking.

Collect
50m
pledges never to drink and drive through #JoinThePact.

Reach
200m
people with moderation messages from our brands.

Responsible marketing continued

aged 18 years or over, and an age filter was applied to target the lens only at users with a registered age of 18 years and over. However, the ASA ruled that Diageo had not taken sufficient care, in relation to the selection of media, to ensure the Captain Morgan lens was not directed at under 18s. We acknowledge the ASA's ruling and have taken steps to apply additional interest-based targeting to our social media advertising. We have stopped all advertising on Snapchat globally since January 2018 while we assess the incremental age verification safeguards that Snapchat is implementing.

In the US, the Distilled Spirits Council of the United States (DISCUS) upheld complaints against four advertisements for Casamigos Tequila, which we acquired in 2017. The complaints concerned two Instagram advertisements and a tweet for Casamigos, and to the brand website's age affirmation method at the time. We responded in each case, with Casamigos deleting the Instagram advertisements and tweet. We also changed the age gate to one that uses month, day and year. Finally, we promptly conducted a training session with the Casamigos brand team to review and ensure full compliance with the Diageo Marketing Code and Digital Code.

Building thriving communities

Supporting our employees and the communities where we live and work is one of our biggest opportunities to create value. Making Diageo a great, safe and inclusive place to work; building sustainable and inclusive value chains; delivering empowerment programmes that enhance skills and opportunities and break down gender barriers – all these interconnected themes share the same aim: promoting inclusive growth for both society and our company. And they are all based on the respect for human rights that is fundamental to who we are and how we do business.

A sustainable value chain, built on respect for human rights

Whether in our agricultural supply chains or our workplaces, our distribution networks or the communities in which we're based, our business has been built on long-term relationships based on trust and shared value. The success of those relationships, now and in the future, is underpinned by respect for human rights.

Embedding human rights throughout our value chain

We have a well-developed policy framework that addresses human rights and sets out our commitment to acting with integrity. Respecting human rights informs the core principles of our Partnering with Suppliers Standard, described further below. And our human rights commitments apply throughout our value chain – we will not work with anyone, including any supplier, who does not align with these principles.

Identifying issues and risks

We've been signatories to the UN Guiding Principles on Business and Human Rights (UNGP) since 2014. We continue to embed human rights throughout our value chain in line with the UNGP, using our robust and comprehensive human rights impact assessment (HRIA) in our markets prioritised by risk on a global basis. The HRIA considers our entire value chain from sourcing to selling within a market, looking at local risks. This leads to mitigation plans to address specific human rights issues or strengthen our processes to prevent them arising.

In line with the UNGP, we have identified three risks as particularly salient to our business: labour rights, including the risk of child labour, especially in agricultural supply networks; labour standards for contract workers; and sexual harassment in the hospitality sector.

These issues are external risk factors in the places where we operate, and we recognise the challenges they pose in our value chain. We are particularly aware of these risks when carrying out HRIAs (see our progress against our target, below), and in our supply chain.

Having identified these risks, we have focused resources on awareness programmes around child protection, and measures to protect workers, including seasonal contract workers and sales teams working in bars.

Target Act in accordance with the UN Guiding Principles on Business and Human Rights.

KPI number of markets in which we have carried out human rights assessments.

Progress toward 2020 We aim to conduct HRIAs in all markets by 2020. This year, we carried out HRIAs in Tanzania, Guatemala, the UK, India and Colombia, bringing our total since 2015 to 12. As a result of the findings, we have developed a child protection programme for our work with smallholder farmers, and initiatives aimed at preventing sexual harassment in the hospitality sector. Each market has developed an action plan to address its specific risks. We have also developed contractor standards guided by the International Labour Organization's Declaration on Fundamental Principles and Rights to Work, focused on promoting conditions in which people can work in freedom and safety.

Our principles

We do not tolerate discrimination, harassment, bullying or abuse; we comply with wage and working time laws; we respect our employees' decisions to join or not join a trade union; and we do not tolerate forced labour. Our Modern Slavery Statement describes the activities we are undertaking to prevent slavery and human trafficking in our business operations and supply chain, in line with the UK Modern Slavery Act 2015 and the California Transparency in Supply Chains Act 2010. That statement and further details of our policies are available on www.diageo.com.

Focus on supply chain opportunities

Robust, resilient, thriving supply chains are fundamental to our business. They also enable us to contribute to the UN Sustainable Development Goals (SDGs) by reducing poverty and inequality, particularly in farming communities, and by addressing environmental challenges, including climate change. We're focused on supporting and building capability among our suppliers, and strengthening both respect for human rights and environmental practices to ensure that growth is inclusive and sustainable.

We see all our suppliers as partners in providing responsibly sourced materials and services. Our Partnering with Suppliers Standard sets out the minimum social, ethical and environmental standards we require suppliers to follow as part of their contract with us, as well as aspirations for long-term partners to work towards.

Global raw materials(i) by volume
(Total – 1.6 million tonnes)

Barley(ii)	36%	Sugar	6%
Wheat	11%	Agave	4%
Maize	11%	Rice	3%
Molasses	10%	Dairy	1%
Grapes	8%	Raisins	1%
Sorghum	7%	Rye	1%
		Other (including aniseed, cassava and hops)	1%

(i) Figures represent raw materials we buy directly, and exclude raw materials used to make the neutral spirit we purchase.
(ii) Includes malted barley.

Global packaging materials(i) by volume
(Total – 1.4 million tonnes)

Glass	82%	Cans	2%
Corrugate	8%	PET	1%
Cartons	3%	Beverage cartons	1%
Closures and crowns	2%	Labels and sleeves	1%

(i) Excludes promotional materials.

We continue to work through SEDEX, a not-for-profit organisation that enables suppliers to share assessments and audits of ethical and responsible practices with multiple customers, and through AIM-PROGRESS, a forum of 40 leading consumer goods companies which promotes responsible sourcing and sustainable supply chains. Our Know Your Business Partner (KYBP) programme also assesses third parties against the risk of bribery and corruption.

In 2018, we worked with industry peers under the umbrella of AIM-PROGRESS to develop a Supplier Business Toolkit, which is available on www.diageo.com. It aims to share best practice with suppliers and provide practical guidance on how to improve productivity, quality and workforce management, by ensuring good working conditions and ethical standards.

Target Deliver our responsible sourcing commitments with suppliers to improve labour standards and human rights in our supply chains.

KPI % of potential high-risk supplier sites audited.

Progress toward 2020 This year, 1,248 of our supplier sites assessed as a potential risk completed a SEDEX self-assessment. Of these, 486 were assessed as a potential high risk, with 76% independently audited over the past three years, up from 65% in 2017. Of these audits, we commissioned 231 and 139 came through the SEDEX or AIM-PROGRESS mutual recognition programmes. 170 audits were conducted in the past year.

Driving progress through sustainable agriculture
Embedding human rights, empowering women, building skills and increasing water resilience are essential themes of our sustainable development strategy. We work within farming communities to simultaneously advance these themes and fulfil the business imperative of making our supply of ingredients more secure.

The cornerstone of our approach is 'Building Sustainable Supply Chains', our strategy for sustainable agriculture. This strategy, published on www.diageo.com, is built on three core principles:

- Securing a supply for our business, while contributing to economic and wider growth
- Respecting human rights, building capacity and creating shared value with farming communities
- Using resources efficiently, minimising environmental impact, and safeguarding future crops and ecosystems.

In June 2018, we published our new Sustainable Agriculture Guidelines. These build on our strategy by outlining how we expect our suppliers to work continuously toward more sustainable agricultural practices. That includes treating farmers and workers fairly, reducing negative environmental impacts while protecting natural capital, and supporting wider economic benefits for farming communities.

Partnering with farmers
In sourcing the raw materials for our brands, we work with farmers and their communities around the world. In Africa, we focus on supporting smallholder farmers to build stronger farm enterprises, through training, better access to seeds and fertilisers to improve yields, access to capital through micro-loans, and engagement with NGOs and other stakeholders to build farmer resilience.

Where developed quality assurance standards exist, we work with industry partners to create a more harmonised approach that helps farmers become more sustainable. We did this in 2018 with Scottish Quality Crops (SQC), an independent, third-party farm and quality assurance standard with which close to 90% of Scottish growers comply and which is now benchmarked to FSA Bronze. This allows all our Scottish-sourced grains to meet our minimum sustainability requirement. We continue to work with SQC to promote enhanced agricultural practices.

Wherever we work, we want to find ways to promote sustainable agricultural practices that meet our standards, while avoiding duplication for our suppliers.

Target Source 80% of our agricultural raw materials locally in Africa by 2020.

KPI % of agricultural raw materials sourced locally in Africa.

Progress toward 2020 We sourced 78% of agricultural materials locally within Africa for use by our African markets, compared to 76% last year. We support this target through a range of farmer capacity building programmes.

Target Establish partnerships with farmers to develop sustainable agricultural supplies of key raw materials.

KPI Number of smallholder farmers supported.

Progress toward 2020 We support more than 80,000 farmers in Africa. Our work with farmers is described in 'Partnering with farmers', above.

Setting new standards, and helping farmers meet them
We use the Sustainable Agriculture Initiative's Farm Sustainability Assessment (FSA) tool to assess sustainability within our agricultural supply chain.

In 2018, we set FSA Bronze as the minimum compliance level to meet our sustainable agriculture requirements. This must be verified through third-party assurance, either directly, or using a benchmarked standard such as SQC (outlined above).

More than 80 global, regional, company or crop-specific standards have now been benchmarked against the FSA, meaning suppliers that already comply with an equivalent scheme can demonstrate that they meet our requirements. Where we work directly with suppliers at farm level – or where we have operational control of farms – we help them meet our requirements. And in markets where our supply chains include many smallholder farmers who may not yet achieve FSA Bronze, we help farmers improve their yield and livelihood, supporting sustainable farming practices and working with suppliers to identify and address their most material issues and promote inclusive growth.

Empowering and enabling communities through our programmes

In all our markets, we know that everything we do is connected to communities. As an alcohol business, we sell iconic brands responsibly to consumers; as a local employer, we provide jobs and pay taxes; and as a manufacturer, we use shared natural resources and purchase from local suppliers.

Our direct investment in programmes that support the communities where we source, make and sell our products must also reflect, and be connected to, our core business. That's why our programmes are designed to support the four main strands of our community strategy, which align with the SDGs:

- Promoting entrepreneurship, employability and skills (SDG4, SDG8)
- Building sustainable and inclusive supply chains (SDG1, SDG4)
- Improving health and wellbeing, and access to clean water, sanitation and hygiene (SDG3, SDG6)
- Empowering women and enabling inclusive societies (SDG5 and SDG10).

Target Our community programmes enable those who live and work in our communities, particularly women, to have the skills and resources to build a better future for themselves. We will evaluate and report on the tangible impacts of our programmes.

KPI Each programme has its own KPI.

Progress toward 2020

- **Water of Life** has reached more than 10 million people in India and in 21 countries in Africa since 2006, including 234,000 this year. It is focused on access to water, sanitation and hygiene in line with SDG 6. Typically, we are implementing projects in rural areas that supply our raw materials, to ensure the programme is aligned with our core business.
- **Women's empowerment:** by applying a gender-inclusive approach across all of our community programmes, this year we reached more than 164,000 women in support of SDGs 5 and 10.
- **Learning for Life** supports vocational and life-skills training, and strengthens our value chain through its emphasis on hospitality, retail and entrepreneurship, while delivering long-term opportunities for the people involved. More than 130,000 people have taken part since we launched the programme in 2008, with typically more than 70% gaining permanent jobs. This year we trained 7,000 people globally. In May 2018, we published an independent evaluation of the programme's impact in the UK. The study, by researchers from the Business School of the University of Edinburgh, found that the programme had a positive impact on the graduates' perceptions of self-efficacy, self-esteem and self-confidence, and that 77% of participants felt that they had become more responsible drinkers.

Community investment by region

North America	32%
Europe and global functions	24%
Asia Pacific	20%
Latin America and Caribbean	18%
Africa	6%

Community investment by focus area

Community aspects of responsible drinking projects(i)	43%
Learning for Life	25%
Brand-led and local community spend(ii)	17%
Water of Life	9%
Plan W	6%

(i) This is a sub-section of the total responsible drinking budget.

(ii) Category includes cause-related brand campaigns, local market giving and disaster relief.

A value chain approach to women's empowerment

We will only succeed in promoting inclusive growth if we enable women throughout our value chain to play an equal role in the economy and society – from the smallholder farmers who grow our raw materials, to the employees in our workplaces and distribution networks, to the people who serve our brands to consumers all over the world.

To date, our programmes such as Plan W have empowered more than 390,000 women with access to training and skills. But we know that there is an opportunity – and a need – to do more. No country has achieved gender equality, and we know that every value chain contains barriers to women's equal participation. That's why we are now applying a gender-inclusive approach to all our community initiatives; this year we reached more than 164,000 women through our programmes.

To magnify our impact, we are working in a global partnership with the NGO CARE International to address the root causes of gender inequality throughout our value chain through a combination of research, community programmes and advocacy.

In 2017, we worked with CARE on a gender analysis of our barley supply chain in Ethiopia, where we have developed local farming programmes. It showed that, despite expanding the number of supplier farmers from 1,047 to over 6,000 in four years, the proportion of female farmers increased by just 1% – largely a result of barriers to women's participation in the farmers' groups we work with and the land rights afforded to women. We're addressing this within our local sourcing programmes, enabling equal access to skills and resources for women farmers and supporting them within farmer unions and co-operatives.

Building a more interconnected approach

We're working to increase our impact by further integrating our programmes, core business activities, and partnerships using our Social Impact Framework (SIF) to identify and measure potential benefits. That means, for example, developing combined water and women's empowerment initiatives as part of our work with farmers in India and Africa.

Partnerships are key to this approach, and this year we worked with the UN Development Programme, the German government's development agency GIZ, CARE International and the NGO WaterAid, among others, to improve livelihoods in our value chain.

Highlight

Clean water for everyone, everywhere

We believe everyone should have access to safe water and sanitation – and we're proud of our 15-year partnership with WaterAid, an NGO whose purpose is to make water, toilets and hygiene normal for everyone, everywhere. During the course of our partnership, we've brought clean water and sanitation to more than 300,000 people in Africa, including this year's project which is bringing safe water to 3,500 people in Kebbi, Nigeria. Together we are creating shared value by empowering and investing in communities and advocating for universal access to safe water, sanitation and hygiene at local, national and global levels.

Our people

We aim to create a trusting, respectful, honest and inclusive culture, where people are proud of their work, empowered to succeed, and know that their safety and other human rights are respected.

Our leaders at every level play a critical part in creating and maintaining that culture, and inspiring our performance. In 2018, we launched a new Diageo leadership standard to guide leaders on how they can shape the future of our business, invest in talent, inspire others with our purpose, and drive performance. Programmes such as our Future Leaders initiative, which supports employees in the early to middle stages of their development over a three-year period, is one example of how we unlock the potential of our people and invest in their growth.

Health and safety

Our global Zero Harm programme is designed to ensure that all our people go home safe, every day – and our health and safety strategy aims to make ours a business in which no one is hurt, anywhere.

Our Zero Harm programme has driven industry-leading progress in the safety of our people. We are delighted to say that this year we achieved our 2020 target of one lost-time accident (LTA) per 1,000 employees and no work-related fatalities two years early, which constitutes world-class performance. In 13 markets, including North America, Mexico, Ethiopia and Australia, we operated without any LTAs for the year.

While we are proud of this progress, and in particular of the speed with which safety performance has improved in businesses we have recently acquired, we know there is more work to be done. We continue to focus on fully embedding a best practice safety culture into all levels of our business, ensuring consistency in performance everywhere we operate.

We are also continuing to grow our capability around predictive safety, building safety resilience into everything we do, to anticipate and mitigate the risks that lead to incidents. Given our significant progress in reducing LTAs to date, we are expanding our focus to look at total recordable accidents in 2019. This change is intended to bring the full weight of our accident prevention programmes to bear on lower-level incidents, to help predict and prevent more serious incidents.

Target Keep our people safe by achieving less than one lost-time accident (LTA) per 1,000 employees and no fatalities.

KPI Number of LTAs; number of fatalities.

Progress toward 2020 There was just one LTA per 1,000 employees this year, a decrease of 12% from 2017, and no work-related fatalities, which means we achieved our 2020 target two years early. The health, safety and wellbeing of our employees remains our highest priority, with the overall aim of zero accidents.

Lost-time accident frequency rate per 1,000 full-time employees(i)

Region	2014	2015	2016	2017	2018
North America	0.84	1.83	0.37	0.7	0.0
Europe and Turkey	2.08	2.51	1.28	1.46	1.58
Africa	0.56	1.2	0.77	1.26	1.35
Latin America and Caribbean	4.7	0.66	2.27	1.79	0.36
Asia Pacific	1.62	1.21	2.01	0.81	0.66
Diageo (total)	**1.66**	**1.66**	**1.44**	**1.14**	**1.00**Δ

(i) Number of accidents per 1,000 employees and directly supervised contractors resulting in time lost from work of one calendar day or more.
Δ Within PwC's independent limited assurance scope. Please see page 162 for further details.

Number of days lost to accidents per 1,000 full-time employees

	2014	2015	2016	2017	2018
Diageo (total)	**49.7**	**89.4**	**57**	**36**	**45**

Fatalities	2014	2015	2016	2017	2018
Diageo (total)	**1**	**1**	**1**	**1**	**0**

Diversity and inclusion

Celebrating our inclusive and diverse culture is core to Diageo's purpose. We want to create a business which, from recruitment onwards, allows everyone to be at their best, irrespective of their gender, race, religion, disability, age or sexual orientation. We see diversity and inclusion as a critical business priority. We know that for our business to thrive, we depend on having diverse talent with a range of backgrounds, skills and capabilities in each of the 180 countries in which we operate.

We are proud that 40% of our Executive and 50% of our Board are women. Our progress is illustrated by the fact that in 2003, those figures were 0% and 10% respectively. Our efforts have been recognised externally, with Diageo named first in the FTSE 100 for female executive directors in the Female FTSE Board Report 2018 by Cranfield University School of Management. In January 2018 we were recognised by the Bloomberg Gender-Equality Index for performance and disclosure around gender equality, and we also ranked fifth in the Thomson Reuters Global Diversity and Inclusion Index.

Across the business, women currently hold more than 34% of leadership positions, and we are nearing our target of 35% of leadership positions held by women by 2020. We want to be the employer of choice for women, and we're committed to developing a strong pipeline of female talent for all roles. We're also focused on the areas of our business where we know female representation is low, such as our supply operations. This year we were proud to announce the recruitment of our first female coppersmith apprentice at Diageo Abercrombie, the famous stills which are at the heart of Scotch whisky distillation.

But we know we still have further to go. Throughout the company, we set ourselves ambitious plans for achieving these targets. The managing director of each market has a strategy in place to foster greater inclusion and diversity. We also seek to promote diversity and inclusion with consumers and communities through our brands and programmes.

Target Build diversity, with 35%(i) of leadership positions held by women and measures implemented to help female employees attain and develop in leadership roles.

KPI % of leadership positions held by women.

Progress toward 2020 This year, 34% of leadership roles were held by women. At the most senior level, 50% of our Board members and 40% of our Executive Committee members are women. We have also added a target of 40% of women in leadership roles by 2025.

(i) We increased the target from 30% to 35% in 2017.

Engaged and empowered employees

Empowering employees to be the 'best they can be' is at the heart of our business strategy. We want our people to be engaged – passionate about our strategy, connected to our values and purpose, and motivated to perform at their best as advocates of our brands.

That means helping employees understand our strategy and their role within it through our communications and leadership interventions. It also means bringing our purpose to life within our organisation and communities, while developing knowledge and passion for our brands and products. We also engage employees on the role of alcohol in society through initiatives such as our Drink Positive campaign, described on page 18.

To support our employees' performance, we have a framework of clear policies, competitive reward programmes, coaching and development opportunities, and health and wellbeing initiatives.

This year is the 20th anniversary of Diageo's formation, and we marked the occasion with global interactive sessions celebrating our heritage and achievements, described on www.diageo.com. These included celebrating International Women's Day on 8 March 2018, when we underlined our commitment to gender equality.

We report employee engagement on page 9 as one of the overarching KPIs that measure the progress of our business.

Target Increase employee engagement to 80%, becoming a top-quartile performer on measures such as employee satisfaction, pride and loyalty.

KPI Employee satisfaction, loyalty, advocacy and pride, measured through our Values Survey.

Progress toward 2020 In our annual Values Survey, 76% of participants in the survey identified as being engaged, an increase of 1% on last year. 94% of our people participated overall (22,826 of the 24,214 invited to take part), a best-in-class response rate.

Average number of employees by region by gender(i)

Region	Men	%	Women	%	Total
North America	1,596	59.8	1,073	40.2	2,669
Europe and Turkey	6,347	60.3	4,185	39.7	10,532
Africa	3,703	75.3	1,213	24.7	4,916
Latin America and Caribbean	1,802	65.6	946	34.4	2,748
Asia Pacific	6,954	76.8	2,098	23.2	9,052
Diageo (total)	**20,402**	**68.2**	**9,515**	**31.8**	**29,917**

Average number of employees by role by gender

Role	Men	%	Women	%	Total
Senior manager(ii)	392	66.4	199	33.6	591
Line manager(iii)	3,017	69.2	1,341	30.8	4,358
Supervised employee(iv)	16,930	67.8	8,038	32.2	24,968
Diageo (total)	**20,339**	**68.0**	**9,578**	**32.0**	**29,917**

New hires by region by gender(i)

Region	Men	Women	Total	% of headcount
North America	249	125	374	14.0
Europe and Turkey	720	644	1,364	12.9
Africa	279	166	445	9.1
Latin America and Caribbean	234	180	414	15.1
Asia Pacific	837	514	1,351	14.9
Diageo (total)	**2,319**	**1,629**	**3,948**	**13.2**
Percentage of total new hires	58.7%	41.3%		

Leavers by region by gender(i)

Region	Men	Women	Total	% of headcount
North America	204	118	322	12.1
Europe and Turkey	990	750	1,740	16.5
Africa	481	206	687	14.0
Latin America and Caribbean	319	188	507	18.4
Asia Pacific	761	416	1,177	13.0
Diageo (total)	**2,755**	**1,678**	**4,433**	**14.8**
Percentage of total leavers	62.1%	37.9%		

(i) Employees have been allocated to the region in which they reside.
(ii) Top leadership positions in Diageo, excluding Executive Committee.
(iii) All Diageo employees (non-senior managers) with one or more direct reports.
(iv) All Diageo employees (non-senior managers) who have no direct reports.

Highlight

Diageo Abercrombie recruits Scotland's first female coppersmith

For centuries, coppersmiths have used the same tried and tested methods to make the famous stills which are at the heart of Scotch whisky distillation. This year, Diageo Abercrombie (based in Alloa, Scotland), which makes the stills for all our distilleries, scored a first for gender equality by hiring Scotland's first female coppersmith, Rebecca Weir, 18, as part of our apprentice intake.

Rebecca, who comes from Alloa, said: "I wasn't put off by gender stereotypes – I don't think that should stop anyone from doing what they want to do. It's really exciting to be part of something which is so important to the whisky industry. I can't wait to learn more about the essential skills needed to build and preserve the stills which produce some of the world's most-loved Scotch whisky."

Reducing our environmental impact

Behind every Diageo product is a story of shared natural resources. The ingredients and water we use, the air and land around our operations and supply chain, the energy we consume – all these are shared with the people and communities around us.

Climate change, water scarcity, soil degradation and the loss of biodiversity are shared risks, which have the potential to affect our supply chain and operations. By impacting the development of the communities we live and work in, they also undermine the inclusive economic growth on which our own growth depends. So, as well as being the right thing to do, it makes clear business sense to use natural resources efficiently across our whole value chain and, where possible, to restore the environment we operate in.

Climate and risk

We're already seeing some of the impacts of climate change and water stress in our supply chain and operations. Drought has affected our supply of raw materials in Nigeria, South Africa, India and Brazil. In Africa and India, water security is a central factor in our planning and investments.

Impacts like these affect people and businesses throughout local value chains. And they increase our conviction that supporting global action on climate change and taking leadership in responsible water stewardship are both ethically and commercially critical.

As long-term members of the UN Global Compact, and the We Mean Business Coalition, we are already making progress on a range of global initiatives, such as on science-based carbon emissions reduction targets, and on eliminating commodity-driven deforestation. We are also committed to procuring 100% of our electricity from renewable sources by 2030, and reducing emissions from short-lived climate pollutants such as HFCs.

Our Water Blueprint, updated this year, is another crucial component in our climate change mitigation plans. It is supported by our targets for responsible water use in our own and third-party operations and agriculture, and for replenishing water in water-stressed areas; by supporting community water programmes; and by our advocacy of greater collaboration and commitment to responsible water stewardship.

Aligning with TCFD

We have also conducted a gap analysis to assess the extent to which our existing public disclosures on climate risk align with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). We're already integrating climate-related issues into our mainstream business operations: this year, we continued to analyse our approach and our resilience. We are clear on where issues such as water stress are greatest, and continue to build activity into our core business plans to mitigate this.

Based on analysis of our existing public climate change disclosures in our Annual Report and CDP submission, we have developed a plan to progressively meet TCFD requirements. We do not consider our short-term (three-year) impacts to be material in the context of TCFD. However, we are reviewing our medium-term (three to ten years) and longer-term (more than ten years) impacts and will report on those in the future. By mitigating risks of water stress in both our operations and supply chain through implementation of our Water Blueprint, we are enabling a more resilient business for the future that will support our growth.

Our approach to reducing carbon emissions contributes to global delivery of the Paris Agreement while also mitigating any risks that may arise for Diageo in a low-carbon policy environment.

Managing water responsibly

We've described how climate change is a critical consideration for water management. Water is a strategic priority for other reasons, too – because it is such a vital resource for us, and for the people and habitats around us.

Our strategic aim is to reduce our overall impact, especially in our operations in water-stressed regions in Africa, India and Brazil, as shown in the map on page 15. Our sites located in these water-stressed regions account for approximately a third of our total production by volume.

Working with other stakeholders is crucial. In 2018, for example, our Meta brewery in Ethiopia formed a new partnership with the local authority and German development agency GIZ to provide safe water and support responsible management of the water catchment. We continue to look for opportunities like this to work on catchment-based approaches, which include community-focused programmes that align with SDG 6: 'Clean water and sanitation', including through our Water of Life programme, described on page 47.

Absolute targets. Absolute commitment.

Our commitment to minimising our environmental impacts is long-standing. Building on the success of previous environmental sustainability programmes, in 2015 we set ourselves ambitious targets for reducing our impacts and building our resilience in critical areas by 2020, adding new targets at intervals to further push performance.

These targets are business-orientated, and deliberately stretching. Many commit us to achieving absolute reductions, rather than relative reductions, because we believe that in areas such as greenhouse gas emissions or waste to landfill, the most responsible policy is to decouple our impacts from business growth.

Making progress and addressing challenges

Our long-standing systematic approach has driven substantial progress. Despite increasing production, we've reduced absolute greenhouse gas emissions from our direct operations by 40.8% against our 2007 baseline, and from our entire supply chain by 23.1%. In the same period, waste to landfill was down by 84.3%, and the total weight of our packaging has reduced by 9.4%.

Nonetheless, we do face challenges, and our progress slowed in 2018 as in some markets it has taken longer than expected to implement environmental projects. Delivering carbon reductions and water efficiency improvements in particular will require additional investment in renewable energy and water conservation technologies at specific sites, as well as implementing continuous improvement opportunities across all locations.

This does not alter our commitment to our 2020 targets. We have identified a range of environmental investments that will help us continue our progress to 2020.

Setting out our plastics ambition

In June 2018, we announced new targets specifically designed to address plastics in our packaging. They build on our existing sustainable packaging ambitions and aim to address the full value chain impact of our use of plastics. These include that 100% of plastic used should be widely recyclable by 2025 and plastic bottles should be made of 100% recycled content by 2030. Our new targets for 2025 commit us to:

- Ensure 100% of our plastic use is designed to be widely recyclable (or reusable/compostable), using plastics that allow for increased consumer recycling rates
- Achieve 40% average recycled content in our plastic bottles – and 100% by 2030
- Continue to invest in circular economy opportunities and other sustainable packaging breakthroughs
- Accelerate our support for recycling by increasing collaboration, particularly where we have influence, and engaging with governments, peers and consumers to facilitate improved recycling.

We will report against these targets from 2019.

Summary performance against targets

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)
Reduce water use through a 50% improvement in water use efficiency	% improvement in litres of water used per litre of packaged product	0.8%	40.3%
Return 100% of wastewater from our operations to the environment safely	% reduction in wastewater polluting power measured in BOD ('000 tonnes)	(31.5)%	27.5%
Replenish the amount of water used in our final product in water-stressed areas	% of water replenished in water-stressed areas (m^3)	8.6%	47.9%
Equip our suppliers with tools to protect water resources in our most water-stressed locations	% of key suppliers engaged in water management practices	90.0%	n/a
Reduce absolute greenhouse gas emissions from direct operations by 50%	% reduction in absolute GHG (kt CO_2e)	1.0%	40.8%
Achieve a 30% reduction in absolute greenhouse gas emissions along the total supply chain	% reduction in absolute GHG (kt CO_2e)	2.2%	23.1%
Ensure all our new refrigeration equipment in trade is HFC-free, with a reduction in associated greenhouse gas emissions from 2015	% of new equipment sourced HFC-free from 1 July 2015	100%	100%
Reduce total packaging by 15%, while increasing recycled content to 45% and making 100% of packaging recyclable	% of total packaging by weight	0.7%	9.4%
	% of recycled content by weight	(0.5)%	40.5%
	% of recyclable packaging by weight	0.0%	98.7%
Sustainably source all of our paper and board packaging to ensure zero net deforestation	% of sustainably sourced paper and board packaging	81.0%	n/a
Achieve zero waste to landfill	% reduction in total waste to landfill (tonnes)	(145.4)%	84.3%

(i) Baseline year is 2007 except for packaging which is 2009 and water replenishment which is 2015.

Performance against 2020 targets

Water stewardship

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)	Progress
Reduce water use through a 50% improvement in water use efficiency	% improvement in litres of water used per litre of packaged product	0.8%	40.3%	Overall water use efficiency has improved by 0.8% this year. In India, water use efficiency improved by 18%, reflecting the benefits from investments in water recovery and reuse technologies. 492,686 cubic metres of water were used for agricultural purposes on land under Diageo's operational control. This is reported separately from water used in our direct operations. Planned investments in environmental projects, including water efficiency technology in Africa, and continuous improvements in our brewing and distilling operations worldwide, should significantly improve performance in the next two years.
Return 100% of wastewater from our operations to the environment safely	% reduction in wastewater polluting power measured in BOD ('000 tonnes)	(31.5)%	27.5%	Wastewater BOD increased by 31.5%, principally due to increased distillation volume. This masked the strong performance at our sites in India and Africa, where the benefits from our investments reduced the polluting power of wastewater by more than 96%. While we meet all regulatory requirements on wastewater discharge from our sites, we know we must do more to meet our ambitious target, and we are actively pursuing design work on additional wastewater handling capacity as well as exploring alternative and new technologies.
Replenish the amount of water used in our final product in water-stressed areas	% of water replenished in water-stressed areas (m^3)	8.6%	47.9%	Cumulatively, 47.9% of total water used in final product in water-stressed areas was replenished. This is an improvement of 8.6% on last year, driven in particular by our efforts in Uganda, where we implemented projects to increase provision of access to clean water and sanitation in Gulu District and to reforest an area near Mount Kenya. It was also helped by water replenishment initiatives in Tanzania and Ghana. The volume of water recycled or reused in our own production was 1,070,994 m^3, representing 5.1% of total water withdrawals.
Equip our suppliers with tools to protect water resources in our most water-stressed locations	% of key suppliers engaged in water management practices	90%	n/a	We continue to engage our tier one suppliers through our CDP Supply Chain Water Programme. This year, we contacted 103 of our largest suppliers to disclose their water management practices through this programme. Ninety per cent responded, with 61% reporting active targets. At the same time, our growing understanding and mapping of water risk in our supply chain, driven by our global water risk assessment of third-party operators (TPOs), is providing greater insight into which of our suppliers operate in water-stressed areas. In 2018 we completed water risk assessments of more than 100 TPOs, identifying more than 20 sites as being in water-stressed areas in 16 countries. This helps us to engage more TPOs with tools for water management, such as the water toolkit we began piloting in India this year. This will help their water management to improve alongside ours.

Carbon

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)	Progress
Reduce absolute greenhouse gas emissions from direct operations by 50%	% reduction in absolute GHG (kt CO_2e)	1.0%	40.8%	We use the World Resources Institute/World Business Council for Sustainable Development Greenhouse Gas Protocol as a basis for reporting our emissions, and we include all facilities where we have operational control for the full financial year. Diageo's total direct and indirect carbon emissions (location/gross) this year were 800,434 tonnes (2017 – 808,107 tonnes), comprising direct emissions (Scope 1) of 621,127 tonnes (2017 – 617,015 tonnes), and indirect (Scope 2) emissions of 179,307 tonnes (2017 – 191,092 tonnes). The intensity ratio for this year was 190 grams per litre packaged (2017 – 191 grams per litre packaged.) This year we reduced greenhouse gas emissions by 1.0%. We have defined and scoped new projects, especially in Africa and Scotland, to re-establish our carbon reduction trajectory, and we are confident that we will resume the progress we've made in reducing absolute emissions. This year, approximately 49.8% of electricity at our production sites came from low-carbon sources such as wind, hydro and nuclear (2017 – 53.7%), and 18.5% of our electricity was from renewable sources only. In the United Kingdom, 100% of our electricity came from low-carbon sources.

Carbon continued

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)	Progress
Achieve a 30% reduction in absolute greenhouse gas emissions along the total supply chain	% reduction in absolute GHG (kt CO_2e)	2.2%	23.1%	In 2018, our total supply chain carbon footprint was reduced by 2.2% and cumulatively by 23.1% versus the baseline. We continue to engage suppliers on measuring and managing their carbon emissions through CDP; this year we received responses from 95% of the 166 tier one suppliers we engaged, an increase in both supplier numbers and response rate. 52% of these suppliers report that they have emissions reduction targets. We also continue to work with our suppliers on emissions reduction through our carbon performance review programme which, alongside our own background data assurance, enables us to analyse and assess our Scope 3 emissions.
Ensure all our new refrigeration equipment in trade is HFC-free, with a reduction in associated greenhouse gas emissions from 2015	% of new equipment sourced HFC-free from 1 July 2015	100%	100%	Eliminating HFCs plays a role in reducing our overall carbon footprint. 100% of the 38,000 new fridges we have purchased since July 2015 were HFC-free.

Packaging

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)	Progress
Reduce total packaging by 15%, while increasing recycled content to 45% and making 100% of packaging recyclable	% of total packaging by weight	0.7%	9.4%	This year, we achieved a 0.7% reduction in packaging weight but recycled content decreased by 0.5%. On average, recycled content was 40.5%, an improvement of 19% against our 2009 baseline. This progress was driven by lightweighting and new bottle configurations. We know we have to accelerate progress in this area if we are to meet our 2020 targets, and have plans in place to do so. Overall this year, 98.7% of our packaging was recyclable. We continue to work with our suppliers and other partners to improve recycled glass content. Our Sustainable Packaging Commitments are used by brand and technical teams as well as suppliers, and support our ongoing programme to produce packaging with lower environmental impact. This year we announced additional targets specifically designed to address the use of plastics in our packaging, described on page 51. We will report against these targets from 2019.
	% of recycled content by weight	(0.5)%	40.5%	
	% of recyclable packaging by weight	0.0%	98.7%	
Sustainably source all of our paper and board packaging to ensure zero net deforestation	% of sustainably sourced paper and board packaging	81.0%	n/a	We define sustainably sourced as Forest Stewardship Council (FSC) or Programme for the Endorsement of Forest Certification (PEFC) certified, or recycled fibre. To date we have engaged over 250 suppliers and 82% responded. Collectively these suppliers have self-reported that 81% of the paper and board packaging they supply meets our sustainable sourcing criteria, and we continue to work with our suppliers to deliver our goal of 100% by 2020.

Waste

2020 target	KPI	2018 performance	Cumulative performance vs baseline(i)	Progress
Achieve zero waste to landfill	% reduction in total waste to landfill (tonnes)	(145.4)%	84.3%	This year our overall strong performance on waste was offset by one-off damage caused by Hurricane Maria in September 2017, which meant that by-products from our distillery in St Croix in the US Virgin Islands, which are usually recycled as animal feed, were diverted to landfill. This meant waste to landfill increased by 145.4% this year. We have taken remedial action, including upgrading equipment, to minimise the risk of this reoccurring.

(i) Baseline year is 2007 except for packaging which is 2009 and water replenishment which is 2015.

Environmental data by region

Water efficiency by region, by year (l/l)(i), (ii)

Region	2007	2016	2017	2018
North America	6.88	5.20	5.73	5.55
Europe and Turkey	7.94	5.87	5.78	6.02
Africa	8.48	4.55	4.32	4.28
Latin America and Caribbean	34.84	4.49	3.88	4.66
Asia Pacific	7.06	5.05	4.31	3.64
Diageo (total)	**8.27**	**5.16**	**4.98**	**4.94**Δ

Wastewater polluting power by region, by year (BOD/t)(i)

Region	2007	2016	2017	2018
North America	214	101	240	176
Europe and Turkey	22,610	19,508	17,617	23,502
Africa	9,970	436	183	150
Latin America and Caribbean	10	34	34	14
Asia Pacific	92	296	64	3
Corporate	–	–	–	–
Diageo (total)	**32,896**	**20,375**	**18,138**	**23,845**
Total under direct control	**32,070**	**20,097**	**17,936**	**23,584**Δ

(i) 2007 baseline data and data for each of the intervening years in the period ended 30 June 2017 have been restated in accordance with Diageo's environmental reporting methodologies.
(ii) In accordance with Diageo's environmental reporting methodologies, total water used excludes irrigation water for agricultural purposes on land under the operational control of the company.
Δ Within PwC's independent limited assurance scope. Please see page 162 for further details.

Total waste to landfill by region (tonnes)(i)

Region	2007	2016	2017	2018
North America	39,857	148	146	12,177
Europe and Turkey	19,898	2,953	1,252	169
Africa	37,062	6,080	3,937	3,108
Latin America and Caribbean	243	143	379	106
Asia Pacific	8,583	922	380	504
Corporate	604	682	719	657
Diageo (total)	**106,247**	**10,928**	**6,813**	**16,721**Δ

(i) 2007 baseline data and data for each of the intervening years in the period ended 30 June 2017 have been restated in accordance with Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 162 for further details.

Carbon emissions by weight by region (1,000 tonnes CO_2e)(i), (ii)

Region	2007	2016	2017	2018
North America	211	45	50	44
Europe and Turkey	399	284	264	281
Africa	271	244	234	225
Latin America and Caribbean	8	15	15	18
Asia Pacific	151	72	58	48
Corporate	20	12	12	11
Diageo (total)	**1,060**	**672**	**633**	**627**Δ

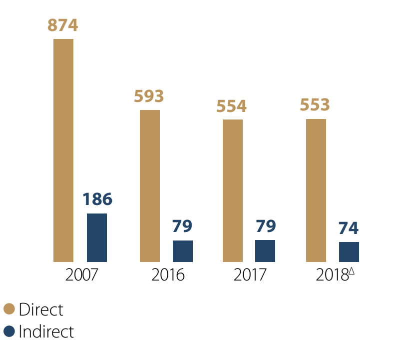
(i) CO_2e figures (market/net) are calculated using the WRI/WBCSD GHG Protocol guidance available at the beginning of our financial year, the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation, or the International Energy Agency, as applicable.
(ii) 2007 baseline data, and data for each of the intervening years in the period ended 30 June 2017, have been restated in accordance with the WRI/WBCSD GHG Protocol and Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 162 for further details.

Highlight

Sustainability & Responsibility Performance Addendum

See the Sustainability & Responsibility Performance Addendum 2018 for our detailed disclosures against the GRI Standards, the United Nations Global Compact and the Sustainability Accounting Standards Board.

Direct and indirect carbon emissions by weight (1,000 tonnes CO_2e)(i),(ii) (market-/net-based)



(i) CO_2e figures are calculated using the WRI/WBCSD GHG Protocol guidance available at the beginning of our financial year, the kWh/CO_2e conversion factor provided by energy suppliers, the relevant factors to the country of operation, or the International Energy Agency, as applicable.
(ii) 2007 baseline data, and data for each of the intervening years in the period ended 30 June 2017, have been restated in accordance with the WRI/WBCSD GHG Protocol and Diageo's environmental reporting methodologies.
Δ Within PwC's independent limited assurance scope. Please see page 162 for further details.

Governance and ethics

Doing business with integrity and winning trust are key to Diageo's Performance Ambition. Our global risk and compliance framework is designed to support our business through rigorous oversight of our risk management, controls and compliance environment. But, while compliance is non-negotiable, we want our culture to go beyond compliance in encouraging the right behaviours and attitudes – and we want to ensure we're supporting people to make the right choices, every day. After all, each employee holds the hard-earned reputation of Diageo and our brands in their hands.

Raising standards and embracing productivity

Wherever it will help raise standards, we aim to make our compliance processes simpler and more efficient.

Our global Code of Business Conduct (Code) sets out what we stand for as a company, enabling our employees to demonstrate the highest standards of integrity and ethical behaviour. Our Code training – our way of assuring that all employees fully understand what is expected of them – is delivered predominantly by elearning, with an integrated Annual Certification of Compliance (ACC) requirement for managers and above. In 2018, the ACC was completed by 100% of eligible employees, a total of 9,009 people.

The elearning covers all areas of our Code, and employees have the choice of 20 languages in which to complete it on their desktop, laptop, tablet or smartphone, with a face-to-face classroom training option provided for sites where employees do not use computers. This year, employees who had previously completed the training were offered a fast track option to demonstrate their competency. New joiners are required to complete the training within 30 days.

We also used global elearning solutions this year to roll out business-wide refresher training on our Competition and Anti-Trust, Data Privacy, and Information Security policies.

Monitoring

As we evolve our risk and compliance programme, making it more efficient and effective, we are starting to adopt increasingly data-driven and analytical approaches to identify areas of our business that need more focus. This year, we started to use data analytics to help us spot potential areas of risk and support our internal monitoring and reporting.

Managing third parties

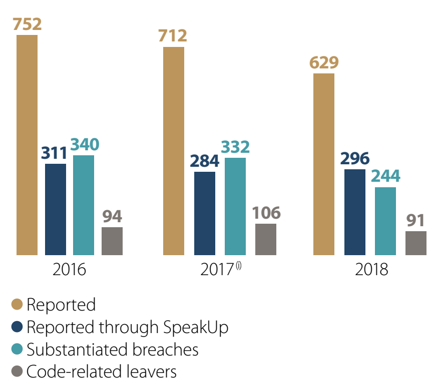
We also continue to evolve our third-party due diligence programme, Know Your Business Partner (KYBP), to make sure it has the greatest effectiveness at identifying risk, while being efficient to use for us and our partners. While we continue to screen all new business partners, our risk assessment processes focus our due diligence on those third parties that pose a higher risk. Further automating KYBP, using the same technology globally, and standardising processes to ensure robustness, have also improved the efficiency of our due diligence while enabling stronger central oversight.

Reporting and investigating

We want employees to feel comfortable raising concerns about potential breaches of our Code or policies. We expect anyone who comes across a breach to report it immediately, either through our confidential whistleblowing helpline SpeakUp, to their manager, or to a member of the compliance, human resources or legal teams. Our www.diageospeakup.com website, available in all our 20 Code languages, was refreshed last year to make it simpler to report and follow up on potential breaches; it is also available to our business partners. We have seen an increase in breaches reported through the site, particularly via mobile devices, since these changes were made.

There were 629 suspected breaches reported this year, of which 244 were subsequently substantiated. Of the suspected breaches, 296 were reported through SpeakUp, compared with 284 in 2017. All allegations are taken seriously and, where required, investigated and acted on. This also applies to human rights issues, and seven were reported through this process this year. These reports are also fed into our wider human rights programme. We monitor breaches to identify trends or common areas where further action may be required. This year, 91 people exited the business as a result of breaches of our Code or policies.

Reported and substantiated breaches



(i) 2017 data restated in accordance with Diageo's reporting methodologies for reported and substantiated breaches of the Code of Business Conduct.

KPI Number of eligible employees completing the Annual Certification of Compliance (ACC).

Progress 100% of manager level and above employees completed the ACC as part of our combined Master the Code elearning and ACC. In 2018, the ACC was completed by all eligible employees, a total of 9,009 people.

Definitions and reconciliation of non-GAAP measures to GAAP measures

Diageo's strategic planning process is based on the following non-GAAP measures. They are chosen for planning and reporting, and some of them are used for incentive purposes. The group's management believes these measures provide valuable additional information for users of the financial statements in understanding the group's performance. These non-GAAP measures should be viewed as complementary to, and not replacements for, the comparable GAAP measures and reported movements therein.

It is not possible to reconcile the forecast tax rate before exceptional items and forecast organic operating margin improvement to the most comparable GAAP measures as it is not possible to predict, with reasonable certainty, the future impact of changes in exchange rates, acquisitions and disposals and potential exceptional items.

Volume

Volume is a non-GAAP measure that is 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 the discussion of the performance of the business, 'organic' information is presented using pounds sterling amounts on a constant currency basis excluding the impact of exceptional items and acquisitions and disposals. Organic measures enable users to focus on the performance of the business which is common to both years and which represents those measures that local managers are most directly able to influence.

Calculation of organic movements

The organic movement percentage is the amount in the row titled 'Organic movement' in the tables below, expressed as a percentage of the amount in the row titled '2017 adjusted'. Organic operating margin is calculated by dividing operating profit before exceptional items by net sales after excluding the impact of exchange rate movements and acquisitions and disposals.

(a) Exchange rates

'Exchange' in the organic movement calculation reflects the adjustment to recalculate the prior year results as if they had been generated at the current year's exchange rates.

Exchange impacts in respect of the external hedging of intergroup sales of products and the intergroup recharging of third party services are allocated to the geographical segment to which they relate. Residual exchange impacts are reported in Corporate.

(b) Acquisitions and disposals

For acquisitions in the current year, the post acquisition results are excluded from the organic movement calculations. For acquisitions in the prior year, post acquisition results are included in full in the prior year but are included in the organic movement calculation from the anniversary of the acquisition date in the current year. The acquisition row also eliminates the impact of transaction costs that have been charged to operating profit in the current or prior year in respect of acquisitions that, in management's judgement, are expected to be completed.

Where a business, brand, brand distribution right or agency agreement was disposed of, or terminated, in the period up to the date of the external results announcement, the group, in the organic movement calculations, excludes the results for that business from the current and prior year. In the calculation of operating profit, the overheads included in disposals are only those directly attributable to the businesses disposed of, and do not result from subjective judgements of management. In addition, disposals include the elimination of the results (for volume, sales and net sales only) of operations in India where United Spirits Limited (USL) previously fully consolidated the results but which are now operated on a royalty or franchise model where USL now only receives royalties for sales made by that operation.

(c) Exceptional items

Exceptional items are those which, in management's judgement, need to be disclosed by virtue of their size or nature. Such items are included within the income statement caption to which they relate, and are separately disclosed in the notes to the consolidated financial statements, and are excluded from the organic movement calculations.

Exceptional operating items are those that are considered to be material and are part of the operating activities of the group such as impairments of intangible and fixed assets, duty settlements, property disposals and changes in post employment plans.

Gains and losses on the sale of businesses, brands or distribution rights, step up gains and losses that arise when an investment becomes an associate or an associate becomes a subsidiary and other material, unusual non-recurring items, that are not in respect of the production, marketing and distribution of premium drinks, are disclosed as non-operating exceptional items below operating profit in the consolidated income statement.

Exceptional tax items comprise the direct tax consequences in respect of operating and non-operating exceptional items, material settlements with the tax authorities and material changes in tax rates.

It is believed that separate disclosure of exceptional items and the classification between operating and non-operating further helps investors to understand the performance of the group.

Organic movement calculations for the year ended 30 June 2018 were as follows:

	North America million	Europe and Turkey(iii) million	Africa million	Latin America and Caribbean million	Asia Pacific million	Corporate million	Total million
Volume (equivalent units)							
2017 reported	47.4	44.4	32.2	21.1	97.1	–	242.2
Reclassification(ii)	(0.1)	0.2	–	–	(0.1)	–	–
Disposals(iv)	–	–	–	–	(8.0)	–	(8.0)
2017 adjusted	47.3	44.6	32.2	21.1	89.0	–	234.2
Acquisitions and disposals(iv)	**0.3**	**–**	**–**	**–**	**0.1**	**–**	**0.4**
Organic movement	**0.6**	**1.7**	**1.0**	**1.1**	**1.4**	**–**	**5.8**
2018 reported	**48.2**	**46.3**	**33.2**	**22.2**	**90.5**	**–**	**240.4**
Organic movement %	**1**	**4**	**3**	**5**	**2**	**–**	**2**
Sales							
2017 reported	4,725	4,985	2,132	1,303	4,923	46	18,114
Exchange(i)	(261)	(113)	(130)	(61)	(160)	1	(724)
Reclassification(ii)	(8)	16	1	2	(11)	–	–
Disposals(iv)	–	(3)	–	–	(207)	–	(210)
2017 adjusted	4,456	4,885	2,003	1,244	4,545	47	17,180
Acquisitions and disposals(iv)	**55**	**–**	**–**	**–**	**8**	**–**	**63**
Organic movement	**160**	**347**	**80**	**108**	**489**	**5**	**1,189**
2018 reported	**4,671**	**5,232**	**2,083**	**1,352**	**5,042**	**52**	**18,432**
Organic movement %	**4**	**7**	**4**	**9**	**11**	**11**	**7**
Net sales							
2017 reported	4,161	2,824	1,556	1,044	2,419	46	12,050
Exchange(i)	(228)	(15)	(105)	(43)	(64)	1	(454)
Reclassification(ii)	(8)	16	1	2	(11)	–	–
Disposals(iv)	–	(3)	–	–	(55)	–	(58)
2017 adjusted	3,925	2,822	1,452	1,003	2,289	47	11,538
Acquisitions and disposals(iv)	**49**	**–**	**–**	**–**	**4**	**–**	**53**
Organic movement	**142**	**110**	**39**	**66**	**210**	**5**	**572**
2018 reported	**4,116**	**2,932**	**1,491**	**1,069**	**2,503**	**52**	**12,163**
Organic movement %	**4**	**4**	**3**	**7**	**9**	**11**	**5**
Marketing							
2017 reported	642	443	166	195	343	9	1,798
Exchange(i)	(21)	2	(11)	(8)	(5)	(1)	(44)
Reclassification(ii)	(2)	1	–	1	–	–	–
Disposals(iv)	–	–	–	–	–	–	–
2017 adjusted	619	446	155	188	338	8	1,754
Acquisitions and disposals(iv)	**8**	**–**	**–**	**–**	**–**	**–**	**8**
Organic movement	**35**	**28**	**3**	**8**	**50**	**(4)**	**120**
2018 reported	**662**	**474**	**158**	**196**	**388**	**4**	**1,882**
Organic movement %	**6**	**6**	**2**	**4**	**15**	**(50)**	**7**
Operating profit before exceptional items							
2017 reported	1,899	936	218	250	487	(189)	3,601
Exchange(i)	(60)	7	(20)	10	1	6	(56)
Reclassification(ii)	(4)	11	2	(1)	(8)	–	–
Acquisitions and disposals(iv)	–	–	–	–	(2)	1	(1)
2017 adjusted	1,835	954	200	259	478	(182)	3,544
Acquisitions and disposals(iv)	**4**	**–**	**–**	**–**	**1**	**–**	**5**
Organic movement	**43**	**74**	**(9)**	**49**	**89**	**24**	**270**
2018 reported	**1,882**	**1,028**	**191**	**308**	**568**	**(158)**	**3,819**
Organic movement %	**2**	**8**	**(5)**	**19**	**19**	**13**	**8**
Organic operating margin %							
2018	**46.2%**	**35.1%**	**12.8%**	**28.8%**	**22.7%**	**n/a**	**31.5%**
2017	46.8%	33.8%	13.8%	25.8%	20.9%	n/a	30.7%
Margin (decline)/improvement (bps)	**(58)**	**126**	**(96)**	**299**	**181**	**n/a**	**78**

(1) For the reconciliation of sales to net sales see page 21 and page 34.
(2) Percentages and margin improvement are calculated on rounded figures.

Notes: Information in respect of the organic movement calculations
(i) The exchange adjustments for sales, net sales, marketing and operating profit are principally in respect of strengthening of sterling against the US dollar, the Turkish lira and the Kenyan shilling, partially offset by weakening of sterling against the euro.
(ii) Reclassification comprised a change to a reallocation of the results of the Travel Retail operations to the appropriate geographical regions.
(iii) The Europe and Turkey region was formerly named 'Europe, Russia and Turkey'. Countries included in the region have not changed.
(iv) In the year ended 30 June 2018 the acquisitions and disposals that affected volume, sales, net sales, marketing and operating profit were as follows:

	Volume equ. units million	Sales £ million	Net sales £ million	Marketing £ million	Operating profit £ million
Year ended 30 June 2017					
Acquisitions					
Transaction costs	–	–	–	–	1
	–	–	–	–	1
Disposals					
USL owned to franchise	(7.8)	(188)	(46)	–	–
Nepal	(0.2)	(19)	(9)	–	(2)
Yellow tail	–	(3)	(3)	–	–
	(8.0)	(210)	(58)	–	(2)
Acquisitions and disposals	(8.0)	(210)	(58)	–	(1)
Year ended 30 June 2018					
Acquisitions					
Casamigos	0.3	55	49	8	8
Transaction costs	–	–	–	–	(4)
	0.3	55	49	8	4
Disposals					
Nepal	0.1	8	4	–	1
	0.1	8	4	–	1
Acquisitions and disposals	0.4	63	53	8	5

Earnings per share before exceptional items

Earnings per share before exceptional items is calculated by dividing profit attributable to equity shareholders of the parent company before exceptional items by the weighted average number of shares in issue.

Earnings per share before exceptional items for the year ended 30 June 2018 and 30 June 2017 are set out in the table below.

	2018 £ million	2017 £ million
Profit attributable to equity shareholders of the parent company – continuing operations	3,022	2,717
Exceptional operating items attributable to equity shareholders of the parent company	128	28
Non-operating items attributable to equity shareholders of the parent company	–	(20)
Tax on exceptional operating and non-operating items for equity shareholders	(13)	1
Net exceptional taxation credit	(190)	–
	2,947	2,726

Weighted average number of shares	million	million
Shares in issue excluding own shares	2,484	2,512
Dilutive potential ordinary shares	11	11
	2,495	2,523
	pence	pence
Basic earnings per share before exceptional items	118.6	108.5
Diluted earnings per share before exceptional items	118.1	108.0

Free cash flow

Free cash flow comprises the net cash flow from operating activities aggregated with the net cash received/paid for working capital loans receivable, cash paid or received for investments and the net cash cost paid for property, plant and equipment and computer software that are included in net cash flow from investing activities.

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 acquisition and sale of businesses and non-working capital loans to and from associates.

The group's management regards the purchase and disposal of property, plant and equipment and computer software as ultimately non-discretionary since ongoing investment in plant, machinery and technology is required to support the day-to-day operations, whereas acquisitions and sales of businesses are discretionary.

Where appropriate, separate explanations are given for the impacts of acquisitions and sale of businesses, 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.

Free cash flow reconciliations for the years ended 30 June 2018 and 30 June 2017 are set out in the table below.

	2018 £ million	2017[i] £ million
Net cash from operating activities	3,084	3,132
Disposal of property, plant and equipment and computer software	40	46
Purchase of property, plant and equipment and computer software	(584)	(518)
Movements in working capital loans and other investments	(17)	3
Free cash flow	2,523	2,663

(i) For the year ended 30 June 2018 loans made to associates where management believe the loan will convert to equity at some point in the future are not included in free cash flow. For the year ended 30 June 2017 such loans were £1 million and the comparative has not been restated on the basis of materiality.

Operating cash conversion

Operating cash conversion is calculated by dividing cash generated from operations excluding cash inflows and outflows in respect of exceptional items, dividends received from associates, maturing inventories, provisions, other items and post employment payments in excess of the amount charged to operating profit by operating profit before depreciation, amortisation, impairment and exceptional operating items.

The ratio is stated at the budgeted exchange rates for the respective year in line with management reporting and is expressed as a percentage.

Operating cash conversion for the years ended 30 June 2018 and 30 June 2017 were as follows:

	2018 £ million	2017 £ million
Operating profit	3,691	3,559
Exceptional operating items	128	42
Depreciation and amortisation[i]	368	361
Retranslation to budgeted exchange rates	68	(582)
	4,255	3,380
Cash generated from operations	4,086	4,177
Cash payments in respect of exceptional items[ii]	19	45
Post employment payments less amounts included in operating profit	108	111
Net movement in maturing inventories[iii]	239	138
Provision cash movement	(4)	(5)
Dividends received from associates	(159)	(223)
Other items[i][iv]	(10)	(25)
Retranslation to budgeted exchange rates	52	(611)
	4,331	3,607
Operating cash conversion[v]	101.8%	106.7%

(i) Excluding exceptional items.
(ii) Exceptional cash payments for exceptional restructuring and for discontinued operations were £19 million (2017 – £14 million) and £nil million (2017 – £31 million), respectively.
(iii) Excluding exchange of £(31) million (2017 – £35 million).
(iv) Excluding payment of £31 million in respect of discontinued operations in the year ended 30 June 2017.
(v) The provision cash movement is excluded from the cash generated from operations. For the year ended 30 June 2017 the operating cash conversion percentage has been restated to 106.7% from previously reported 106.8% to be comparable.

Return on average total invested capital

Return on average total invested capital is used by management to assess the return obtained from the group's asset base and is calculated to aid evaluation of the performance of the business.

The profit used in assessing the return on average total invested capital reflects operating profit before exceptional items attributable to the equity shareholders of the parent company plus share of after tax results of associates and joint ventures after applying the tax rate before exceptional items for the year. Average total invested capital is calculated using the average derived from the consolidated balance sheets at the beginning, middle and end of the year. Average capital employed comprises average net assets attributable to equity shareholders of the parent company for the year, excluding post employment benefit net liabilities (net of deferred tax) and average net borrowings. This average capital employed is then aggregated with the average restructuring and integration costs net of tax, and goodwill written off to reserves at 1 July 2004, the date of transition to IFRS, to calculate average total invested capital.

Calculations for the return on average total invested capital for the years ended 30 June 2018 and 30 June 2017 are set out in the table below.

	2018 £ million	2017 £ million
Operating profit	3,691	3,559
Exceptional operating items	128	42
Profit before exceptional operating items attributable to non-controlling interests	(122)	(119)
Share of after tax results of associates and joint ventures	309	309
Tax at the tax rate before exceptional items of 20.7% (2017 – 20.6%)	(829)	(781)
	3,177	3,010
Average net assets (excluding net post employment assets/liabilities)	12,067	11,828
Average non-controlling interests	(1,749)	(1,715)
Average net borrowings	8,727	8,488
Average integration and restructuring costs (net of tax)	1,639	1,639
Goodwill at 1 July 2004	1,562	1,562
Average total invested capital	22,246	21,802
Return on average total invested capital	14.3%	13.8%

Net borrowings to earnings before operating exceptional items, interest, tax, depreciation, amortisation and impairment (EBITDA)

Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels. The group regularly assesses its debt and equity capital levels to enhance its capital structure by reviewing the ratio of adjusted net borrowings to EBITDA.

Calculations for net borrowings to EBITDA leverage for the years ended 30 June 2018 and 30 June 2017 are set out in the table below.

	2018 £ million	2017 £ million
Borrowings due within one year	1,828	2,459
Borrowings due after one year	8,074	6,583
Fair value of foreign currency derivatives and interest rate hedging instruments	(92)	(142)
Finance lease liabilities	155	183
Less: Cash and cash equivalents	(874)	(1,191)
Net borrowings	9,091	7,892
Post employment benefit liabilities before tax	872	772
Adjusted net borrowings	9,963	8,664
Operating profit	3,691	3,559
Exceptional operating items	128	42
Depreciation, amortisation and impairment (excluding exceptional items)	368	361
Share of associates' and joint ventures' result after tax	309	309
EBITDA	4,496	4,271
Net borrowings to EBITDA (x)	2.2	2.0

Tax rate before exceptional items

Tax rate before exceptional items is calculated by dividing the total tax charge on continuing operations before tax charges and credits in respect of exceptional items, by profit before taxation adjusted to exclude the impact of exceptional operating and non-operating items, expressed as a percentage. The measure is used by management to assess the rate of tax applied to the group's continuing operations before tax on exceptional items.

The tax rates from operations before exceptional and after exceptional items for the years ended 30 June 2018 and 30 June 2017 are set out in the table below.

	2018 £ million	2017 £ million
Tax before exceptional items (a)	799	736
Tax in respect of exceptional items	(13)	(4)
Exceptional tax items	(190)	–
Taxation on profit from continuing operations (b)	596	732
Profit from continuing operations before taxation and exceptional items (c)	3,868	3,581
Non-operating items	–	20
Exceptional operating items	(128)	(42)
Profit before taxation (d)	3,740	3,559
Tax rate before exceptional items (a/c)	20.7%	20.6%
Tax rate from continuing operations after exceptional items (b/d)	15.9%	20.6%

Other definitions

Volume share is a brand's retail volume expressed as a percentage of the retail volume of all brands in its segment. Value share is a brand's retail sales value expressed as a percentage of the retail sales value of all brands in its segment. Unless otherwise stated, share refers to value share.

Price/mix is the number of percentage points by which the organic movement in net sales differs to the organic movement in volume. The difference arises because of changes in the composition of sales between higher and lower priced variants/markets or as price changes are implemented.

Shipments comprise the volume of products made to Diageo's immediate (first tier) customers. Depletions are the estimated volume of the onward sales made by our immediate customers. Both shipments and depletions are measured on an equivalent units basis.

References to emerging markets include Russia, Eastern Europe, Turkey, Africa, Latin America and Caribbean, and Asia Pacific (excluding Australia, Korea and Japan).

References to reserve brands include, but not limited to, Johnnie Walker Blue Label, Johnnie Walker Green Label, Johnnie Walker Gold Label Reserve, Johnnie Walker Platinum Label 18 year old, John Walker & Sons Collection, Johnnie Walker The Gold Route, Johnnie Walker The Royal Route and other Johnnie Walker super premium brands; Roe & Co; The Singleton, Cardhu, Talisker, Lagavulin and other malt brands; Buchanan's Special Reserve, Buchanan's Red Seal; Bulleit Bourbon, Bulleit Rye; Tanqueray No. TEN, Tanqueray Malacca Gin; Cîroc vodka, Ketel One vodka; Don Julio, Casamigos, Zacapa, Bundaberg SDlx, Shui Jing Fang, Jinzu gin, Haig Club whisky, Orphan Barrel whiskey and DeLeón tequila.

References to global giants include the following brand families: Johnnie Walker, Smirnoff, Captain Morgan, Baileys, Tanqueray and Guinness. Local stars spirits include Buchanan's, Bundaberg, Crown Royal, JɛB, McDowell's, Old Parr, Yenì Raki, Black & White, Shui Jing Fang, Windsor and Ypióca. Global giants and local stars exclude ready to drink and beer except Guinness. References to Shui Jing Fang represent total Chinese white spirits of which Shui Jing Fang is the predominant brand.

References to ready to drink also include ready to serve products, such as pre-mix cans in some markets, and progressive adult beverages in the United States and certain markets supplied by the United States.

References to beer include cider and some non-alcoholic products such as Malta Guinness.

The results of Hop House 13 Lager are included in the Guinness figures.

References to the group include Diageo plc and its consolidated subsidiaries.

This Strategic Report, which has been approved by a duly appointed and authorised committee of the Board of Directors, was signed on its behalf by David Harlock, the Company Secretary, on 25 July 2018.

Board of Directors and Company Secretary

Javier Ferrán

Chairman, Non-Executive Director [3*]
Nationality: Spanish

Appointed Chairman: January 2017 (Appointed Chairman Designate and Non-Executive Director July 2016)
Current external appointments: Partner, Lion Capital LLP; Non-Executive Director and Senior Independent Director, Associated British Foods plc; Non-Executive Director, Coca-Cola European Partners plc; Member, Advisory Board of ESADE Business School
Previous relevant experience: President and CEO, Bacardi Limited; Non-Executive Director, SABMiller plc

Ivan Menezes

Chief Executive, Executive Director [2*]
Nationality: American/British

Appointed Chief Executive: July 2013 (Appointed Executive Director July 2012)
Current external appointments: Member of the Council, Scotch Whisky Association; Non-Executive Director, Tapestry Inc.; Member of the Global Advisory Board, Kellogg School of Management, Northwestern University; Chairman, Movement to Work; Chair, International Alliance for Responsible Drinking, CEO Group
Previous Diageo roles: Chief Operating Officer; President, North America; Chairman, Diageo Asia Pacific; Chairman, Diageo Latin America and Caribbean; senior management positions, Guinness and then Diageo
Previous relevant experience: marketing and strategy roles, Nestlé, Booz Allen Hamilton Inc. and Whirlpool

Kathryn Mikells

Chief Financial Officer, Executive Director [2]
Nationality: American

Appointed Chief Financial Officer and Executive Director: November 2015
Current external appointments: Non-Executive Director, The Hartford Financial Services Group, Inc.
Previous relevant experience: Corporate Executive Vice President and Chief Financial Officer, Xerox Corporation; Senior Vice President and Chief Financial Officer, ADT Corporation; Executive Vice President and Chief Financial Officer, Nalco Holding Company and UAL Corporation

Lord Davies of Abersoch

Senior Non-Executive Director [1,3,4*]
Nationality: British

Appointed Senior Non-Executive Director and Chairman of the Remuneration Committee: October 2011 (Appointed Non-Executive Director September 2010)
Current external appointments: Partner and Chairman, Corsair Capital LLC; Chairman, LetterOne Holdings S.A and Cyder Limited.; Chair of Trustees, Royal Academy of Arts; Member of Advisory Committee, Native Land Limited; Adviser, Teneo Holdings; Chairman, UK India Business Council, Member of Executive Committee, World Rugby
Previous relevant experience: Chairman, Chime Communications PLC, Jack Wills; Minister for Trade, Investment and Small Business for the UK Government; Chairman and Group Chief Executive, Standard Chartered PLC

Peggy B Bruzelius

Non-Executive Director [1,3,4]
Nationality: Swedish

Appointed Non-Executive Director: April 2009
Current external appointments: Chairman, Lancelot Asset Management; Non-Executive Director, Akzo Nobel NV, Lundin Petroleum AB and Skandia Liv AB
Previous relevant experience: Non-Executive Director, Axfood AB, Husgvarna AB, Syngenta AG and Scania AB; Vice Chairman, Electrolux AB; CEO, ABB Financial Services AB; Executive Vice President, Skandinaviska Enskilda Banken AB

Ho KwonPing

Non-Executive Director [1,3,4]
Nationality: Singaporean

Appointed Non-Executive Director: October 2012
Current external appointments: Executive Chairman and Founder, Banyan Tree Holdings Limited; Chairman, Laguna Resorts & Hotels Public Company Limited and Thai Wah Public Company Limited; Chairman of Board of Trustees, Singapore Management University; Chairman of School Advisory Committee, School of Hotel and Tourism Management of the Hong Kong Polytechnic University
Previous relevant experience: Member, Global Advisory Board of Moelis & Company; Chairman, MediaCorp Pte. Ltd; Non-Executive Director, Singapore Airlines Limited, Singapore Power Limited and Standard Chartered PLC

Betsy D Holden

Non-Executive Director [1,3,4]
Nationality: American

Appointed Non-Executive Director: September 2009
Current external appointments: Senior Advisor, McKinsey & Company; Non-Executive Director, Dentsply Sirona, Inc, Lyons Magnus and Western Union Company; Member of the Executive Committee, Board of Trustees, Duke University; Member of the Executive Committee of the Global Advisory Board, Kellogg School of Management
Previous relevant experience: Non-Executive Director, Catamaran Corporation, MediaBank LLC, Tribune Company and Time Inc; President, Global Marketing and Category Development and Co-Chief Executive Officer, Kraft Foods, Inc.

Susan Kilsby

Non-Executive Director [1,3,4]
Nationality: American/British

Appointed Non-Executive Director: April 2018
Current external appointments: Chairman, Shire plc; Non-Executive Director, BBA Aviation plc, Fortune Brands Home & Security, Inc. and Goldman Sachs International
Previous relevant experience: Chairman, Mergers and Acquisitions EMEA, Credit Suisse; Senior Advisor, Credit Suisse; Non-Executive Director, Keurig Green Mountain, L'Occitane International and Coca-Cola HBC

Nicola S Mendelsohn

Non-Executive Director [1,3,4]
Nationality: British

Appointed Non-Executive Director: September 2014
Current external appointments: Vice president, Facebook EMEA; Director, Women's Prize for Fiction; Co-Chair, Creative Industries Council; Co-President, Norwood; Member, Mayor's Business Advisory Board
Previous relevant experience: Executive Chairman, Karmarama; Deputy Chairman, Grey London; Board Director, BBH and Fragrance Foundation; President, Institute of Practitioners in Advertising; Board Member, CEW; Trustee, White Ribbon Alliance; Chair of the Corporate Board, Women's Aid

Alan JH Stewart

Non-Executive Director [1*,3,4]
Nationality: British

Appointed Chairman of the Audit Committee: January 2017 (Appointed Non-Executive Director September 2014)
Current external appointments: Director and Chief Financial Officer, Tesco PLC; Member of the Advisory Board, Chartered Institute of Management Accountants; Member of the Main Committee & Chairman of Pension Committee, 100 Group of Finance Directors
Previous relevant experience: Chief Financial Officer, Marks & Spencer and AWAS; Non-Executive Director, Games Workshop plc; Group Finance Director, WH Smith plc; Chief Executive, Thomas Cook UK

David Harlock

Company Secretary and General Counsel Corporate Centre
Nationality: British

Appointed Company Secretary and General Counsel Corporate Centre: July 2016
Previous Diageo roles: General Counsel Corporate, Africa, Russia and Turkey; General Counsel M&A and Global Functions; Regional Counsel International
Previous relevant experience: Hogan Lovells

Philip G Scott ceased to be a Non-Executive Director on 20 September 2017.

Ursula Burns has been appointed as a Non-Executive Director with effect from a date to be confirmed.

Key to committees
1. Audit
2. Executive (comprising senior management)
3. Nomination
4. Remuneration
*Chairman of committee

Executive Committee

David Cutter

President, Global Supply and Procurement
Nationality: Australian

Appointed President, Global Supply and Procurement: July 2014
Previous Diageo roles: Supply Director, International Supply Centre; President, Supply Americas; Supply Director, Asia Pacific
Previous relevant experience: leadership roles, Frito-Lay and SC Johnson
Current external appointments: Member of the Council, Scotch Whisky Association

Sam Fischer

President, Diageo Greater China and Asia
Nationality: Australian

Appointed President, Greater China and Asia: September 2014
Previous Diageo roles: Managing Director, Diageo Greater China; Managing Director of South East Asia, Diageo Asia Pacific; General Manager, Diageo IndoChina and Vietnam
Previous relevant experience: Senior management roles across Central Europe and Indochina, Colgate Palmolive

Victoria Frame

Group Strategy Director
Nationality: British

Appointed Group Strategy Director: May 2017
Previous relevant experience: MD International and Chief Marketing Officer, Barry's Bootcamp; Partner, Bain & Company; Roles at Marakon Associates and CITI

Brian Franz

Chief Productivity Officer
Nationality: American/British

Appointed Chief Productivity Officer: August 2015
Previous Diageo roles: CIO and Head of GDBS, IS Services
Previous relevant experience: Senior Vice President and CIO, PepsiCo International; Commercial CIO, various CIO and management roles, General Electric

Alberto Gavazzi

President, Diageo Latin America and Caribbean, Global Travel & Sales Opex
Nationality: Brazilian/Italian

Appointed President, Latin America and Caribbean: July 2013
Previous Diageo roles: Managing Director, West Latin America and Caribbean; Global Category Director Whiskey, Gins and Reserve Brands; General Manager Brazil, Paraguay and Uruguay; Vice President Consumer Marketing, Chicago; Marketing Director, Brazil
Previous relevant experience: Colgate-Palmolive; Unilever PLC

John Kennedy

President, Diageo Europe, Russia, Turkey and India
Nationality: American

Appointed President, Diageo Europe, Russia, Turkey and India: July 2016
Previous Diageo roles: President, Europe and Western Europe; Chief Operating Officer, Western Europe; Marketing Director, Australia; General Manager for Innovation, North America; President and Chief Executive Officer, Diageo Canada; Managing Director, Diageo Ireland
Previous relevant experience: brand management roles, GlaxoSmithKline and Quaker Oats

Anand Kripalu

CEO, United Spirits Limited
Nationality: Indian

Appointed CEO, United Spirits Limited: September 2014
Previous Diageo roles: CEO-designate, United Spirits Limited
Previous relevant experience: Various management roles at Mondelez International, Cadbury and Unilever
Current external appointments: Non-Executive Director, Marico

Deirdre Mahlan

President, Diageo North America
Nationality: American

Appointed President, Diageo North America: December 2015
Previous Diageo roles: Chief Financial Officer and Executive Director; Deputy Chief Financial Officer; Head of Tax and Treasury
Previous relevant experience: Member, Main Committee, 100 Group of Finance Directors; senior finance positions, Joseph E. Seagram & Sons, Inc.; Senior manager, PricewaterhouseCoopers
Current external appointments: Non-Executive Director, Experian plc

Daniel Mobley

Corporate Relations Director
Nationality: British

Appointed Corporate Relations Director: June 2017
Previous Diageo roles: Corporate Relations Director, Europe
Previous relevant experience: Regional Head of Corporate Affairs India & South Asia, Standard Chartered; Regional Head of Corporate Affairs Africa, Standard Chartered; Group Head of Government Relations, Standard Chartered; Extensive government experience including in HM Treasury and Foreign & Commonwealth Office

Siobhan Moriarty

General Counsel
Nationality: Irish

Appointed General Counsel: July 2013
Previous Diageo roles: General Counsel Designate; Corporate M&A Counsel; Regional Counsel Ireland; General Counsel Europe
Previous relevant experience: various positions in law firm private practice, Dublin and London
Current external appointments: Non-Executive Director, Friends Board of the Royal Academy of Arts

Mairéad Nayager

Human Resources Director
Nationality: Irish

Appointed Human Resources Director: October 2015
Previous Diageo roles: HR Director, Diageo Europe; HR Director, Brandhouse, South Africa; HR Director, Diageo Africa Regional Markets; Talent & Organisational Effectiveness Director, Diageo Africa; Employee Relations Manager, Diageo Ireland
Previous relevant experience: Irish Business and Employers' Confederation

John O'Keeffe

President, Diageo Africa
Nationality: Irish

Appointed President Africa: July 2015
Previous Diageo roles: CEO and Managing Director, Guinness Nigeria; Global Head of Innovation and Beer and Baileys; Managing Director Russia and Eastern Europe; various management and marketing positions

Syl Saller

Chief Marketing Officer
Nationality: American/British

Appointed Chief Marketing Officer July 2013
Previous Diageo roles: Global Innovation Director; Marketing Director, Diageo Great Britain
Previous relevant experience: brand management and marketing roles, Allied Domecq PLC, Gillette Company and Holson Burnes Group, Inc; Non-Executive Director, Domino's Pizza Group plc

Corporate governance report

Letter from the Chairman of the Board of Directors and the Company Secretary

Dear Shareholder

On behalf of the Board, we are pleased to present the corporate governance report for the year ended 30 June 2018. The purpose of the report is to set out Diageo's corporate governance structures and procedures, and to describe how the Board, its committees and the Executive Committee work.

The Board has ultimate responsibility for the corporate governance of Diageo, being the way in which the company is directed and controlled. The Board's responsibilities include: setting strategic aims and values; providing the leadership to put them into effect; supervising and constructively challenging management, who have responsibility for day to day operational running of the business; and reporting to shareholders on their stewardship. We continue to believe that Diageo's Board demonstrates suitable and appropriate behaviours and independence, and that its composition includes a diverse range of experience, skills and backgrounds, which as a whole enables the Board to discharge its duties.

There has been continued debate over the past twelve months on the need for effective corporate governance in the interests of shareholders and other stakeholders. The Board strongly believes that the maintenance of strong corporate governance is critical in enabling sustainable long-term business performance as well as in enhancing the reputation and standing of Diageo.

The principal corporate governance rules applying to Diageo (as a UK company listed on the London Stock Exchange (LSE)) for the year ended 30 June 2018 are contained in The UK Corporate Governance Code as updated and published by the Financial Reporting Council (FRC) in April 2016 (the Code) and the UK Financial Conduct Authority (FCA) Listing Rules, which require us to describe, in our Annual Report, our corporate governance from two points of view: the first dealing generally with our application of the Code's main principles and the second dealing specifically with non-compliance with any of the Code's provisions. The two descriptions together are designed to give shareholders a picture of governance arrangements in relation to the Code as a criterion of good practice.

Throughout the year, Diageo has complied with all relevant provisions set out in the Code, which is publicly available under the heading 'Corporate Governance' at the website of the FRC, **www.frc.org.uk**.

Diageo must also comply with corporate governance rules contained in the FCA Disclosure Guidance and Transparency Rules as well as certain related provisions in the Companies Act 2006 (the Act).

As well as being subject to UK legislation and practice, as a company listed on the New York Stock Exchange (NYSE), Diageo is subject to the listing requirements of the NYSE and the rules of the US Securities and Exchange Commission (SEC), as they apply to foreign private issuers. Compliance with the provisions of the US Sarbanes-Oxley Act of 2002 (SOX), as it applies to foreign private issuers, is continually monitored. As Diageo follows UK corporate governance practice, differences from the NYSE corporate governance standards are summarised in Diageo's 20-F filing and on our website at **www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance**.

J Ferrán
Chairman

D Harlock
Company Secretary

Board of directors

Membership of the Board and Board Committees

The Chairmen, Senior Non-Executive Director and other members of the Board, Audit Committee, Nomination Committee and Remuneration Committee are as set out in this Annual Report in the biographies of Directors and members of the Executive Committee.

There is a clear separation of the roles of the Chairman and the Chief Executive. The Chairman, Javier Ferrán, is responsible for the running of the Board and for ensuring all Directors are fully informed of matters, sufficient to make informed judgements. As Chief Executive, Ivan Menezes has responsibility for implementing the strategy agreed by the Board and for managing the company and the group. He is supported in this role by the Executive Committee.

The Non-Executive Directors, all of whom the Board has determined are independent, are experienced and influential individuals from a diverse range of industries, backgrounds and countries. No individual or group dominates the Board's decision-making processes.

A summary of the terms and conditions of appointment of the Non-Executive Directors is available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Activities and duties of the Board

The Board manages overall control of the company's affairs with reference to the formal schedule of matters reserved for the Board for decision. The schedule was last reviewed in July 2018 and is available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

The Board has agreed an approach and adopted guidelines for dealing with conflicts of interest and responsibility for authorising conflicts of interest is included in the schedule of matters reserved for the Board. The Board confirmed that it was aware of no situations that may or did give rise to conflicts with the interests of the company other than those that may arise from Directors' other appointments as disclosed in their biographies.

In order to fulfil their duties, procedures are in place for Directors to seek both independent advice and the advice and services of the Company Secretary who is responsible for advising the Board, through the Chairman, on all governance matters. The Non-Executive Directors meet without the management present, and also meet with the Chairman without management present, on a regular basis.

The terms of reference of Board Committees are available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Induction, training and business engagement

There is a formal induction programme for new Directors, which includes meeting with Executive Committee members and other senior executives individually and visiting a number of operations and sites around the group.

Following the initial induction for Non-Executive Directors, a continuing understanding of the business is developed through appropriate business engagements. Visits to customers, engagements with employees, and brand events were arranged during the year.

In addition, Executive Committee members and other senior executives are invited, as appropriate, to Board and strategy meetings to make presentations on their areas of responsibility. The company's policy is for all Directors to attend the AGM.

All Directors are also provided with the opportunity, and encouraged, to attend regular training to ensure they are kept up to date on relevant legal developments or changes and best practice and changing commercial and other risks.

Performance evaluation

During the year an externally facilitated evaluation of the Board's effectiveness, including the effectiveness of the Chairman and the Board's committees, was undertaken. The external facilitator, Consilium Board Review, has no other connection with the company.

Consilium Board Review prepared and presented a report to the Board, which concluded that the Board and its Committees continued to operate in an effective, thoughtful and robust manner, meeting the requirements and spirit of the Code. The report noted the positive role played by the Chairman and his deep industry knowledge, as well as complementary roles played by the Non-Executive Directors and their interaction with the Chief Executive and the Chief Financial Officer. Also noted were the high quality of the Board's processes and practices, its broad range of agenda items and its productive leadership and internal dynamics.

While noting that the Board was top performing and that there was no need for significant changes, the report did include some suggestions designed to ensure that the Board continues to perform to a high level of effectiveness, including in respect of future composition of the Board, its development and dynamics, and the provision of adequate focus and time to emerging external factors. The Board discussed the report and its suggestions, and have taken various actions to address these suggestions. It is the Board's intention to continue to review annually its performance and that of its committees and individual directors. The evaluation later in 2018 will be undertaken internally.

The Chairman has confirmed that the Non-Executive Directors standing for re-election at this year's AGM continue to perform effectively, both individually and collectively as a Board, and that each demonstrate commitment to their roles.

Nomination Committee

Role of the Nomination Committee

The Nomination Committee is responsible for keeping under review the composition of the Board and succession to it, and succession planning for senior leadership positions. It makes recommendations to the Board concerning appointments to the Board.

Any new Directors are appointed by the Board and, in accordance with the company's articles of association, they must be elected at the next AGM to continue in office. All existing Directors retire by rotation every year.

Activities of the Nomination Committee

The principal activities of the Nomination Committee during the year were: the consideration of potential new Non-Executive Directors; the review of individual Director performance; a review of the Executive Committee membership and succession planning for it and for senior leadership positions, in addition to a review of diversity within the group.

The recruitment process for Non-Executive Directors typically includes the development of a candidate profile and the engagement of a professional search agency (which has no other connection with the company) specialising in the recruitment of high calibre Non-Executive Directors. Reports on potential appointees are provided to the committee, which, after careful consideration, makes a recommendation to the Board.

In respect of the appointment of Susan Kilsby the recruitment process included the development of a candidate profile and the engagement of a professional search agency (JCA Group, which has no other connection with the company) specialising in the recruitment of high calibre Non-Executive Directors. Reports on potential appointees were provided to the committee, which, after careful consideration, made a recommendation to the Board. The Board approved her appointment.

Diversity
Diageo strongly supports diversity within its Board of Directors, including gender, age and professional diversity. The Board is comprised of individuals from a diverse range of skills, industries, backgrounds and nationalities, which enables a broad evaluation of all matters considered by the Board and contributes to a culture of collaborative and constructive discussion. In particular, women currently make up 50% of the company's Board and 40% of its Executive Committee. Further information is given in the sections of this Annual Report on sustainability & responsibility, our people, and on our role in society in the Chairman's Statement.

Remuneration Committee

Role of the Remuneration Committee
The role of the Remuneration Committee and details of how the company applies the principles of the Code in respect of Directors' remuneration are set out in the directors' remuneration report.

The Chairman and the Chief Executive may, by invitation, attend Remuneration Committee meetings, except when their own remuneration is discussed. No Director is involved in determining his or her own remuneration.

Executive direction and control

Executive Committee

The Executive Committee, appointed and chaired by the Chief Executive, supports him in discharging his responsibility for implementing the strategy agreed by the Board and for managing the company and the group.

It consists of the individuals responsible for the key operational and functional components of the business: North America, Europe and Turkey, Africa, Latin America and Caribbean, Asia Pacific, International Supply Centre and Corporate.

The Executive Committee focuses its time and agenda to align with the Performance Ambition and how to achieve Diageo's financial and non-financial performance objectives. Performance metrics have been developed to measure progress. There is also focus on the company's reputation. In support, monthly performance delivery calls, involving the senior leadership group, focus on progress against the six performance drivers.

To support the market visits made by the presidents in the ordinary course of their business, a small group led by the Chief Executive makes regular market visits focused on the execution of strategy and designed to assist in continuing the development of strategy and in the delivery of performance against the Performance Ambition.

Committees appointed by the Chief Executive and intended to have an ongoing remit, including the Audit & Risk Committee, Finance Committee and Filings Assurance Committee are shown (with their remits) at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Additional information

Internal control and risk management
An ongoing process has been established for identifying, evaluating and managing risks faced by the group. This process, which complies with the requirements of the Code, has been in place for the full financial year and up to the date the financial statements were approved and accords with the guidance issued by the FRC in September 2014, Guidance on Risk management, Internal Control and related Financial and Business Reporting. The Board confirms that, through the activities of the Audit Committee described below, a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity has been carried out. These risks and mitigations are set out above in the section of this Annual Report dealing with principal risks.

The Board acknowledges that it is responsible for the company's systems of internal control and risk management and for reviewing their effectiveness. The Board confirms that, through the activities of the Audit Committee described below, it has reviewed the effectiveness of the company's systems of internal control and risk management.

During the year, in line with the Code, the Board considered the nature and extent of the risks it was willing to take to achieve its strategic goals and reviewed the existing internal statement of risk appetite (which was considered and recommended to the Board by both the Audit & Risk Committee and the Audit Committee). In accordance with the Code, the Board has also considered the company's longer term viability, based on a robust assessment of its principal risks. This was done through the work of the Audit Committee which recommended the Viability Statement (as set out above) to the Board.

The company has in place internal control and risk management systems in relation to the company's financial reporting process and the group's process for preparation of consolidated accounts. Further, a review of the consolidated financial statements is completed by management to ensure that the financial position and results of the group are appropriately reflected.

Compliance and ethics programme
Diageo is committed to conducting its business responsibly and in accordance with all laws and regulations to which its business activities are subject. We hold ourselves to the principles in our Code of Business Conduct, which is embedded through a comprehensive training and education programme for all employees.

Our Code of Business Conduct and other Diageo global policies are available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

In accordance with the requirements of SOX (and related SEC rules), Diageo has adopted a code of ethics covering its Chief Executive, Chief Financial Officer, presidents and other identifiable persons in the group, including those performing senior accounting and controller functions. No amendments to, or waivers in respect of, the code of ethics were made during the year.

The full text of the code of ethics is available at www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance.

Both the Audit & Risk Committee and the Audit Committee regularly review the strategy and operation of the compliance and ethics programme through the year.

Further information is given in the section of this Annual Report on sustainability and responsibility, governance and ethics.

Relations with shareholders
The Board's primary contact with institutional shareholders is through the Chief Executive and Chief Financial Officer. The Chief Executive and Chief Financial Officer are supported by the investor relations department, who are in regular contact with institutional shareholders and sell-side analysts. A monthly investor relations report, including coverage of the company by sell-side analysts, is circulated to the Board.

The Board also ensures that all Directors develop an understanding of the views of major institutional shareholders through an independent survey of shareholder opinion. In addition, major shareholders are invited to raise any company matters of interest to them at meetings with the chairman of the Board and the chairman of the remuneration committee. Reports on any meetings are made to the Board.

Private shareholders are invited to write to the Chairman or any other Director and express their views on any issues of concern at any time and the AGM provides an opportunity for private shareholders to put their questions in person.

Political donations

The group has not given any money for political purposes in the United Kingdom and made no donations to EU political organisations and incurred no EU political expenditure during the year.

The group made contributions to non-EU political parties totalling £0.3 million during the year (2017 – £0.4 million). These contributions were made exclusively to federal and state candidate committees, state political parties and federal leadership committees in North America (consistent with applicable laws), where it is common practice to make political contributions. No particular political persuasion was supported and contributions were made with the aim of promoting a better understanding of the group and its views on commercial matters, as well as a generally improved business environment.

Going concern

The Directors confirm that, after making appropriate enquiries, they have reasonable expectation that the group has adequate resources to continue in operational existence. Accordingly, they continue to adopt the going concern basis in preparing the financial statements. Although not assessed over the same period as the going concern, the viability of the group has been assessed above.

Management's report on internal control over financial reporting

Management, under the supervision of the Chief Executive and Chief Financial Officer, is responsible for establishing and maintaining adequate control over the group's financial reporting.

Management has assessed the effectiveness of Diageo's internal control over financial reporting (as defined in Rules 13(a)-13(f) and 15(d)-15(f) under the US Securities Exchange Act of 1934) based on the framework in 'Internal Control – Integrated Framework', issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) in 2013. Based on this assessment, management concluded that, as at 30 June 2018, internal control over financial reporting was effective.

During the period covered by this report, there were no changes in internal control over financial reporting that have materially affected or are reasonably likely to materially affect the effectiveness of internal control over financial reporting.

PricewaterhouseCoopers LLP (PwC), an independent registered public accounting firm, who also audit the group's consolidated financial statements, has audited the effectiveness of the group's internal control over financial reporting, and has issued an unqualified report thereon, which is included in PwC's integrated audit report below and which will be included in the company's Form 20-F to be filed with the SEC.

Directors' responsibilities in respect of the Annual Report and financial statements

The Directors are responsible for preparing the Annual Report, the information filed with the SEC on Form 20-F and the group and parent company financial statements in accordance with applicable law and regulations.

Responsibility statement

Each of the Directors, whose names are set out in the Board of Directors and Executive Committee section of this Annual Report, confirms that to the best of his or her knowledge:

- the Annual Report and Accounts for the year ended 30 June 2018, taken as a whole, is fair, balanced and understandable, and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy;
- the consolidated financial statements contained in the Annual Report and Accounts for the year ended 30 June 2018, which have been prepared in accordance with IFRS as issued by the IASB and as adopted for use in the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group; and
- the management report represented by the Directors' Report contained in the Annual Report and Accounts for the year ended 30 June 2018 includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that the group faces.

The responsibility statement was approved by the Board of Directors on 25 July 2018.

Directors' attendance record at the AGM, scheduled Board meetings and Board committee meetings, for the year ended 30 June 2018 was as set out in the table below. For Board and Board committee meetings, attendance is expressed as the number of meetings attended out of the number that each Director was eligible to attend.

	Annual General Meeting 2017	Board (maximum 6)	Audit Committee (maximum 4)(iii)	Nomination Committee (maximum 3)(iii)	Remuneration Committee (maximum 5)(iii)
Javier Ferrán	✓	6/6	4/4(i)	3/3	5/5(i)
Ivan Menezes	✓	6/6	2/2(ii)	2/2(i)	5/5(i)
Kathryn Mikells	✓	6/6	4/4(i)	1/1(ii)	3/3(i)
Lord Davies	✓	6/6	3/4	3/3	5/5
Peggy Bruzelius	✓	6/6	4/4	3/3	5/5
Betsy Holden	✓	6/6	4/4	3/3	5/5
Ho KwonPing	✓	6/6	4/4	3/3	5/5
Nicola Mendelsohn(iii)	✓	6/6	3/4	3/3	4/5
Alan Stewart	✓	6/6	4/4	3/3	5/5
Philip Scott	×	1/2	1/1	1/2	1/1
Susan Kilsby	n/a	1/1	1/1	1/1	2/2

(i) Attended by invitation.
(ii) Attended by invitation, for part only.
(iii) Where Non-Executive Directors were unable to attend a meeting they gave their views to the Chairmen of the respective meetings ahead of the meetings being held.
One Sub-Committee meeting of the Audit Committee was also held involving Mr Stewart and Ms Bruzelius.
Mr Scott was unable to attend the 2017 AGM as a result of a prior engagement.

Report of the Audit Committee

Letter from the Chairman of the Audit Committee

Dear Shareholder

On behalf of the Audit Committee, I am pleased to present its report for the year ended 30 June 2018.

The purpose of this report is to describe how the Committee has carried out its responsibilities during the year.

In overview, the role of the Audit Committee is to monitor and review: the integrity of the company's financial statements; internal control and risk management; audit and risk programmes; business conduct and ethics; 'whistleblowing'; and the appointment of the external auditor.

The work of the Committee during the year gave attention to all elements of its remit. Over the year, the Committee continued to focus on particular topics within the company's risk management programme, including in particular detailed reviews of the changing global tax environment and emerging risks in relation to technology, including a review of the company's IT platforms and systems.

In discharging its duties, the Audit Committee seeks to balance independent oversight of the matters within its remit with providing support and guidance to management. I am confident that the Committee, supported by members of senior management and the external auditors, has carried out its duties in the year under review effectively and to a high standard.

Alan Stewart
Chairman of the Audit Committee

Report of the Audit Committee

Role of the Audit Committee
The formal role of the Audit Committee is set out in its terms of reference, which are available at **www.diageo.com/en-row/ourbusiness/aboutus/corporategovernance**. Key elements of the role of the committee and work carried out during the year are set out as follows.

Financial statements
During the year, the Audit Committee met four times (and a sub-committee met twice) and reviewed both the interim results announcement, which included the interim financial statements, and the annual reports and associated preliminary year end results announcement, focusing on key areas of judgement and complexity, critical accounting policies, provisioning and any changes required in these areas or policies.

The company has in place internal control and risk management systems in relation to the company's financial reporting process and the group's process for preparation of consolidated accounts. A review of the consolidated financial statements is completed by management (through the work of its filings assurance committee (FAC)) to ensure that the financial position and results of the group are appropriately reflected therein. The Audit Committee reviewed the work of the FAC and a report on the conclusions of the FAC process was provided to the Audit Committee by the Chief Financial Officer.

Significant issues and judgements that were considered in respect of the 2018 financial statements were as follows. These include the matters relating to risks disclosed in the UK external auditor's report.

- Disclosure on the quality of the earnings and one off items included in cash flow. The committee agreed that sufficient disclosure was made in the financial statements.
- The committee determined that exceptional items are appropriately classified considering their size and nature, and sufficient disclosure is provided in the financial statements (see note 4).
- Review of carrying value of assets – in particular intangible assets. The committee assessed the impairment charge recognised and agreed that at 30 June 2018 the fair value of the company's assets was in excess of their carrying value (see notes 6 and 10).
- Adoption of new accounting standards – IFRS 9 – Financial instruments and IFRS 15 – Revenue from contracts with customers were adopted from the start of the year. The committee agreed that the adoption of IFRS 9 and IFRS 15 did not require a restatement of prior year figures and that the amount recorded in other retained earnings in the year in respect of the adoption of IFRS 9 and IFRS 15 was appropriate (see note 1).
- Exchange rate used to translate operations in Venezuela. The committee determined an appropriate rate used for the year ended 30 June 2018 for consolidation purposes, that represents the best estimation of the rate at which capital and dividend repatriations are expected to be realised (see note 1).
- Disclosure on taxation. The committee agreed that the separate presentation of the tax risk appropriately addresses the significant change in the international tax environment and sufficient and transparent disclosures are provided for the ongoing tax discussions (see page 21 and note 7).
- Review of legal cases. The committee agreed that adequate provision has been made for all material litigation and disputes, based on the currently most likely outcomes, including the litigation summarised in note 18.
- Assumptions used in respect of post employment plans. Having considered advice from external actuaries and assumptions used by companies with comparator plans, the committee agreed that the assumptions used to calculate the income statement and balance sheet assets and liabilities for post employment plans were appropriate (see note 13).
- Viability statement. The committee noted that severe but plausible risk scenarios had been identified; a robust risk assessment had been carried out; and the group's viability and going concern consideration proved with stress testing. Taking into account the company's balance sheet position, the committee expected the group to be able to meet its liabilities as they fell due over the three-year period ending 30 June 2021. The risk that the group would become insolvent during this timeframe was considered remote. The Committee recommended to the Board that the Viability statement above be approved.

As part of its review of the Annual Report, the committee considered whether the report is 'fair, balanced and understandable' (noting the Code's reference to 'position' as well as 'performance, business model and strategy'). On the basis of this work, the Audit Committee recommended to the Board that it could make the required statement that the Annual Report is 'fair, balanced and understandable'.

Internal control and risk management; audit and risk programme; business conduct and ethics (including 'whistleblowing')
At each of its meetings, the Audit Committee reviewed detailed reports from the heads of the Global Risk & Compliance (GRC) and Global Audit & Risk (GAR) teams (including coverage of the areas mentioned in the title of this section) and had sight of the minutes of meetings of the Executive Audit and Risk Committee. The work and reporting to the Committee of both GRC and GAR during the year included focus on the impact of a challenging environment and public policy change, cyber risk and information management. The Committee in turn were thus able to keep under review the operation of the controls and compliance framework in these and other areas. The Committee also received regular updates from the group general counsel on significant litigation and from the head of tax on the group's tax profile and key issues.

The GRC reporting included a consideration of key risks and related mitigations, including those set out in the section of this Annual Report dealing with principal risks. Based on this activity during the year, the Audit Committee made a recommendation to the Board covering the nature and extent of the risks it was willing to take to achieve its strategic goals and its internal statement of risk appetite (which was considered also by the Executive Audit and Risk Committee). The Board agreed this recommendation.

Through the activities of the Audit Committee described in this report and its related recommendations to the Board, the Board confirms that it has reviewed the effectiveness of the company's systems of internal control and risk management and that there were no material failings identified and no significant failings identified which require disclosure in this Annual Report.

External auditor

During the year, the Audit Committee reviewed the external audit strategy and the findings of the external auditor from its review of the interim results and its audit of the consolidated financial statements.

The Audit Committee reviews annually the appointment of the auditor (taking into account the auditor's effectiveness and independence and all appropriate guidelines) and makes a recommendation to the Board accordingly. Any decision to open the external audit to tender is taken on the recommendation of the Audit Committee. There are no contractual obligations that restrict the company's current choice of external auditor. Following the last tender process, PwC was appointed as auditor of the company in 2015 and the current audit partner is Ian Chambers.

The company has complied with the provisions of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 ('CMA Order') for the year ended 30 June 2018.

The Audit Committee assesses the ongoing effectiveness and quality of the external auditor and audit process on the basis of meetings and a questionnaire-based internal review with the finance team and other senior executives.

The group has a policy on auditor independence and on the use of the external auditor for non-audit services, which is reviewed annually, most recently in July 2018. The review took into consideration the new regulations on non-audit services. Under this policy, the provision of any non-audit service must be approved by the Audit Committee, unless the proposed service is both expected to cost less than £250,000 and also falls within one of a number of service categories which the Audit Committee has pre-approved. Fees paid to the auditor for audit, audit related and other services are analysed in note 3(b) to the consolidated financial statements. The nature and level of all services provided by the external auditor is a factor taken into account by the Audit Committee when it reviews annually the independence of the external auditor.

'Financial expert', composition and other attendees

For the purposes of the Code and the relevant rule under SOX, section 407, the Board has determined that Alan Stewart is independent and may be regarded as an Audit Committee financial expert, having recent and relevant financial experience, and that all members of the Audit Committee are independent Non-Executive Directors with relevant financial and sectoral competence.

The Chairman, the Chief Financial Officer, the group general counsel, the group financial controller, the head of GAR, the GRC director, the group chief accountant and the external auditor regularly attend meetings of the committee.

The Audit Committee met privately with the external auditor and with the head of GAR as appropriate.

Training and deep dives

During the year, the Audit Committee had risk reviews and training sessions, presented by senior executives, on indirect tax and restrictions on marketing and availability of alcoholic products, preparation for implementation of the GDPR, the company's current and future technology infrastructure, and its cyber security risk management processes.

Directors' remuneration report

"Long-term value for shareholders and pay for performance is at the heart of our remuneration policy."

Contents

Annual statement by the Chairman of the Remuneration Committee

Dear Shareholder

As Chairman of the Remuneration Committee, I am pleased to present the Directors' remuneration report for the year ended 30 June 2018. This report complies with Schedule 8 of the Large and Medium-sized Companies and Groups (Account and Reports) Regulations 2008 and contains:

- The current directors' remuneration policy, which was approved at the AGM on 20 September 2017; and
- The annual remuneration report, describing how the remuneration policy has been put into practice during the year ended 30 June 2018, and how it will be implemented in the year ending 30 June 2019.

In this section you will find the remuneration principles that have guided the Remuneration Committee in their decision making throughout the year. Fundamentally, this is about balance: ensuring that remuneration structures are designed in a way that enables the right outcomes for the business in line with its long-term strategy, making sure that we have the best people in place to deliver on that strategy and ensuring that executive pay is appropriate in the wider context in which the business operates.

Like many multinational companies, we source talent globally and we need to attract and retain the best people to lead our business in an increasingly competitive marketplace. Remuneration is a key part of our offering and the significant market pay differential between executives in the United States and in the United Kingdom and the rest of Europe continues to be challenging. This is particularly an issue for Diageo since a significant part of our business is based in the United States, and this is a critical talent market for our senior leadership group. We continue to monitor external practices across our key strategic markets and set our remuneration policy and practices in a way that provides appropriate balance between risk and reward, delivering market competitive packages in return for high performance against the company's strategic objectives and stretching performance targets.

The key decisions that have been made by the Remuneration Committee during the past year in relation to pay outcomes for Executive Directors are highlighted in the 'at a glance' table overleaf, together with an explanation of how each element of pay supports the business strategy, and a comparison of pay outcomes for the past year against the prior year. You will note that strong performance against very stretching targets over the past three years has led to long-term incentive awards vesting at 60% of maximum for 2015 performance shares and 70% of maximum for 2015 share options (0% for both schemes last year), and this underlines our principle of pay for performance.

Diageo's remuneration principles

At Diageo, long-term value creation for shareholders and pay for performance is at the heart of our remuneration policy and practices. The principles for setting executive remuneration are outlined below and in more detail in the remuneration policy on page 74.

1 Delivery of business strategy

Short and long-term incentive plans reward the delivery of our business strategy and performance ambition. Performance measures are reviewed regularly and stretching targets are set relative to the Company's growth plans and peer group performance. The Committee seeks to embed simplicity and transparency in the design and delivery of executive reward.

2 Sustainable, long-term performance

A significant proportion of remuneration is delivered in variable pay linked to business and individual performance, focused on consistent and responsible drivers of long-term growth. Performance against targets is assessed in the context of underlying business performance and the 'quality of earnings'.

3 Competitive total remuneration

Market competitive total remuneration with an appropriate balance of reward and upside opportunity allows us to attract and retain the best talent from all over the world, which is critical to our continued business success. Executive remuneration decisions are made in the context of the broader all-employee and external climate.

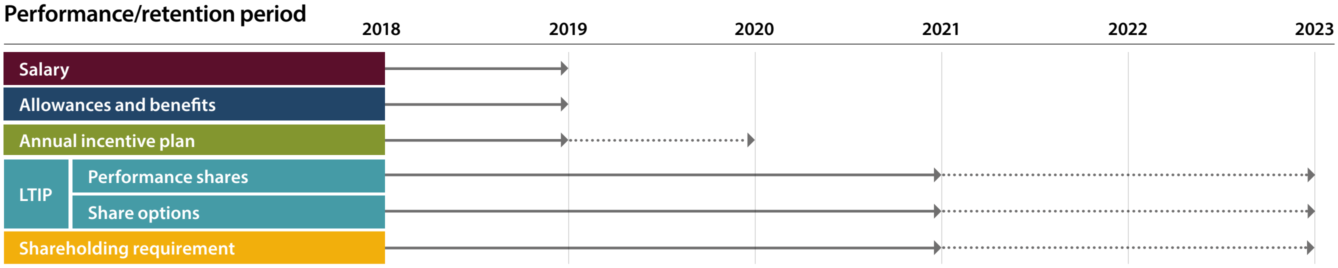
4 Alignment with shareholder interests

Executives are required to build significant personal shareholdings in Diageo to encourage leaders of the business to think and act like owners. Long-term incentives are held for two years following vesting to provide further focus on sustainable share price growth.

Remuneration in 2018 at a glance

	Key features	Purpose and link to strategy	Implementation in 2018	Implementation in 2017
Salary	• Reviewed annually on 1 October • Salaries take account of external market and internal employee context	• Supports the attraction and retention of the best global talent with the capability to deliver Diageo's strategy	• Effective 1 October 2018: – CEO 2% increase to $1,613,036 – CFO 2% increase to $1,061,208 • Supported by a comprehensive review of total target remuneration versus the external market • Salary increases are below the pay budget for the wider workforce Page 86	• Effective 1 October 2017: – CEO 2% increase to $1,581,408 – CFO 2% increase to $1,040,400
Allowances and benefits	• Provision of competitive benefits based on country • Maximum company pension contribution is 20% of base salary for new appointments	• Provision of market competitive and cost-effective benefits supports attraction and retention of talent	• Unchanged from prior year: – CEO 30% of salary – CFO 20% of salary	• Unchanged from prior year • CEO's company contribution was reduced from 40% to 30% effective 1 July 2016
Annual incentive	• Target opportunity is 100% of salary and maximum is 200% of salary • Paid out in cash after the end of the financial year • Discretion to apply clawback	• Incentivises delivery of Diageo's annual financial and strategic targets • Provides focus on key financial metrics and the individual's contribution to the company's performance	• F18 pay-out above target: – CEO 70% of maximum – CFO 72% of maximum Page 81 • For F19, measures on net sales growth, operating profit and average working capital weighted equally, with remaining 20% on individual objectives Page 86 • Opportunites are unchanged	• F17 pay-out above target: – CEO 68% of maximum – CFO 70% of maximum
Long-term incentives	• Annual grant of performance shares and share options – CEO award 500% of salary – CFO award 480% of salary • Performance measures, weightings and stretching targets are set annually • 3-year performance period + 2-year retention period • Malus and clawback provisions	• Rewards long-term consistent performance in line with Diageo's business strategy • Provides focus on delivering superior long-term returns to shareholders	• Vesting of 2015 performance shares at 70% of maximum • Vesting of 2015 share options at 60% of maximum Page 82 • No change to performance measures for 2018 awards as these are appropriate in line with the business strategy • Targets for net sales growth and cumulative free cash flow adjusted upwards for 2018 awards Page 86 • Opportunites are unchanged	• Nil vesting of 2014 performance shares and options
Shareholding requirement	• Minimum shareholding requirement within 5 years of appointment: – CEO 500% of salary – CFO 400% of salary	• Ensures alignment between the interests of Executive Directors and shareholders	• CEO shareholding 2115% of salary • CFO shareholding 123% of salary Page 88	• CEO shareholding 1696% of salary • CFO shareholding 123% of salary

Performance/retention period



Indicates a holding or clawback period

Performance against incentive plan measures

Long-term incentives (for the period 1 July 2015 to 30 June 2018)

We are pleased to report strong performance against our targets under both the annual and long-term incentive plans this year, as summarised below.

Organic net sales growth (25% weighting)

CAGR	Threshold	Midpoint	Maximum
Target	3.0%	4.5%	6.0%
Actual	4.0%		

Cumulative free cash flow (25% weighting)

	Threshold	Midpoint	Maximum
Target	£5,000m	£6,000m	£7,000m
Actual	£6,969m		

Adjusted earnings per share growth (25% weighting)

CAGR	Threshold	Midpoint	Maximum
Target	4.0%	6.5%	9.0%
Actual	6.5%		

Relative TSR ranking vs peer group (25% weighting)

	Threshold	Midpoint	Maximum
Target	9th	–	3rd
Actual	6th		

Annual incentive (for the period 1 July 2017 to 30 June 2018)

Net sales growth (25% weighting)

	Threshold	Target	Maximum
Target	2.25%	4.5%	6.75%
Actual	5.2%		

Operating profit (25% weighting)

	Threshold	Target	Maximum
Target	4.1%	8.2%	12.3%
Actual	8.5%		

Average working capital (30% weighting) (% net sales)

	Threshold	Target	Maximum
Target	30bps	120bps	210bps
Actual	220bps		

Diageo's share price growth over the period 1 July 2015 to 30 June 2018

↑ 46%

2018	2722p
2015	1860p

Total dividend of 181.2 pence per share paid.

Dividend distribution to shareholders in year ended 30 June 2018

↑ 5%

2018	63.4p
2017	60.3p

Looking ahead

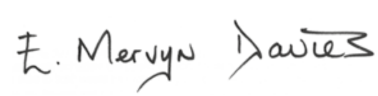
The remuneration policy was approved by 96% of shareholders at the AGM held on 20 September 2017. There are no changes to the remuneration policy proposed for the year ending 30 June 2019 and the performance measures applicable to Executive Directors under both the annual and long-term incentive plans will remain the same as the year before, with the only exception being that the weighting of financial performance measures under the annual incentive plan will be equalised (in the year ended 30 June 2018, 30% of the annual incentive plan was based on average working capital performance and 25% on each of net sales growth and operating profit growth, with the remaining 20% based on individual business objectives).

We will continue to operate executive remuneration arrangements in line with the approved remuneration policy. Whilst arrangements that defer part of the annual bonus into shares are common in the FTSE 100, the Committee is satisfied that the company's current annual bonus structure (payable entirely in cash) remains appropriate. The high shareholding requirement, which was increased significantly last year as part of the policy review, the level of stretch in the performance targets under the long-term incentive plan, and the post-vesting holding period together provide appropriate alignment of executives with the interests of shareholders in fostering sustainable share price growth over the long term. There are also robust clawback and malus provisions under both the annual and long-term incentive plans, which apply to all members of the Executive Committee.

The Committee remains confident that the mix of performance shares and share options is an appropriate long-term incentive for the leaders of the business, and the share options element provides an additional stretch in that the share price has to grow materially in addition to the performance condition being achieved in order for the award to provide value for executives. This further strengthens the alignment between the interests of executives and shareholders. Share option plans remain majority practice within Diageo's international peer group, against which the company needs to remain competitive in order to attract and retain the highest calibre of talent.

The annual remuneration report will be put forward for your consideration and approval by advisory vote at the AGM on 20 September 2018.

We were very pleased to receive a strong vote in favour of our remuneration policy and report last year. I highly value the direct engagement and feedback from our shareholders and their representative bodies on Diageo's remuneration policy and practices and look forward to welcoming you and receiving your support again at the AGM this year.



Lord Davies of Abersoch
Senior independent Non-Executive Director and Chairman of the Remuneration Committee

Directors' remuneration policy

This section of the report sets out the policy for Executive Directors' remuneration. The policy formally came into effect at the AGM on 20 September 2017, in accordance with section 439A of the Companies Act 2006, after being approved in a binding vote.

The policy approved in September 2017 can be found on the company's website at **www.diageo.com**.

Policy table

Set out below is the remuneration policy for Executive Directors, which applied from the date of the AGM on 20 September 2017.

There have been no changes to the policy since last year, other than to update the number of employees during 2018 and the pay for performance scenario charts for the year ending 30 June 2019.

Base salary

More detail on **p86**

Purpose and link to strategy

Supports the attraction and retention of the best global talent with the capability to deliver Diageo's strategy and performance goals.

Operation

- Normally reviewed annually or following a change in responsibilities with any increases usually taking effect from 1 October.
- The Remuneration Committee considers the following parameters when reviewing base salary levels:
  - Pay increases for other employees across the group.
  - Economic conditions and governance trends.
  - The individual's performance, skills and responsibilities.
  - Base salaries (and total remuneration) at companies of similar size and international scope to Diageo, with roles typically benchmarked against the FTSE 30 excluding financial services companies, or against similar comparator groups in other locations dependent on the Executive Director's home market.

Opportunity

Salary increases will be made in the context of the broader employee pay environment, and will normally be in line with those made to other employees in relevant markets in which Diageo operates, typically the United Kingdom and the United States, unless there is a change in role or responsibility or other exceptional circumstances.

Benefits

More detail on **p80**

Purpose and link to strategy

Provides market competitive and cost effective benefits.

Operation

- The provision of benefits depends on the country of residence of the Executive Director and may include but is not limited to a company car or car allowance, the provision of a car and contracted car service or equivalent, product allowance, life insurance, accidental death & disability insurance, medical cover, financial counselling and tax advice.
- The Remuneration Committee has discretion to offer additional allowances, or benefits, to Executive Directors, if considered appropriate and reasonable. These may include relocation expenses, housing allowance and school fees where a Director is asked to relocate from his/her home location as part of their appointment.

Opportunity

The benefits package is set at a level which the Remuneration Committee considers:

- Provides an appropriate level of benefits depending on the role and individual circumstances;
- Is appropriate in the context of the benefits offered to the wider workforce in the relevant market, and
- Is in line with comparable roles in companies of a similar size and complexity in the relevant market.

Post-Retirement Provisions

More detail on **p83-84**

Purpose and link to strategy
Provides cost-effective, competitive post-retirement benefits.

Operation
- Provision of market competitive pension arrangements or a cash alternative based on a percentage of base salary.
- Further detail on current pension provisions for Executive Directors is disclosed in the annual report on remuneration.

Opportunity
- The maximum company pension contribution is 20% of base salary for any new external appointments to an Executive Director position.
- Current legacy company contributions for Ivan Menezes and Kathryn Mikells in the year ended 30 June 2018 were 30% and 20% of base salary respectively. At his request, Ivan Menezes' company contribution was reduced from 40% to 30% effective 1 July 2016.

Annual Incentive Plan (AIP)

More detail on **p81 and 86**

Purpose and link to strategy
Incentivises year on year delivery of Diageo's annual financial and strategic targets. Provides focus on key financial metrics and the individual's contribution to the company's performance.

Operation
- Performance measures, weightings and targets are set annually by the Remuneration Committee. Appropriately stretching targets are set by reference to the annual operating plan and historical and projected performance for the company and its peer group.
- The level of award is determined with reference to Diageo's overall financial and strategic performance and individual performance and is paid out in cash after the end of the financial year.
- The Committee has discretion to adjust the level of payment if it is not deemed to reflect appropriately the individual's contribution or the overall business performance. Any discretionary adjustments will be detailed in the following year's annual report on remuneration.
- The Committee has discretion to apply clawback to bonus, i.e. the company may seek to recover bonus paid, in exceptional circumstances such as gross misconduct or gross negligence during the performance period.

Opportunity
For threshold performance, up to 50% of salary may be earned, with up to 100% of salary earned for on target performance and a maximum of 200% of salary payable for outstanding performance.

Performance conditions
Annual incentive plan awards are based 70%-100% on financial measures which may include, but are not limited to, measures of revenue, profit and cash and 0%-30% on broader objectives based on strategic goals and/or individual contribution. Details of the targets will be disclosed retrospectively in next year's annual report on remuneration, when they are no longer deemed commercially sensitive by the Board.

DIAGEO Long-Term Incentive Plan (DLTIP)

More detail on **p82-84 and 86-87**

Purpose and link to strategy
Provides focus on delivering superior long-term returns to shareholders.

Operation
- An annual grant of performance shares and/or market price share options which vest subject to a performance test and continued employment normally over a period of three years.
- Measures and stretching targets are reviewed annually by the Remuneration Committee for each new award. Details of the measures, weightings and targets applicable for the financial year under review are provided in the annual report on remuneration.
- Following vesting there is a further retention period of two years. Executive Directors are able to exercise an option or sell sufficient shares to cover any tax liability when an award vests, provided they retain the net shares arising for the two-year retention period.
- Notional dividends accrue on performance share awards to the extent that the performance conditions have been met, delivered as shares or cash at the discretion of the Remuneration Committee at the end of the vesting period.
- The Committee has discretion to reduce the number of shares which vest (subject to HMRC rules regarding approved share options), for example in the event of a material performance failure, or a material restatement of the financial statements. There is an extensive malus clause for awards made from September 2014. The Committee has discretion to decide that:
  - the number of shares subject to the award will be reduced;
  - the award will lapse;
  - retention shares (i.e. vested shares subject to the additional two-year retention period) will be forfeited;
  - vesting of the award or the end of any retention period will be delayed (e.g. until an investigation is completed);
  - additional conditions will be imposed on the vesting of the award or the end of the retention period; and/or
  - any award, bonus or other benefit which might have been granted or paid to the participant in any later year will be reduced or not awarded.

Malus and clawback provisions will apply up to delivery of shares at the end of the retention period (as opposed to the vesting date). The company also has the standard discretion to take account of unforeseen events such as a variation to share capital.

Opportunity
- The maximum annual grants for the CEO and CFO are 500% and 480% of salary in performance share equivalents respectively (where a market price option is valued at one-third of a performance share). Under the DLTIP no more than 375% of salary will be awarded in face value terms in options to any Executive Director in any year.
- Threshold vesting level of 20% of maximum with straight line vesting up to 100% at maximum for attaining financial metrics and a ranking profile for relative total shareholder return.

Performance conditions

- The vesting of awards is linked to a range of measures which may include, but are not limited to:
  - a growth measure (e.g. net sales growth, profit before exceptional items and taxation (PBET) growth);
  - a measure of efficiency (e.g. operating margin, cumulative free cash flow, return on invested capital (ROIC)); and
  - a measure of Diageo's relative performance in relation to its peers (e.g. relative total shareholder return).

Measures that apply to performance shares and market price options may differ, as is the case for current awards. Weightings of these measures may vary year-on-year.

- The Remuneration Committee has discretion to amend the performance conditions in exceptional circumstances if it considers it appropriate to do so, e.g. in cases of accounting policy changes, merger and acquisition activities and disposals. Any such amendments would be fully disclosed and explained in the following year's annual report on remuneration.

All-employee share plans

Purpose and link to strategy

To encourage broader employee share ownership through locally approved plans.

Operation

- The company operates tax-efficient all-employee share savings plans in various jurisdictions.
- Executive Directors' eligibility may depend on their country of residence, tax status and employment company.

Opportunity

Limits for all-employee share plans are set by the tax authorities. The company may choose to set its own lower limits.

Performance conditions

UK Freeshares: based on Diageo plc financial measures which may include, but are not limited to, measures of revenue, profit and cash.

Shareholding requirement

More detail on **p88**

Purpose and link to strategy

Ensures alignment between the interests of Executive Directors and shareholders.

Operation

- The minimum shareholding requirement is 500% of base salary for the Chief Executive and 400% of base salary for any other Executive Directors.
- Executive Directors are expected to build up their shareholding within five years of their appointment to the Board.
- Executive Directors will be restricted from selling more than 50% of shares which vest under the long-term incentive plan (excluding the sale of shares to cover tax on vesting and other exceptional circumstances to be specifically approved by the Chief Executive and/or Chairman), until the shareholding requirement is met.

Chairman of the Board and Non-Executive Directors

More detail on **p89**

Purpose and link to strategy

Supports the attraction, motivation and retention of world-class talent and reflects the value of the individual, their skills and experience, and performance.

Operation

Fees for the Chairman and Non-Executive Directors are normally reviewed every two years.

- A proportion of the Chairman's annual fee is used for the monthly purchase of Diageo ordinary shares, which have to be retained until the Chairman retires from the company or ceases to be a Director.
- Fees are reviewed in the light of market practice in the FTSE 30, excluding financial services companies, and anticipated workload, tasks and potential liabilities.
- The Chairman and Non-Executive Directors do not participate in any of the company's incentive plans nor do they receive pension contributions or benefits. Their travel and accommodation expenses in connection with the attendance of Board meetings (and any tax thereon) are paid by the company.
- The Chairman and the Non-Executive Directors are eligible to receive a product allowance or cash equivalent at the same level as the Executive Directors.

All Non-Executive Directors have letters of appointment. A summary of their terms and conditions of appointment is available at **www.diageo.com**. The Chairman of the Board, Javier Ferrán, was appointed on 1 January 2017, under a letter of appointment for an initial three-year term, terminable on six months' notice by either party or, if terminated by the company, by payment of six months' fees in lieu of notice.

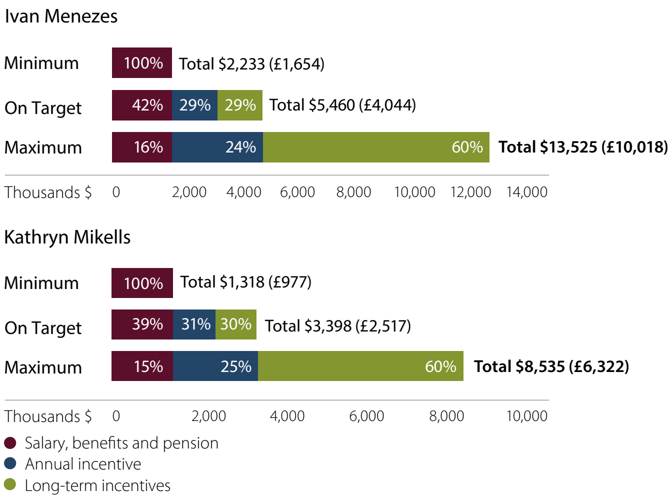
Opportunity

- Fees for Non-Executive Directors are within the limits set by the shareholders from time to time, with an aggregate limit of £1,200,000, excluding the Chairman's fees.

Notes to the policy table

Illustrations of application of the remuneration policy

The graphs below illustrate scenarios for the projected total remuneration of Executive Directors at three different levels of performance: minimum, on-target and maximum. Note that the projected values exclude the impact of any share price movements. These charts reflect projected remuneration for the financial year ending 30 June 2019.



Basis of calculation and assumptions:

The 'Minimum' scenario shows fixed remuneration only, i.e. base salary for the year ending 30 June 2019, total value of contractually agreed benefits for 2019, and the pension benefits to be accrued over the year ending 30 June 2019. These are the only elements of the Executive Directors' remuneration packages which are not subject to performance conditions.

The 'On-target' scenario shows fixed remuneration as above, plus a target pay-out of 50% of the maximum annual bonus and threshold performance vesting for long-term incentive awards of 20% of maximum award.

The 'Maximum' scenario reflects fixed remuneration, plus full pay-out of annual and long-term incentives.

Performance measures and targets

Further details of AIP performance measures and DLTIP performance measures and targets that will apply for awards made in September 2018, and how they are aligned with company strategy and the creation of shareholder value, are set out in the annual report on remuneration on pages 81-83.

Performance targets are set to be stretching yet achievable, and take into account the company's strategic priorities and business environment. The Committee sets targets based on a range of reference points including the corporate strategy and broker forecasts for both Diageo and its peers.

Approach to remuneration for other employees

The remuneration approach for Executive Directors is consistent with the reward package for members of the Executive Committee and the senior management population.

Generally speaking, a much higher proportion of total remuneration for the Executive Directors is linked to business performance, compared to the rest of the employee population, so that remuneration will increase or decrease in line with business performance and to align the interests of Executive Directors and shareholders. The structure of the reward package for the wider employee population is based on the principle that it should be sufficient to attract and retain the best talent and be competitive within our broader industry, remunerating employees for their contribution linked to our holistic performance whilst mindful not to over-pay. It is driven by local market practice as well as level of seniority and accountability, reflecting the global nature of Diageo's business.

Approach to recruitment remuneration

Diageo is a global organisation operating in more than 180 countries around the world. The ability, therefore, to recruit and retain the best talent from all over the world is critical to the future success of the business. People diversity in all its forms is a core element of Diageo's global talent strategy and, managed effectively, is a key driver in delivering Diageo's performance ambition.

The Remuneration Committee's overarching principle for recruitment remuneration is to pay no more than is necessary to attract an Executive Director of the calibre required to shape and deliver Diageo's business strategy in recognition that Diageo competes for talent in a global marketplace. The Committee will seek to align the remuneration package with Diageo's remuneration policy as laid out above, but retains the discretion to offer a remuneration package which is necessary to meet the individual circumstances of the recruited Executive Director and to enable the hiring of an individual with the necessary skills and expertise. However, except as described below, variable pay will follow the policy.

On appointment of an external Executive Director, the Committee may decide to compensate for variable remuneration elements the Director forfeits when leaving their current employer. In doing so, the Committee will ensure that any such compensation would have a fair value no higher than that of the awards forfeited, and would generally be determined on a comparable basis taking into account factors including the form in which the awards were granted, performance conditions attached, the probability of the awards vesting (e.g. past, current and likely future performance) as well as the vesting schedules. Depending on individual circumstances at the time, the Committee has the discretion to determine the type of award (i.e. cash, shares or options, holding period and whether or not performance conditions would apply).

Any such award would be fully disclosed and explained in the following year's annual report on remuneration. When exercising its discretion in establishing the reward package for a new Executive Director, the Committee will carefully consider the balance between the need to secure an individual in the best interests of the company against the concerns of investors about the quantum of remuneration and, if considered appropriate at the time, will consult with the company's biggest shareholders. The Remuneration Committee will provide timely disclosure of the reward package of any new Executive Director.

In the event that an internal candidate is promoted to Executive Director, legacy terms and conditions would normally be honoured, including pension entitlements and any outstanding incentive awards.

Service contracts and policy on payment for loss of office (including takeover provisions)
Executive Directors have rolling service contracts, details of which are set out below. These are available for inspection at the company's registered office.

Executive Director	Date of service contract
Ivan Menezes	7 May 2013
Kathryn Mikells	1 October 2015

Notice period	The contracts provide for a period of six months' notice by the Executive Director or 12 months' notice by the company. A payment may be made in lieu of notice equivalent to 12 months' base salary and the cost to the company of providing contractual benefits (excluding incentive plans). The service contracts also provide for the payment of outstanding pay and bonus, if Executive Directors are terminated following a takeover, or other change of control of Diageo plc. If, on the termination date, the Executive Director has exceeded his/her accrued holiday entitlement, the value of such excess may be deducted by the company from any sums due to him/her, except to the extent that such deduction would subject the Executive Director to additional tax under Section 409A of the Code (in the case of Ivan Menezes). If the Executive Director on the termination date has accrued but untaken holiday entitlement, the company will, at its discretion, either require the Executive Director to take such unused holiday during any notice period or make a payment to him/her in lieu of it, provided always that if the employment is terminated for cause then the Executive Director will not be entitled to any such payment. For these purposes, salary in respect of one day of holiday entitlement will be calculated as 1/261 of salary.
Mitigation	The Remuneration Committee may exercise its discretion to require a proportion of the termination payment to be paid in instalments and, upon the Executive Director commencing new employment, to be subject to mitigation except where termination is within 12 months of a takeover, or within such 12 months the Executive Director leaves due to a material diminution in status.
Annual incentive plan (AIP)	Where the Executive Director leaves for reasons including retirement, death in service, disability, ill-health, injury, redundancy, transfer out of the group and other circumstances at the Remuneration Committee's discretion ('Good Leaver Reasons') during the financial year, they are usually entitled to an incentive payment pro-rated for the period of service during the performance period, which is typically payable at the usual payment date. Where the Executive Director leaves for any other reason, no payment will be made. The amount is subject to performance conditions being met and at the discretion of the Committee. The Committee has discretion to determine an earlier payment date, for example on death in service.
Diageo 2014 long-term incentive plan (DLTIP)	When an Executive Director leaves for any reason other than Good Leaver Reasons, all unvested awards generally lapse immediately. In cases where Good Leaver Reasons apply, awards vest on the original vesting date unless the Remuneration Committee decides otherwise (for example in the case of death in service). The retention period for vested awards continues for all leavers other than in cases of disability, ill health or death in service, unless the Remuneration Committee decides otherwise. The proportion of the award released depends on the extent to which the performance condition is met. The number of shares is reduced on a pro-rata basis reflecting the length of time the Executive Director was employed by the company during the performance period, unless the Committee decides otherwise (for example in the case of death in service). On a takeover or other corporate event, awards vest subject to the extent to which the performance conditions are met and, unless the Committee decides otherwise, the awards are time pro-rated. Otherwise the Committee, in agreement with the new company, may decide that awards should be swapped for awards over shares in the new company; where awards are granted in the form of options then on vesting they are generally exercisable for 12 months (or six months for approved options). Awards may be adjusted on a variation of share capital, demerger or other similar event. The Remuneration Committee may amend the plans, except that any changes to the advantage of participants require shareholder approval, unless the change relates to the administration, or taxation of the plan or participants, or is needed to ensure that the plans operate effectively in another jurisdiction. Details of existing awards are set out in the annual report on remuneration.
Repatriation	In cases where an Executive Director was recruited from outside the United Kingdom and has been relocated to the United Kingdom as part of their appointment, the company will pay reasonable costs for the repatriation of Good Leavers.

Non-Executive Directors' unexpired terms of appointment

All Non-Executive Directors are on three-year terms which are expected to be extended up to a total of nine years. The date of initial appointment to the Board and the point at which the current letter of appointment expires for Non-Executive Directors are shown in the table below. Philip G Scott stepped down from the Board on 20 September 2017.

Non-Executive Directors	Date of appointment to the Board	Current letter of appointment expires
Javier Ferrán	22 July 2016	AGM September 2019
Peggy B Bruzelius	24 April 2009	AGM September 2018
Lord Davies of Abersoch	1 September 2010	AGM September 2019
Betsy D Holden	1 September 2009	AGM September 2018
Susan Kilsby	4 April 2018	AGM September 2021
Ho KwonPing	1 October 2012	AGM September 2018
Nicola S Mendelsohn	1 September 2014	AGM September 2020
Alan JH Stewart	1 September 2014	AGM September 2020

Payments under previous policies

The Committee reserves the right to make any remuneration payments and payments for loss of office, notwithstanding that they are not in line with the policy set out above, where the terms of the payment were agreed (i) under a previous policy, in which case the provision of that policy shall continue to apply until such payments have been made; (ii) before the policy or the relevant legislation came into effect; or (iii) at a time when the relevant individual was not a director of the company and, in the opinion of the Committee, the payment was not in consideration for the individual becoming a director of the company. For these purposes, 'payments' include the satisfaction of awards of variable remuneration and, in relation to awards of shares, the terms of the payment which are agreed at the time the award is granted.

Consideration of employment conditions elsewhere in the company

When reviewing and determining pay for Executive Directors, the Committee takes into account the level and structure of remuneration as well as salary budgets for other employees in the group. More specifically, the Committee reviews annual salary increase budgets for the general employee population in the United Kingdom and United States as well as the remuneration structure and policy for the global senior management population.

Diageo employs c.30,000 employees and operates in more than 180 countries around the world. Diageo runs annual employee surveys which give employees the opportunity to give feedback and express their views on a variety of topics, including remuneration. Any comments relating to Executive Directors' remuneration are fed back to the Remuneration Committee.

Consideration of shareholder views

The Committee values the continued dialogue with Diageo's shareholders and engages directly with them and their representative bodies at the earliest opportunity to take their views into account when setting and implementing the company's remuneration policies. This year, the company has engaged with shareholders and their proxy advisers on the base salary proposals for 2018, short and long-term incentive plan design and target setting for long-term incentive awards to be made in 2018.

Annual report on remuneration

The following section provides details of how the company's 2017 remuneration policy was implemented during the year ended 30 June 2018, and how the Remuneration Committee intends to implement the proposed remuneration policy in the year ending 30 June 2019.

Single total figure of remuneration for Executive Directors (audited)

The table below details the Executive Directors' remuneration for the year ended 30 June 2018.

	Ivan Menezes[i]				Kathryn Mikells[i][ii]			
Fixed pay	2018 '000	2018 '000	2017 '000	2017 '000	2018 '000	2018 '000	2017 '000	2017 '000
Salary	£1,166	$1,574	£1,215	$1,543	£767	$1,035	£671	$853
Benefits[ii]	£69	$94	£92	$117	£30	$40	£198	$251
Pension[iii]	£351	$474	£432	$549	£157	$212	£135	$171
Total fixed pay	£1,586	$2,142	£1,739	$2,209	£954	$1,287	£1,004	$1,275
Performance related pay								
Annual incentive	£1,640	$2,214	£1,660	$2,109	£1,105	$1,492	£1,120	$1,422
Long-term incentives[iv]								
Value delivered through performance	£2,966	$4,004	–	–	£3,584	$4,838	–	–
Value delivered through share price growth	£1,836	$2,479	–	–	£1,289	$1,740	–	–
Other incentives[v]	–	–	–	–	£4	$5	£4	$5
Total remuneration for Executive Director appointment	£8,028	$10,839	£3,399	$4,318	£6,936	$9,362	£2,128	$2,702
Other performance related pay								
(Granted prior to appointment as Executive Director)								
Long-term incentives[vi]	£1,035	$1,398	–	–	–	–	–	–
TOTAL SINGLE FIGURE	£9,063	$12,237	£3,399	$4,318	£6,936	$9,362	£2,128	$2,702

Notes

(i) Exchange rate — The amounts shown in sterling are converted using the cumulative weighted average exchange rate for the respective financial year. For the year ended 30 June 2018 the exchange rate was £1 = $1.35 and for the year ended 30 June 2017 the exchange rate was £1 = $1.27. Ivan Menezes and Kathryn Mikells are both paid in US dollars. Kathryn Mikells' remuneration was previously set in sterling prior to 1 June 2017, as disclosed in the 2017 remuneration report.

(ii) Benefits — Benefits is the gross value of all taxable benefits. For Ivan Menezes, these include medical insurance (£19k), company car allowance (£17k), contracted car service (£7k), financial counselling (£23k), product allowance, flexible benefits allowance and life and long-term disability cover. Kathryn Mikells' benefits include flexible benefits allowance (£18k), financial counselling (£6k), contracted car service (£2k), life cover and product allowance. 2017 remuneration included one-off relocation costs in relation to Kathryn Mikells' move from the United States to the United Kingdom, grossed up for tax (£162k). Page 74

(iii) Pension — Pension benefits earned during the year represent the increase in the pension fund balances over the year in the Diageo North America Inc. pension plans over and above the increase due to inflation. As Ivan Menezes has been a deferred member of the Diageo Pension Scheme (DPS) in the United Kingdom since 31 January 2012, and receives standard statutory increases in deferment the United Kingdom pension amount that accrued over the two years in excess of inflation is nil. Kathryn Mikells became a director and started accruing benefits in the Supplemental Executive Retirement Plan (SERP) with effect from 9 November 2015. Pages 83-84

(iv) Long-term incentives — Long-term incentives represent the estimated gain delivered through share options and performance shares where performance conditions have been met in the respective financial year. For Ivan Menezes in 2018, this includes performance shares and share options awarded in 2015 and due to vest in September 2018 at 70% and 60% of maximum respectively. For Kathryn Mikells in 2018, this includes performance shares vesting under the final tranche of the replacement share award made on 9 November 2015 in recognition of share awards forfeited from her former employer, and granted in accordance with the remuneration policy on recruitment remuneration. The average closing share price of an ordinary share over the three dealing days prior to the date of grant was 1892.0 pence. The performance measures, targets and weightings that applied to this award are the same as the 2015 PSP award, details of which are disclosed on page 82. The award will vest on 9 November 2018, based on performance over the three-year period ending 30 June 2018, at 70% of the shares granted. There are no other long-term incentive awards vesting based on performance in the year ended 30 June 2018 to report for Kathryn Mikells. Page 82

'Value delivered through performance' is calculated as the number of performance shares and dividend shares vesting in September/November 2018 multiplied by the share price on the date of grant.

'Value delivered through share price growth' is calculated as the difference between the average share price in the last three months of the financial year and the share price on the date of grant multiplied by the number of performance shares and share options vesting in September 2018.

Long-term incentives due to vest in 2017 all lapsed due to the performance measures not being met.

(v) Other incentives — Other incentives include the face value of awards made under the all-employee share plans (number of shares multiplied by the share price on the date of grant). Awards do not have performance conditions attached.

(vi) Discretionary incentive plan — Ivan Menezes retains interests in long-term incentive awards that were granted to him in 2012, prior to joining the Board under 'below-Board' plans (Discretionary Incentive Plan). For 2018, the amount disclosed in the table above is the part of the fourth and final tranche of the award based on performance for the year ended 30 June 2018, which is due to vest at 67% of maximum. The part of the award based on continuing employment for the year ended 30 June 2018 is not required to be reported in the table above and amounts to 14,643 ADRs, which will vest on 8 March 2019. For 2017, the part of the third tranche of the award based on performance for the year ended 30 June 2017 lapsed in full due to the performance conditions not being met. Page 83

Payments to former directors (audited)

There were no payments to former directors above the de minimis level of £3k in the year ended 30 June 2018, other than payments that have been disclosed in previous remuneration reports.

Payments for loss of office (audited)

There were no payments for loss of office to Executive Directors for the year ended 30 June 2018.

Annual incentive plan (AIP) (audited)

AIP payout for the year ended 30 June 2018

AIP payouts for the Executive Directors are based 80% on performance against the group financial measures and 20% on performance against the Individual Business Objectives (IBOs), as assessed by the Remuneration Committee and summarised in the table below. The Committee assessed the Executive Directors' performance against each of the IBOs separately and awarded a rating based on whether they had partially met, achieved or exceeded each goal. The average of all IBO ratings (weighted equally) is shown as the IBO outcome in the table below.

The overall level of performance achieved resulted in an AIP award equating to 70% of base salary for Ivan Menezes and 71.7% of base salary for Kathryn Mikells. The actual awards received by the Executive Directors are shown in the 'single total figure of remuneration' table on page 80.

Group financial measures(i)

Measure	Weighting	Threshold	Target	Maximum	Actual	Payout (% of total AIP opportunity)
Net sales (% growth)(ii)	25%	2.25%	4.5%	6.75%	5.2%	16.5%
Operating profit (% growth)(iii)	25%	4.1%	8.2%	12.3%	8.5%	13.5%
Average working capital (% net sales)(iv)	30%	30bps	120bps	210bps	220bps	30.0%
Group financial payout	80%					**60.0%**

Individual business objectives

Measure	Weighting	Outcome	Payout (% of total AIP opportunity)
Ivan Menezes Chief Executive	20%		**10.0%**
Delivery of F18 productivity outcomes		Diageo productivity savings were marginally ahead target in F18	
Delivery of key business performance driver		Diageo operating cash conversion exceeded 100% but was slightly below target Adjusted earnings per share growth at 9.3% for the year was ahead of the target	
Deliver a key business performance driver		Delivered in whole or in part against key financial metrics on the North America business	
Kathryn Mikells Chief Financial Officer	20%		**11.7%**
Delivery of F18 productivity outcomes		Diageo productivity savings were marginally ahead target in F18	
Delivery of key business performance driver		Diageo operating cash conversion exceeded 100% but was slightly below target Adjusted earnings per share growth at 9.3% for the year was ahead of the target	
Deliver a key business performance driver		Delivered end-to-end cost savings across the Global Finance function in line with target. Progress made on strengthening of diverse talent within the finance function Delivered end-to-end process simplification in the business planning cycle that has improved the effectiveness of the organisation	

Payout

	Group (weighted 80%)	IBO (weighted 20%)	Total (% max)	Total (% salary)	Total (£)(v)	Total ($)(v)
Ivan Menezes	60.0%	10.0%	**70.0%**	140.0%	£1,640	$2,214
Kathryn Mikells	60.0%	11.7%	**71.7%**	143.4%	£1,105	$1,492

(i) Performance against the AIP measures is calculated using 2018 budgeted exchange rates in line with management reporting and excludes the impact of exchange and any exceptional items.
(ii) For AIP purposes, the net sales measure is calculated after adjustments for acquisitions and disposals.
(iii) For AIP purposes, the operating profit measure is calculated after adjustments for acquisitions and disposals.
(iv) For AIP purposes, average working capital as a percentage of net sales is calculated as the average of the last 12 months of operating working capital (excluding maturing inventories and provisions) divided by annual net sales.
(v) AIP payments are calculated using base salary as at 30 June 2018, in line with the global policy that applies to other employees across the company.

Long-term incentive plans (LTIPs) (audited)

As approved by shareholders at the AGM in September 2014, long-term incentive awards are made under the Diageo Long-Term Incentive Plan (DLTIP) for awards from 2014 onwards. Awards are designed to incentivise Executive Directors and senior managers to deliver long-term sustainable performance and are subject to performance conditions normally measured over a three-year period. Awards are delivered on an annual basis in both performance shares and share options.

Share options – granted in September 2015, vesting in September 2018 (audited)

On 3 September 2015, Ivan Menezes received a share option award of 49,825 (ADRs) under the DLTIP, with an exercise price of $104.93. The award was subject to a performance condition based on compound annual adjusted eps growth at constant exchange rates, with a straight-line payout between threshold and maximum. Vesting is on a pro rata basis ranging from a threshold level of 20% to a maximum level of 100%.

Performance shares – awarded in September 2015, vesting in September 2018 (audited)

On 3 September 2015, Ivan Menezes received a performance share award of 49,825 (ADRs) under the DLTIP. Awards vest after a three-year period subject to the achievement of specified performance conditions. Notional dividends accrue on awards and are paid out either in cash or shares in accordance with the vesting schedule.

The vesting of 2015 performance share awards was subject to the achievement of three equally weighted performance measures:

1. Diageo's three-year total shareholder return (TSR) – the percentage growth in Diageo's share price (assuming all dividends and capital distributions are re-invested) – ranked against the TSR of a peer group of international drinks and consumer goods companies. TSR is calculated on a common currency (US dollar) basis;
2. Growth in organic net sales on a compound annual basis; and
3. Cumulative adjusted free cash flow – the cumulative year-end free cash flow outcome for each year within the three-year performance period, measured before exceptional spend.

For cumulative free cash flow and net sales, there is straight line vesting between threshold and the midpoint, and between the midpoint and the maximum.

The vesting profile for relative TSR is shown below:

TSR ranking (out of 17)	Vesting (% max)
1st, 2nd or 3rd	**100%**
4th	**95%**
5th	**75%**
6th	**65%**
7th	**55%**
8th	**45%**
9th	**20%**
10th or below	**0%**

TSR peer group (16 companies)	
AB Inbev	Mondelēz International
Brown Forman	Nestlé
Carlsberg	PepsiCo
Coca-Cola	Pernod Ricard
Colgate-Palmolive	Procter & Gamble
Groupe Danone	Reckitt Benckiser
Heineken	SABMiller
Kimberly-Clark	Unilever

The targets and vesting outcome for performance share and share option awards granted in September 2015 are shown in the following tables:

Vesting of 2015 DLTIP awards	Threshold	Midpoint	Maximum	Actual	Vesting (% maximum)
Organic net sales growth(i)	3.0%	4.5%	6.0%	**4.0%**	**46.3%**
Relative total shareholder return(ii)	9th	–	3rd	**6th**	**65.0%**
Cumulative free cash flow(iii)	£5,000m	£6,000m	£7,000m	**£6,969m**	**98.8%**
Vesting of performance shares (% maximum)					**70%**
Eps growth(iv)	4.0%	6.5%	9.0%	6.5%	
Vesting of share options (% maximum)					**60%**

(i) Organic net sales growth is calculated as the compound annual growth rate for the three-year period for net sales growth excluding the impact of exchange and acquisitions and disposals.
(ii) Relative total shareholder return is measured as the percentage growth in Diageo's ordinary share price (assuming all dividends and capital distributions are re-invested) compared to the total shareholder return of the peer group of 16 international drinks and consumer goods companies, based on an average period of 6 months, and converted to a common currency (US dollars). SABMiller was acquired by AB Inbev on 10 October 2016. For the 2015 vesting outcome, the total shareholder return of SABMiller has been tracked up to the date of acquisition, after which the total shareholder return tracks that of AB Inbev.
(iii) Cumulative free cash flow is the aggregate of free cash flow for the three-year period excluding the impact of exchange, cash flows from exceptional items and interest on share buy back programmes.
(iv) Earnings per share growth is calculated as the compound annual growth rate for the three-year period for earnings per share excluding the impact of exchange, exceptional items, share buy back programmes and the post employment net charges included in other financial charges.

Accordingly, the 2015 performance share award vested at 70% and the 2015 share option award vested at 60% of the maximum.

Diageo Incentive Plan (DIP) (audited)

Ivan Menezes retains interests in awards under the Diageo Incentive Plan that were granted to him in 2012, prior to his appointment as Executive Director. The number of shares granted to him on 8 March 2012 was 117,142 ADRs. 50% of this award was subject to meeting the midpoint of the targets for the financial measures under the long-term incentive plan over the three-year performance periods ending 30 June 2015, 30 June 2016, 30 June 2017 and 30 June 2018. The remaining 50% is subject to continued satisfactory employment. The financial measures under the performance part of the award are equally weighted. Actual performance for the fourth and final tranche of the 2012 DIP award (i.e. the tranche based on performance over the three years to 30 June 2018) versus target is set out below:

Vesting of final performance-based tranche of 2012 DIP award

Performance measures (equally weighted)	Target	Actual	Vesting (% of maximum)
Organic net sales growth (CAGR)[(i)]	4.5% p.a.	4.0%	0%
Cumulative free cash flow (£m)[(i)]	£6,000m	£6,969m	100%
Compound annual adjusted eps growth[(i)]	6.5% p.a.	6.5% p.a.	100%
Vesting of DIP award (% maximum)			**67%**

(i) These measures are calculated in accordance with the methodology described for 2015 performance share and share option awards on page 82.

9,761 performance related ADRs under the fourth tranche of the 2012 DIP award will vest in March 2019. The part based on continuing employment only (50% of the fourth tranche), which is 14,643 ADRs, will also vest in March 2019, provided Ivan Menezes remains employed at the time of vesting.

● Pension and benefits in the year ended 30 June 2018

Benefits

Benefits provisions for the Executive Directors are in accordance with the information set out in the future policy table.

Pension arrangements (audited)

Ivan Menezes and Kathryn Mikells are members of the Diageo North America Inc. Supplemental Executive Retirement Plan (SERP) with an accrual rate of 30% and 20% of base salary respectively during the year ended 30 June 2018.

The SERP is an unfunded, non-qualified supplemental retirement programme. Under the plan, accrued company contributions are subject to quarterly interest credits. Under the rules of the SERP, employees can withdraw the balance of the plan in the form of five equal annual instalments or a lump sum upon reaching age 55 (Kathryn Mikells) and after having left service with Diageo (within six months of separation from service).

Ivan Menezes participated in the US Cash Balance Plan and the Benefit Supplemental Plan (BSP) until August 2012 and has accrued benefits under both plans. The Cash Balance Plan is a qualified funded pension arrangement. Employer contributions are 10% of pay capped at the Internal Revenue Service (IRS) limit. The BSP is a non-qualified unfunded arrangement; notional employer contributions are 10% of pay above the IRS limit. Interest (notional for the BSP) is credited quarterly on both plans.

Ivan Menezes was also a member of the Diageo Pension Scheme (DPS) in the United Kingdom between 1 February 1997 and 30 November 1999. The accrual of pensionable service ceased in 1999 but the linkage to salary remained until January 2012. Under the Rules of the Scheme, this benefit is payable unreduced from age 60.

Upon death in service, a life insurance benefit of $3 million is payable to Ivan Menezes and a lump sum of four times base salary is payable to Kathryn Mikells.

The table below shows the pension benefits accrued by each Director to date. Note that the accrued United Kingdom benefits for Ivan Menezes are annual pension amounts, whereas the accrued US benefits for Ivan Menezes and Kathryn Mikells are one-off cash balance amounts.

	30 June 2018		30 June 2017	
Executive Director	UK pension £'000 p.a.	US benefit £'000	UK pension £'000 p.a.	US benefit £'000
Ivan Menezes[(i)]	71	6,680	69	6,236
Kathryn Mikells[(ii)]	Nil	391	Nil	227

(i) Ivan Menezes' US benefits are higher at 30 June 2018 than at 30 June 2017 by £444k
(a) £458k of which is due to pension benefits earned over the year (£351k of which is over and above the increase due to inflation – as reported in the single figure of remuneration, see page 80);
(b) £69k of which is due to interest earned on his deferred US benefits over the year; and
(c) (£83k) of which is due to exchange rate movements over the year.
(ii) Kathryn Mikells' US benefits are higher at 30 June 2018 than at 30 June 2017 by £164k
(a) £164k of which is due to pension benefits earned over the year (£157k of which is over and above the increase due to inflation – as reported in the single figure of remuneration, see page 80); and
(b) (£0k) of which is due to exchange rate movements over the year.

The Normal Retirement Age applicable to each Director's benefits depends on the pension scheme, as outlined below.

Executive Director	UK benefits (DPS)	US benefits (Cash balance)	US benefits (BSP)	US benefits (SERP)
Ivan Menezes[(i)]	60	65	6 months after age of leaving service	6 months after age of leaving service
Kathryn Mikells	n/a	n/a	n/a	6 months after age of leaving service, or age 55 if later

(i) Ivan Menezes is able to take his UK pension benefits from age 58 without consent, and his benefits would not be subject to any actuarial reduction in respect of early payment. This is a discretionary policy Diageo offers that is not set out in the DPS Scheme Rules.

DLTIP awards made during the year ended 30 June 2018 (audited)

On 4 September 2017, Ivan Menezes and Kathryn Mikells received awards of 51,268 (ADRs) and 32,380 (ADRs) performance shares respectively, and 51,268 (ADRs) and 32,380 (ADRs) market price share options respectively, under the DLTIP; details are provided in the table below. The three-year period over which performance will be measured is 1 July 2017 to 30 June 2020. The targets were disclosed in full in the 2017 remuneration report.

The performance measures for performance share awards are organic net sales growth, cumulative free cash flow and organic profit before exceptional items and tax growth, equally weighted. The performance measures for share option awards are organic profit before exceptional items and tax growth and relative total shareholder return, equally weighted.

20% of DLTIP awards will vest at threshold, with straight-line vesting up to 100% if the maximum level of performance is achieved.

Executive Director	Date of grant	Plan	Share type	Awards made during the year	Exercise price	Face value '000	Face value (% of salary)
Ivan Menezes	04/09/2017	DLTIP – share options	ADR	51,268	$134.06	$5,930	375%
Ivan Menezes	04/09/2017	DLTIP – performance shares	ADR	51,268	–	$5,930	375%
Kathryn Mikells	04/09/2017	DLTIP – share options	ADR	32,380	$134.06	$3,745	360%
Kathryn Mikells	04/09/2017	DLTIP – performance shares	ADR	32,380	–	$3,745	360%

The proportion of the awards outlined above that will vest is dependent upon the achievement of performance conditions and continued employment, and the actual value may be nil. The vesting outcomes will be disclosed in the 2020 Annual Report.

The face value of each award has been calculated using the award price at the time of grant. In accordance with the rules, the number of performance shares and share options granted under the DLTIP was calculated by using the average closing share price for the last six months of the preceding financial year ($115.67 ADRs). In accordance with the plan rules, the exercise price was calculated using the average closing share price of the three days preceding the grant date ($134.06 ADRs). The share price on the date of grant was $134.83 ADRs.

Outstanding share plan interests (audited)

Plan name	Date of award	Performance period	Date of vesting	Share type	Share price on date of grant	Exercise price	Number of shares/ options at 30 June 2017[i]	Granted	Vested/ exercised	Dividends awarded and released	Lapsed	Number of shares/ options at 30 June 2018
Ivan Menezes												
SESOP[iii]	Sep 2011	2011 – 2014	2014	ADR		$76.70	36,587					36,587
DLTIP – share options	Sep 2014	2014 – 2017	2017	ADR		$117.55	45,447				45,447	–
Total vested but unexercised share options in Ords[ii]												**146,348**
DLTIP – share options[v]	Sep 2015	2015 – 2018	2018	ADR		$104.93	49,825					49,825
DLTIP – share options[vi]	Sep 2016	2016 – 2019	2019	ADR		$113.66	54,356					54,356
DLTIP – share options	Sep 2017	2017 – 2020	2020	ADR		$134.06	–	51,268				51,268
Total unvested share options subject to performance in Ords[ii]												**621,796**
DIP[iv]	Mar 2012	2012 – 2019	2016 – 2019	ADR	$96.44		29,286				14,643	14,643
DLTIP – performance shares	Sep 2014	2014 – 2017	2017	ADR	$115.80		45,447				45,447	–
DLTIP – performance shares[v]	Sep 2015	2015 – 2018	2018	ADR	$104.30		49,825					49,825
DLTIP – performance shares[vi]	Sep 2016	2016 – 2019	2019	ADR	$115.77		54,356					54,356
DLTIP – performance shares	Sep 2017	2017 – 2020	2020	ADR	$134.83		–	51,268				51,268
Total unvested shares subject to performance in Ords[ii]												**680,368**
DIP[iv]	Mar 2012	2012 – 2019	2016 – 2019	ADR	$96.44		29,286		14,643			14,643
Total unvested shares not subject to performance in Ords[ii]												**58,572**

Plan name	Date of award	Performance period	Date of vesting	Share type	Share price on date of grant	Exercise price	Number of shares/ options at 30 June 2017[i]	Granted	Vested/ exercised	Dividends awarded and released	Lapsed	Number of shares/ options at 30 June 2018
Kathryn Mikells												
DLTIP – share options[vi]	Sep 2016	2016 – 2019	2019	Ord		2113p	128,253					128,253
DLTIP – share options	Sep 2017	2017 – 2020	2020	ADR		$134.83	–	32,380				32,380
Total unvested share options subject to performance in Ords[ii]												**257,773**
DBOP – performance shares[vii]	Nov 2015	2015 – 2018	2018	Ord	1866p		246,300					246,300
DLTIP – performance shares[viii] [vi]	Sep 2016	2016 – 2019	2019	Ord	2127p		128,253					128,253
DLTIP – performance shares	Sep 2017	2017 – 2020	2020	ADR	$134.83		–	32,380				32,380
Total unvested shares subject to performance in Ords[ii]												**504,073**
DBOP – restricted shares	Nov 2015	2015 – 2018	2018	Ord	1866p		43,868					43,868
Total unvested shares not subject to performance in Ords[ii]												**43,868**

(i) For unvested awards this is the number of shares/options initially awarded. For exercisable share options, this is the number of outstanding options. All share options have an expiry date of ten years after the date of grant.
(ii) ADRs have been converted to Ords (one ADR is equivalent to four ordinary shares) for the purpose of calculating the total number of vested and unvested shares and options.
(iii) Options granted prior to the Executive's appointment to the Board.
(iv) Ivan Menezes retains interests in an award that was granted to him prior to joining the Board under 'below-board' plans (Discretionary Incentive Plan), amounting to a total of 117,142 ADRs, granted in 2012 (29,286 of award remains unvested). The award is subject to performance conditions and continuing employment. 66.67% of the first tranche vested in March 2016, 66.67% of the second tranche vested in March 2017, 50% of the third tranche vested in March 2018 and 66.67% of the fourth and final tranche is due to vest in March 2019.
(v) Awards made of performance shares and share options under the DLTIP in September 2015 and due to vest in September 2018 are included here as unvested share awards subject to performance conditions, although the awards have also been included in the single figure of remuneration table on page 80, since the performance period ended during the year ended 30 June 2018.
(vi) Details of the performance conditions attached to DLTIP awards of performance shares and share options granted in 2016 were disclosed in Diageo's 2016 Annual Report.
(vii) Replacement shares awarded to Kathryn Mikells on her appointment as Chief Financial Officer on 9 November 2015, in recognition of share awards she forfeited from her previous employer. These awards were made under the Diageo Buy Out Plan (DBOP).
(viii) 1,419 Ords of this award were delivered as tax-qualified share options.

Salary

Salary increases to be applied in the year ending 30 June 2019

As outlined in the 2017 annual report on remuneration, base salaries for the Chief Executive and Chief Financial Officer were increased by 2%, effective from 1 October 2017.

In June 2018, the Remuneration Committee reviewed base salaries for senior management and agreed new salaries which will apply from 1 October 2018. In determining these salaries, the Remuneration Committee took into consideration a number of factors including general employee salary budgets and employment conditions, individual performance and experience, and salary positioning relative to internal and external peers. The overall budgeted salary increase for the salary review in October 2018 is 3% of base salary for employees in the United Kingdom and 3% in North America.

The Committee considered very carefully the total remuneration positioning of the Chief Executive and Chief Financial Officer, the salary budget for all employees in the United Kingdom and the expectations of shareholders with respect to continuing pay restraint. As a result, it was agreed that there would be a 2% salary increase for both the Chief Executive and the Chief Financial Officer, effective from 1 October 2018.

	Ivan Menezes		Kathryn Mikells	
Salary at 1 October ('000)	**2018**	2017	**2018**	2017
Base salary	**$1,613**	$1,581	**$1,061**	$1,040
% increase (over previous year)	**2%**	2%	**2%**	2%

AIP design for the year ending 30 June 2019

The measures and targets used in the AIP are reviewed annually by the Remuneration Committee and are chosen to drive financial and individual business performance goals related to the company's short term strategic operational objectives. The AIP design for Executive Directors in the year ending 30 June 2019 will comprise of the following performance measures and weightings:

- Operating profit (% growth) (26.67% weighting): stretching profit targets drive operational efficiency and influence the level of returns that can be delivered to shareholders through increases in share price and dividend income not including exceptional items or exchange;
- Net sales (% growth) (26.67% weighting): a key performance measure of year-on-year top line growth;
- Average working capital as a proportion of net sales (26.67% weighting): ensures focus on working capital management throughout the year and incentivises sustainable actions that are beneficial for the business in the long term;
- Individual business objectives (20% weighting): measurable deliverables that are specific to the individual and are focused on supporting the delivery of key strategic objectives.

This is the same structure as applied in the year ended 30 June 2018, except that the weightings across the financial measures have been equalised to ensure an appropriate focus on both profit and loss and balance sheet measures.

Details of the targets for the year ending 30 June 2019 will be disclosed retrospectively in next year's annual report on remuneration, by which time they will no longer be deemed commercially sensitive by the Board.

DLTIP awards to be made in the year ending 30 June 2019

The long-term incentive plan measures are reviewed annually by the Remuneration Committee and are selected to reward long-term consistent performance in line with Diageo's business strategy and to create alignment with the delivery of value for shareholders. The Committee has ensured that the incentive structure for senior management does not raise environmental, social and governance risks by inadvertently motivating irresponsible behaviour.

As last year, DLTIP awards made in September 2018 will comprise awards of both performance shares and share options, based on stretching targets against key performance measures as outlined in the table below. The performance share element of the DLTIP applies to the Executive Committee and the top cadre of Senior Leaders across the organisation worldwide, whilst the share option element is applicable to a much smaller population comprising only members of the Executive Committee. One market price option is valued at one-third of a performance share.

The table below outlines the targets and the vesting profile for these awards to the Executive Directors and the relative weightings of each performance measure as a percentage of the total award in performance share equivalents. Performance will be tested over three financial years, beginning with the year ending 30 June 2019.

	Performance shares				Share options	
	Profit before exceptional items and tax (CAGR)	Organic net sales (CAGR)	Cumulative free cash flow (£m)	Relative total shareholder return	Profit before exceptional items and tax (CAGR)	Vesting profile
Weighting (% total)	25%	25%	25%	12.5%	12.5%	100%
Threshold	4.5% p.a.	3.75% p.a.	£7,400m	Median ranking (ninth)	4.5% p.a.	20%
Midpoint	7.5% p.a.	4.875% p.a.	£8,050m	–	7.5% p.a.	60%
Maximum	10.5% p.a.	6% p.a.	£8,700m	Upper quintile (third or above)	10.5% p.a.	100%

It is intended that a DLTIP award of 500% of base salary will be made to Ivan Menezes in September 2018, comprising 375% of salary in performance shares and 125% of salary in market price share options (in performance share equivalents; one market price option is valued at one-third of a performance share).

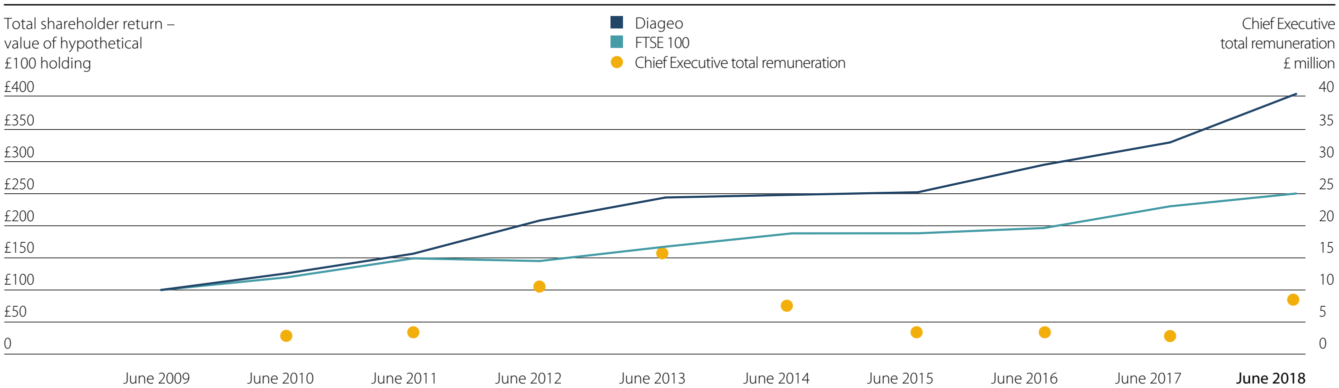
It is intended that a DLTIP award of 480% of salary will be made to Kathryn Mikells in September 2018, comprising 360% of salary in performance shares and 120% of salary in market price share options (in performance share equivalents).

The table below summarises the DLTIP awards to Ivan Menezes and Kathryn Mikells in September 2018.

	Chief Executive Officer	Chief Financial Officer
Grant value (% salary)	Performance share equivalents (1 option: 3 shares)	
Performance shares	375%	360%
Share options	125%	120%
Total	500%	480%

Performance graph and table

The graph below shows the total shareholder return for Diageo and the FTSE100 Index since 30 June 2009 and demonstrates the relationship between pay and performance for the Chief Executive, using current and previously published single total remuneration figures. The FTSE100 Index has been chosen because it is a widely recognised performance benchmark for large companies in the United Kingdom.



	Paul S Walsh £'000	Paul S Walsh £'000	Paul S Walsh £'000	Paul S Walsh £'000	Ivan Menezes(i) £'000	Ivan Menezes(i) £'000	Ivan Menezes(i) £'000	Ivan Menezes(i) £'000	**Ivan Menezes(i) £'000**
Chief Executive total remuneration (includes legacy LTIP awards)	3,231	4,449	11,746	15,557	7,312	3,888	4,156	3,399	**9,063**
Annual incentive (% maximum opportunity)	86%	77%	74%	51%	9%	44%	65%	68%	**70%**
Share options (% maximum opportunity)	100%	100%	100%	100%	71%	0%	0%	0%	**60%**
Performance shares (% maximum opportunity)	0%	0%	65%	95%	55%	33%	31%	0%	**70%**

(i) To enable comparison Ivan Menezes' single total figure of remuneration has been converted into sterling using the average weighted exchange rate for the relevant financial year.

Governance

Directors' shareholding requirements and share and other interests (audited)

The beneficial interests of the Directors in office at 30 June 2018 (and their connected persons) in the ordinary shares (or ordinary share equivalents) of the company are shown in the table below.

	Ordinary shares or equivalent[(i)]					
	11 July 2018	30 June 2018 (or date of departure, if earlier)	30 June 2017 (or date of appointment, if later)	Shareholding requirement (% salary)[(ii)]	Shareholding at 13 July 2018 (% salary)[(ii)]	Shareholding requirement met
Chairman						
Javier Ferrán[(iii)]	148,714	148,415	48,323	–	–	–
Executive Directors						
Ivan Menezes[(iv)]	973,586	973,586	943,854	500%	2115%	Yes
Kathryn Mikells[(iv) (vii)]	37,254	37,245	37,028	400%	123%	No
Non-Executive Directors						
Peggy B Bruzelius	5,000	5,000	5,000	–	–	–
Lord Davies of Abersoch	5,052	5,052	5,052	–	–	–
Betsy D Holden[(iv)]	17,400	17,400	17,400	–	–	–
Susan Kilsby[(v)]	–	–	–	–	–	–
Ho KwonPing	4,463	4,463	4,397	–	–	–
Nicola S Mendelsohn	5,000	5,000	5,000	–	–	–
Philip G Scott[(vi)]	–	2,000	2,000	–	–	–
Alan JH Stewart	6,660	6,660	2,560	–	–	–

Notes
(i) Each person listed beneficially owns less than one percent of Diageo's ordinary shares. Ordinary shares held by Directors have the same voting rights as all other ordinary shares.
(ii) Both the shareholding requirement and shareholding at 11 July 2018 are expressed as a percentage of base salary on 30 June 2018 and calculated using an average share price for the year ended 30 June 2018 of 2544.16 pence.
(iii) Javier Ferrán joined the Board on 22 July 2016, initially in the role of a non-executive director, and was appointed as Chairman on 1 January 2017.
(iv) Ivan Menezes, Kathryn Mikells and Betsy D Holden have share interests in ADRs (one ADR is equivalent to four ordinary shares); the share interests in the table are stated as ordinary share equivalents.
(v) Susan Kilsby was appointed to the Board on 4 April 2018.
(vi) Philip G Scott stepped down from the Board on 20 September 2017.
(vii) Kathryn Mikells has five years from the date of her appointment, that is, until 9 November 2020, to meet the shareholding requirement.

Percentage change in remuneration of the director undertaking the role of Chief Executive

The table below shows a comparison of the percentage change in the Chief Executive's remuneration to the average percentage change in remuneration for the UK and US population from 2017 to 2018. The chosen population represents the most appropriate comparator group for the Chief Executive, as the Committee considers salary increase budgets in these countries when reviewing Executive Directors' base salaries. Furthermore, the majority of Executive Committee members as well as the Executive Directors are on UK or US reward packages.

	Salary	Taxable benefits	Bonus
	% change	% change	% change
Chief Executive percentage change from 2017 to 2018	2%	(20)%	5%
Average % change for the UK and US workforce from 2017 to 2018	4.5%	0%	6%

The percentage change for the Chief Executive is based on the remuneration of Ivan Menezes from 2017 to 2018.

UK salary, benefits and bonus data for both 2017 and 2018 have been converted into US dollars using the cumulative weighted average exchange rate for the year ended 30 June 2018 of £1 = $1.35.

External appointments held by the Executive Directors

Executive Directors may accept external appointments as Non-Executive Directors of other companies and retain any related fees paid to them, subject to the specific approval of the Board in each case.

Ivan Menezes – During the year ended 30 June 2018, Ivan Menezes served as a Non-Executive Director of Tapestry Inc and earned fees of $90,000, which he retained. In line with the Tapestry Inc policy for outside directors, Ivan Menezes is eligible to be granted share options and restricted share units (RSUs). During the year ended 30 June 2018, he was granted 9,338 options at an option price of $40.16 and 1,894 RSUs (including dividends received) at a fair market value of $40.16 per share.

Kathryn Mikells – During the year ended 30 June 2018, Kathryn Mikells served as a Non-Executive Director of Hartford Financial Services Group Inc. and earned fees of $100,000 for the full year, which were deferred into equity.

Non-Executive Directors

Non-Executive Directors' fees

Javier Ferrán's fee as non-executive Chairman effective 1 January 2018 is £600,000 per annum. The Chairman's fee is appropriately positioned against our comparator group of FTSE 30 companies excluding financial services.

The basic fee for Non-Executive Directors was increased from £87,000 to £92,000 effective 1 January 2018 and the additional fee for the Chairman of the Remuneration Committee was increased from £25,000 to £30,000. There was no change to the additional fee for the Chairman of the Audit Committee in the year ended 30 June 2018. The next review is scheduled for January 2020.

Per annum fees	January 2018 £'000	January 2017 £'000
Chairman of the Board	600	600
Non-Executive Directors		
Basic fee	92	87
Senior Non-Executive Director	25	25
Chairman of the Audit Committee	30	30
Chairman of the Remuneration Committee	30	25

Non-Executive Directors' remuneration for the year ended 30 June 2018 (audited)

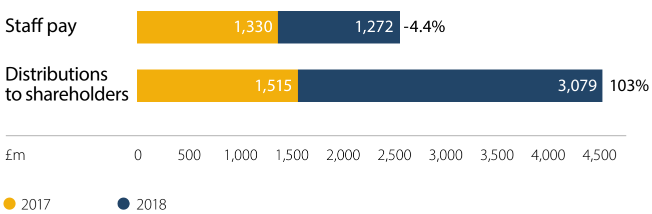
	Fees £'000		Taxable benefits[i] £'000		Total £'000	
	2018	2017	2018	2017	2018	2017
Chairman						
Javier Ferrán[ii]	600	338	2	1	602	339
Non-Executive Directors						
Lord Davies of Abersoch	142	137	3	2	145	139
Peggy B Bruzelius	90	87	5	3	95	90
Betsy D Holden	90	87	11	6	101	93
Susan Kilsby[iv]	22	–	1	–	23	–
Ho KwonPing	90	87	1	1	91	88
Nicola S Mendelsohn	90	87	1	1	91	88
Philip G Scott[iii]	19	102	4	13	23	115
Alan JH Stewart	120	102	2	1	122	103

(i) Taxable benefits include a contracted car service, product allowance and expense reimbursements relating to travel, accommodation and subsistence in connection with the attendance of Board meetings during the year, which are deemed by HMRC to be taxable in the United Kingdom. The amounts in the single figure of total remuneration table above include the grossed-up cost of UK tax paid by the company on behalf of the directors. Non-taxable expense reimbursements have not been included in the single figure of remuneration table above.
(ii) £50,000 of Javier Ferrán's net remuneration in the year ended 30 June 2018 was used for the monthly purchase of Diageo ordinary shares, which must be retained until he retires from the company or ceases to be a Director for any other reason.
(iii) Philip G Scott stepped down from the Board on 20 September 2017.
(iv) Susan Kilsby was appointed to the Board on 4 April 2018.

Relative importance of spend on pay

The graph below illustrates the relative importance of spend on pay (total remuneration of all group employees) compared with distributions to shareholders (including the share buyback programme but excluding transaction costs), and the percentage change from the year ended 30 June 2017 to the year ended 30 June 2018. Distributions to shareholders are total dividends. The Committee considers that there are no other significant distributions or payments of profit or cash flow.

Relative importance of spend on pay – percentage change



Remuneration committee

The Remuneration Committee consists of the following independent Non-Executive Directors: Peggy B Bruzelius, Lord Davies of Abersoch, Betsy D Holden, Ho KwonPing, Nicola S Mendelsohn, Alan JH Stewart and Susan Kilsby. Philip G Scott was a member of the Remuneration Committee until he stepped down from the Board on 20 September 2017. Lord Davies is the Chairman of the Remuneration Committee. The Chairman of the Board and the Chief Executive may, by invitation, attend Remuneration Committee meetings except when their own remuneration is discussed. Diageo's Global Human Resources Director and Global Performance and Reward Director are also invited from time to time by the Remuneration Committee to provide their views and advice. The Chief Executive and Global Human Resources Director are not present when their own remuneration is discussed. The Chief Financial Officer may also attend to provide performance context to the Committee during its discussions about target setting. Information on meetings held and director attendance is disclosed in the corporate governance report.

The Remuneration Committee's principal responsibilities are:

- Making recommendations to the Board on remuneration policy as applied to the Executive Directors and the Executive Committee;
- Setting, reviewing and approving individual remuneration arrangements for the Chairman of the Board, Executive Directors and Executive Committee members including terms and conditions of employment;
- Determining arrangements in relation to termination of employment of the Executive Directors and other designated senior executives;
- Making recommendations to the Board concerning the introduction of any new share incentive plans which require approval by shareholders; and
- Ensuring that remuneration outcomes are appropriate in the context of underlying business performance, that remuneration practices are implemented in accordance with the approved remuneration policy, and that remuneration does not raise environmental, social and governance issues by inadvertently motivating irresponsible behaviour.

Full terms of reference for the Committee are available at **www.diageo.com** and on request from the Company Secretary.

External advisors

During the year ended 30 June 2018, the Remuneration Committee received advice from Mercer, (appointed by the Committee in December 2013 following a tendering process), who provided independent advice on remuneration best practice and senior executive remuneration.

Mercer is a signatory to, and abides by, the Remuneration Consultants Group Code of Conduct. Further details can be found at **www.remunerationconsultantsgroup.com**. Mercer, provides unrelated services to the company in the areas of all-employee reward and retirement benefits. The Remuneration Committee is satisfied that the advice it receives from Mercer is independent. During the year, Mercer supported the Committee in preparing this Directors' remuneration report, provided remuneration benchmarking survey data to support the salary review for the Executive Committee, provided advice on the design of the long-term incentives, and calculated the TSR of Diageo and its peer companies for the 2014 PSP and 2015 DLTIP awards and provided periodic updates on all outstanding performance cycles. The fees paid to Mercer in relation to advice provided to the Committee were £77,059 and are determined on a time and expenses basis.

Clifford Chance provided advice on the operation of share plans during the year. Fees paid in relation to this advice, again on a time and expenses basis, were £5,969.

The Committee is satisfied that the Kepler and Clifford Chance engagement partners and teams that provide remuneration advice to the Committee do not have connections with Diageo that may impair their independence. The Committee reviewed the potential for conflicts of interest and judged that there were appropriate safeguards against such conflicts.

Statement of voting

The following table summarises the details of votes cast in respect of the resolutions on the directors' remuneration policy and Directors' remuneration report at the 2017 AGM.

		For	Against	Total votes cast	Abstentions
Directors' remuneration policy	Total number of votes	1,905,251,510	75,507,013	1,980,758,523	2,048,247
	Percentage of votes cast	96.19%	3.81%	100%	n/a
Annual report on remuneration	Total number of votes	1,915,370,899	54,745,724	1,970,116,623	12,690,154
	Percentage of votes cast	97.22%	2.78%	100%	n/a

The Committee was pleased with the level of support shown for the remuneration policy and implementation report and appreciated the active participation of shareholders and their representative advisory bodies in consulting on executive remuneration matters.

Additional information

Emoluments and share interests of senior management

The total emoluments for the year ended 30 June 2018 of the Executive Directors, the Executive Committee members and the Company Secretary (together, the senior management) of Diageo comprising base salary, annual incentive plan, share incentive plan, termination payments and other benefits were £20.3 million (2017 – £21.8 million).

The aggregate amount of gains made by the senior management from the exercise of share options and from the vesting of awards during the year was £4.2 million. In addition, they were granted 1,056,527 performance-based share options under the Diageo Long-Term Incentive Plan (DLTIP) during the year at a weighted average share price of 2580 pence, exercisable by 2027 and no options were granted under DLTIP that are not subject to performance. In addition they were granted 3,769 options over ordinary shares under the UK savings-related share options scheme (SAYE). They were also awarded 1,001,495 performance shares under the DLTIP in September 2017, which will vest in three years subject to the performance tests described in the section on DLTIP awards made during the year ended 30 June 2018 and 51,451 shares under the DIP, which will vest in September 2020 subject to individually assigned performance conditions.

Senior management options over ordinary shares

At 13 July 2018, the senior management had an aggregate beneficial interest in 2,017,696 ordinary shares in the company and in the following options over ordinary shares in the company:

	Number of options	Weighted average exercise price	Option period
Ivan Menezes	768,144	1,965p	2014 – 2027
Kathryn Mikells	258,804	2,346p	2019 – 2027
Other(i)	2,560,991	1,979p	2012 – 2027
	3,587,939		

(i) Other members of the Executive Committee and the Company Secretary.

Key management personnel related party transactions (audited)

Key management personnel of the group comprises the Executive and Non-Executive Directors, the members of the Executive Committee and the Company Secretary.

Diageo plc has granted rolling indemnities to the Directors and the Company Secretary, uncapped in amount, in relation to certain losses and liabilities which they may incur in the course of acting as Directors or Company Secretary (as applicable) of Diageo plc or of one or more of its subsidiaries. These indemnities continue to be in place at 30 June 2018.

Other than disclosed in this report, no Director had any interest, beneficial or non-beneficial, in the share capital of the company. Save as disclosed above, no Director has or has had any interest in any transaction which is or was unusual in its nature, or which is or was significant to the business of the group and which was effected by any member of the group during the financial year, or which having been effected during an earlier financial year, remains in any respect outstanding or unperformed. There have been no material transactions during the last three years to which any Director or officer, or 3% or greater shareholder, or any spouse or dependent thereof, was a party. There is no significant outstanding indebtedness to the company from any Directors or officer or 3% or greater shareholder.

Statutory and audit requirements

This report was approved by a duly authorised Committee of the Board of Directors, on 24 July 2018 and was signed on its behalf by Lord Davies of Abersoch who is senior Non-Executive Director and Chairman of the Remuneration Committee.

The Board has followed the principles of good governance as set out in the UK Corporate Governance Code and complied with the regulations contained in the Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the Listing Rules of the Financial Conduct Authority and the relevant schedules of the Companies Act 2006.

The Companies Act 2006 and the Listing Rules require the company's auditor to report on the audited information in their report and to state that this section has been properly prepared in accordance with these regulations.

PWC LLP has audited the report to the extent required by the Regulations, being the sections headed Single total figure of remuneration for Executive Directors (and notes), Annual incentive plan (AIP), Long-term incentive plans (LTIPs), Pension arrangements, Directors' shareholding requirements and share and other interests, Outstanding share plan interests, Non-Executive Directors' remuneration and Key management personnel related party transactions.

The annual report on remuneration is subject to shareholder approval at the AGM on 20 September 2018; the directors' remuneration policy was approved by shareholders at the 2017 AGM.

Terms defined in this remuneration report are used solely herein.

Directors' report

The Directors have pleasure in submitting their Annual Report for the year ended 30 June 2018.

Annual General Meeting

The AGM will be held at The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB at 2.30pm on Thursday, 20 September 2018.

Directors

The Directors of the company who served during the year are shown in the section 'Board of Directors and Company Secretary' and 'Executive Committee' above.

In accordance with the UK Corporate Governance Code all the Directors will retire by rotation at the AGM and offer themselves for re-election with the exception of Peggy Bruzelius and Betsy Holden, who will retire at the end of the AGM.

Further details of Directors' contracts, remuneration and their interests in the shares of the company at 30 June 2018 are given in the Directors' remuneration report.

The Directors' powers are determined by UK legislation and Diageo's articles of association. The Directors may exercise all the company's powers provided that Diageo's articles of association or applicable legislation do not stipulate that any powers must be exercised by the members.

Auditor

The auditor, PricewaterhouseCoopers LLP, is willing to continue in office and a resolution for its re-appointment as auditor of the company will be submitted to the AGM.

Disclosure of information to the auditor

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditor is unaware; and each Director has taken all reasonable steps to ascertain any relevant audit information and to ensure that the company's auditor is aware of that information.

Corporate governance statement

The corporate governance statement, prepared in accordance with rule 7.2 of the Financial Conduct Authority's Disclosure Guidance and Transparency Rules, comprises the following sections of the Annual Report: the 'Corporate governance report', the 'Report of the Audit Committee' and the 'Additional information for shareholders'.

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for Diageo's counterparties upon a change of control of the company.

Under the partners agreement governing the company's 34% investment in Moët Hennessy SAS (MH) and Moët Hennessy International SAS (MHI), if a Competitor (as defined therein) directly or indirectly takes control of the company (which, for these purposes, would occur if such competitor acquired more than 34% of the voting rights or equity interests in the company), LVMH Moët Hennessy – Louis Vuitton SA (LVMH) may require the company to sell its interests in MH and MHI to LVMH.

The master agreement governing the operation of the group's market level distribution joint ventures with LVMH states that if any person acquires interests and rights in the company resulting in a Control Event (as defined) occurring in respect of the company, LVMH may within 12 months of the Control Event either appoint and remove the chairman of each joint venture entity governed by such master agreement, who shall be given a casting vote, or require each distribution joint venture entity to be wound up. Control Event for these purposes is defined as the acquisition by any person of more than 30% of the outstanding voting rights or equity interests in the company, provided that no other person or entity (or group of affiliated persons or entities) holds directly or indirectly more than 30% of the voting rights in the company.

Employment policies

A key strategic imperative of the company is to attract, retain and grow a pool of diverse, talented employees. Diageo recognises that a diversity of skills and experiences in its workplace and communities will provide a competitive advantage. To enable this the company has various global employment policies and standards, covering such issues as resourcing, human rights, health, safety and wellbeing. These policies and standards seek to ensure that the company treats current or prospective employees justly, solely according to their abilities to meet the requirements and standards of their role and in a fair and consistent way. This includes giving full and fair consideration to applications from prospective employees who are disabled, having regard to their aptitudes and abilities, and not discriminating against employees under any circumstances (including in relation to applications, training, career development and promotion) on the grounds of any disability.

Other information

Other information relevant to the Directors' report may be found in the following sections of the Annual Report:

Information (including that required by UK Listing Authority Listing Rule 9.8.4)	Location in Annual Report
Agreements with controlling shareholders	Not applicable
Amendment of articles of association	Additional information for shareholders – Articles of association
Contracts of significance	Not applicable
Details of long-term incentive schemes	Directors' Remuneration Report
Directors – appointment and powers	Additional information for shareholders – Articles of association – directors
Directors' indemnities and compensation	Directors' remuneration report – Directors' remuneration policy and Additional information; Financial statements – note 20 Related party transactions
Dividends	Financial Statements – Unaudited financial information and group financial review
Employment policies	Strategic report – How we will deliver our Performance Ambition; Strategic report – How we protect our business: risk management and principal risks; Strategic report – Sustainability & responsibility review
Events since 30 June 2018	Financial statements – note 22 Post balance sheet events
Financial risk management	Financial statements – note 15 Financial instruments and risk management
Future developments	Chairman's statement; Chief Executive's Statement; Market Dynamics
Greenhouse gas emissions	Strategic report – Sustainability & responsibility review – Reducing our environmental impact; Additional information for shareholders – External limited assurance of selected sustainability & responsibility performance data
Interest capitalised	Not applicable
Non pre-emptive issues of equity for cash (including in respect of major unlisted subsidiaries)	Not applicable
Parent participation in a placing by a listed subsidiary	Not applicable
Political donations	Corporate governance report
Provision of services by a controlling shareholder	Not applicable
Publication of unaudited financial information	Unaudited financial information
Purchase of own shares	Additional information for shareholders – Repurchase of shares; Financial statements – note 17 Equity
Research and development	Financial statements – note 3 Operating costs
Restrictions on transfer of securities	Additional information for shareholders – Restrictions on transfer of shares
Review of the business & principal risks and uncertainties	Chief Executive's statement; Strategic report: How we protect our business: risk management and principal risks
Share capital – structure, voting and other rights	Additional information for shareholders – Share capital and Articles of association; Financial statements – note 17 Equity
Share capital – employee share plan voting rights	Financial statements – note 17 Equity
Shareholdings in the company	Additional information for shareholders – Share capital
Shareholder waivers of dividends	Financial statements – note 17 Equity
Shareholder waivers of future dividends	Financial statements – note 17 Equity
Sustainability and responsibility	Strategic report – How we protect our business: risk management and principal risks; Strategic report – Sustainability & responsibility review
Waiver of emoluments by a director	Not applicable
Waiver of future emoluments by a director	Not applicable

The Directors' report of Diageo plc for the year ended 30 June 2018 comprises these pages and the sections of the Annual Report referred to under 'Directors', 'Corporate governance statement' and 'Other information' above, which are incorporated into the Directors' report by reference. In addition, certain disclosures required to be contained in the Directors' report, have been incorporated into the 'Strategic report' as set out in 'Other information' above.

The Directors' Report, which has been approved by a duly appointed and authorised committee of the Board of Directors, was signed on its behalf by David Harlock, the Company Secretary, on 25 July 2018.

Financial statements:

Introduction and contents

Introduction

The financial statements of the group are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the European Union (EU) and as issued by the International Accounting Standards Board (IASB).

The financial statements of Diageo plc (the company) are prepared in accordance with the Companies Act 2006 and in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

The financial statements also include 'Unaudited Financial Information' which is not required by the relevant accounting standards or other regulations but management believes this section provides important additional information.

Contents

Independent auditor's report to the members of Diageo plc

Report on the audit of the financial statements

Opinion

In our opinion:

- Diageo plc's group financial statements and company financial statements (the 'financial statements') give a true and fair view of the state of the group's and of the company's affairs as at 30 June 2018 and of the group's profit and cash flows for the year then ended;
- The group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- The company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law); and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report, which comprise: the consolidated and company balance sheets as at 30 June 2018; the consolidated income statement and consolidated statement of comprehensive income for the year then ended; the consolidated and company statements of changes in equity for the year then ended; and the consolidated statement of cash flows for the year then ended; and the notes to the group and company financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Separate opinion in relation to IFRSs as issued by the IASB

As explained in note 1 to the group financial statements, the group, in addition to applying IFRSs as adopted by the European Union, has also applied IFRSs as issued by the International Accounting Standards Board (IASB).

In our opinion, the group financial statements have been properly prepared in accordance with IFRSs as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the United Kingdom, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the company.

Other than those disclosed in note 3b to the financial statements, we have provided no other non-audit services to the group or the company in the period from 1 July 2017 to 30 June 2018.

Our audit approach
Overview

Materiality

- Group financial statements: £193 million (2017: £179 million), based on 5% of profit before taxation and exceptional items (as defined in note 4 to the group financial statements).
- Company financial statements: £96 million (2017: £97 million), based on 0.5% of net assets. For the purposes of the group audit, we applied a lower materiality of £21 million (2017: £20 million) to company balances and transactions, other than those which were eliminated on consolidation in the group financial statements.

Audit scope

- We conducted full scope audit work in nine countries in which the group has significant operations. Our work also covered the five group shared service centres.
- In addition, we performed the audit of specific balances and transactions in four countries, and obtained reporting over the financial information of Moët Hennessy, the group's principal associate, from its auditor.
- During the year, the group engagement team visited eight countries where full scope audits were performed, four shared service centres and two of the countries where audits of specific balances and transactions took place.

Areas of focus

- Carrying value of goodwill and intangible assets (group)
- Uncertain tax positions in respect of direct and indirect taxes (group)
- Presentation of exceptional items (group)
- Provisions and contingent liabilities (group and company)
- Post-employment benefit obligations (group).
- Business combinations (group)

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the group and the industry in which it operates, and considered the risk of acts by the group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the group and company financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, UK tax legislation and equivalent local laws and regulations applicable to significant component teams. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with legal advisors, enquiries of management, review of significant component auditors' work and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit

<table>
<tr><th>Key audit matter</th><th>How our audit addressed the key audit matter</th></tr>
<tr><td>Carrying value of goodwill and intangible assets (group)
Refer to the Report of the Audit Committee and note 10 – Intangible assets
The group has goodwill of £2,678 million, indefinite-lived brand intangibles of £8,330 million and other intangible assets of £1,564 million as at 30 June 2018, included within 21 cash generating units ('CGUs').
Goodwill and indefinite-lived intangible assets must be tested for impairment on at least an annual basis. The determination of recoverable amount, being the higher of value-in-use and fair value less costs to dispose, requires estimations on the part of management in both identifying and then valuing the relevant CGUs. Recoverable amounts are based on management's assumptions of variables and market conditions such as future price and volume growth rates, the timing of future operating expenditure, and the most appropriate discount and long term growth rates.
An impairment charge was recognised in respect of the Meta brand, related other assets and goodwill allocated to the Africa Regional Markets (ARM) CGU of £40 million, £38 million and £50 million, respectively.
Management has determined that the CGU containing the USL goodwill and the Windsor Premier brand are sensitive to reasonably possible changes in the assumptions used, which could result in the calculated recoverable amount being lower than the carrying value of the CGU or the brand. In addition, the ARM CGU remains sensitive as not all of the goodwill has been impaired and therefore any further deterioration in the forecast plan would result in an additional impairment charge. Additional sensitivity disclosure has been included in the group financial statements in respect of these CGUs.</td><td>We evaluated the appropriateness of management's identification of the group's CGUs and tested the operation of the group's controls over the impairment assessment process, which we found to be satisfactory for the purposes of our audit.
Our audit procedures included challenging management on the appropriateness of the impairment models and reasonableness of the assumptions used, focusing in particular on the CGU containing the USL goodwill, the ARM CGU, the Meta and Windsor Premier brands, through performing the following:
• Benchmarking Diageo's key market-related assumptions in the models, including discount rates, long term growth rates and exchange rates, against external data, using our valuation expertise;
• Assessing the reliability of cash flow forecasts through a review of actual past performance and comparison to previous forecasts;
• Testing the mathematical accuracy and performing sensitivity analyses of the models;
• Understanding the commercial prospects of the assets, and where possible comparison of assumptions with external data sources;
• For the ARM CGU and Meta brand, we specifically assessed the trigger for the impairment charge in the period including the current challenges faced by the business, how these have impacted performance, and whether they were appropriately reflected in the revised forecast growth rates; and
• For USL goodwill, we assessed the reasonableness of the forecasts by challenging the assumptions in respect of growth strategies in the Indian market.
We assessed the appropriateness and completeness of the related disclosures in note 10 of the group financial statements, including the sensitivities provided in respect of USL goodwill, the ARM CGU and the Windsor Premier brand, and considered them to be reasonable.
Based on our procedures, we noted no material exceptions and considered management's key assumptions to be within reasonable ranges.</td></tr>
</table>

Key audit matter	How our audit addressed the key audit matter
Uncertain tax positions in respect of direct and indirect taxes (group) *Refer to the Report of the Audit Committee, note 7 – Taxation and note 18 – Contingent liabilities and legal proceedings* The group operates across a large number of jurisdictions and is subject to periodic challenges by local tax authorities on a range of tax matters during the normal course of business, including transfer pricing, direct and indirect taxes, and transaction related tax matters. As at 30 June 2018, the group has corporate tax receivables of £65 million, corporate tax payables of £243 million, deferred tax assets of £122 million and deferred tax liabilities of £1,987 million. Where the amount of tax payable is uncertain, the group establishes provisions based on management's judgement of the likelihood of settlement being required. We focused on the judgements made by management in assessing the likelihood of potentially material exposures and the estimates used to determine such provisions where required. In particular, we focused on the impact of changes in local tax regulations and ongoing inspections by local tax authorities and international bodies, which could materially impact the amounts recorded in the group financial statements. This included evaluating the impact of the European Commission's state aid investigation, the assessment for transfer pricing issued by HM Revenue & Customs in the United Kingdom, indirect tax assessments in developing markets and assessments relating to financing and transfer pricing structures.	We evaluated the design and implementation of controls in respect of identifying uncertain tax positions, which we found to be satisfactory for the purposes of our audit. We also evaluated the related accounting policy for provisioning for tax exposures and found it to be appropriate. We used our tax specialists to gain an understanding of the current status of tax assessments and investigations and to monitor developments in ongoing disputes. We read recent rulings and correspondence with local tax authorities, as well as external advice provided by the group's tax experts and legal advisors where relevant, to satisfy ourselves that the tax provisions had been appropriately recorded or adjusted to reflect the latest developments. Where the basis for the conclusion reached was less clear, we challenged the legal advisors and tax experts on how their view was reached. We challenged management's key assumptions, in particular on cases where there had been significant developments with tax authorities, noting no significant deviations from our expectations. In respect of the transfer pricing agreement with HMRC during the period, we read the correspondence and the basis of the agreement to obtain the necessary comfort over the classification and quantum of the balances recorded within the financial statements. We assessed the appropriateness of the related disclosures in notes 7 and 18 of the group financial statements, and considered them to be reasonable.
Presentation of exceptional items (group) *Refer to the Report of the Audit Committee and note 4 – Exceptional items* In the past few years the group has reported significant levels of exceptional items separately within the consolidated income statement which are excluded from management's reporting of the underlying results of the group. The nature of these exceptional items is explained within the group accounting policy and includes gains or losses arising on acquisitions or disposals, impairment charges or reversals, and costs resulting from non-recurring legal or regulatory matters. This year the group has reported £128 million of net operating exceptional costs and £203 million of net tax exceptional gains, which are primarily in respect of: • An impairment charge in respect of the Meta brand, related other assets and goodwill allocated to the Africa Regional Markets (ARM) CGU; • An exceptional tax credit primarily resulted from applying the Tax Cuts and Jobs Act (TCJA) enacted on 22 December 2017 in the United States; and • An exceptional tax charge in respect of the transfer pricing agreement with HM Revenue & Customs. Our specific area of focus was to assess whether the items identified by management as exceptional met the definition of the group's accounting policy (i.e. are exceptional in nature and value) and have been treated consistently, as the identification of such items requires judgement by management. Consistency in the identification and presentation of these items is important to ensure the comparability of year on year reporting.	We evaluated the design and implementation of controls in respect of exceptional items, which we found to be satisfactory for the purposes of our audit. We considered the judgements within management's accounting papers for the one-off transactions, and obtained corroborative evidence for the items presented as exceptional items. We considered these to be supportable. The audit procedures pertaining to the impairment charge in respect of Meta and the ARM CGU are summarised under the 'Carrying value of goodwill and intangible assets' section above. We tested management's calculation for the TCJA, including the mathematical accuracy and completeness of the benefit recognised. We engaged our tax experts to also assess the completeness of the adjustment in respect of the impact on corporate taxes, deferred taxes and the associated tolling charge and assessed these as having been appropriately considered. We challenged management's rationale for the designation of certain items as exceptional and assessed such items against the group's accounting policy considering the nature and value of the items. We assessed the appropriateness and completeness of the disclosures in note 4 and other related notes to the group financial statements, and checked that these reflected the output of management's accounting papers, noting no significant deviations from our expectations. We also considered whether there were items that were recorded within underlying profit that we determined to be exceptional in nature and should have been reported within 'exceptional items'. No such material items were identified.

Key audit matter	How our audit addressed the key audit matter
Provisions and contingent liabilities (group and company) *Refer to the Report of the Audit Committee, note 14(d) – Working capital (provisions) and note 18 – Contingent liabilities and legal proceedings* The group faces a number of threatened and actual legal and regulatory cases. There is a high level of judgement required in assessing the likelihood of settlement and the disclosures required. There is also estimation risk in assessing the level of potential exposure that may exist.	We evaluated the design and implementation of controls in respect of litigation and regulatory matters, which we found to be satisfactory for the purposes of our audit. Our procedures included the following: • Where relevant, reading external legal advice obtained by management to assess the likelihood and quantum of the potential liability; • Discussing open matters and developments with the group and regional general counsel; • Meeting with regional and local management and reading relevant correspondence; • Assessing and challenging management's conclusions through understanding precedents set in similar cases to assess management's judgments and estimates of the liability where relevant; and • Circularising relevant third party legal representatives, together with follow up discussions, where appropriate, on certain cases. Based on the evidence obtained, whilst noting the inherent uncertainty with such legal and regulatory matters, we determined that the level of provisioning at 30 June 2018 is appropriate. We assessed the appropriateness of the related disclosures in notes 14(d) and 18 of the group financial statements, and consider them to be reasonable.
Post-employment benefit obligations (group) *Refer to the Report of the Audit Committee and note 13 – Post- employment benefits* The group has approximately 40 defined benefit post employment plans. The total present value of obligations is £9,244 million at 30 June 2018, which is significant in the context of the overall balance sheet of the group. The group's most significant plans are in the United Kingdom, Ireland and North America. The valuation of pension plan liabilities requires estimation in determining appropriate assumptions such as salary increases, mortality rates, discount rates, inflation levels and the impact of any changes in individual pension plans. Movements in these assumptions can have a material impact on the determination of the liability. Management uses external actuaries to assist in determining these assumptions.	We evaluated the design and implementation of controls in respect of post-employment benefit obligations, which we found to be satisfactory for the purposes of our audit. We used our actuarial experts to assess whether the assumptions used in calculating the liabilities for the United Kingdom, Ireland and North America pension plans were reasonable, by performing the following: • Assessing whether salary increases and mortality rate assumptions were consistent with the specifics of each plan and, where applicable, with relevant national and industry benchmarks; • Verifying that the discount and inflation rates used were consistent with our internally developed benchmarks and in line with other companies' recent external reporting; and • Reviewing the calculations prepared by external actuaries to assess the consistency of the assumptions used. Based on our procedures, we noted no exceptions and considered management's key assumptions to be within reasonable ranges. We assessed the appropriateness of the related disclosures in note 13 of the group financial statements, and consider them to be reasonable.

Key audit matter	How our audit addressed the key audit matter
Business combinations (group) *Refer to the Report of the Audit Committee and note 9 – Acquisition and sale of businesses and purchase of non-controlling interests* The group completed the acquisition of Casamigos Tequila, LLC during the year for a total consideration of £721 million, recognising a brand intangible asset of £469 million and goodwill of £237 million. Accounting for business combinations is an area of focus as it can involve judgements and estimates in relation to the value of assets and liabilities that are recognised on acquisition, particularly the allocation of purchase consideration to goodwill and separately identified intangible assets.	We obtained the purchase price allocation performed by management's valuation experts and considered their methodology and assumptions using our own valuation experts. In particular, our experts assessed the growth projections, market participant synergies, margin evolution and discount rates as well as the integrity and mechanical accuracy of management's valuation model. This evaluation included benchmarking growth and profitability ratios to comparable brands of the group. In assessing the above factors we also considered whether any intangibles in addition to the brand were acquired and considered management's judgment that no further assets should be recognised to be supportable. We also performed sensitivity analysis over certain assumptions such as sales volume and the discount rate used in management's valuation. We determined that the cash flows applied within the valuation models and the key assumptions were appropriate. We understood management's opening balance sheet adjustments and obtained supporting evidence to corroborate these.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the geographic structure of the group, the accounting processes and controls, and the industry in which the group operates.

The group operates as 21 geographically based markets across five regions, together with supply and corporate functions. These markets report through a significant number of individual reporting components, which are supported by the group's five principal shared service centres in Hungary, Kenya, Colombia, India and the Philippines. The outputs from these shared service centres are included in the financial information of the reporting components they service, and therefore are not separate reporting components. In establishing the overall approach to the group audit, we determined the type of work that needed to be performed at reporting components by us, as the group engagement team, or component auditors from either other PwC network firms or the non-PwC firm operating under our instruction. This included consideration of the procedures required to be performed by our audit teams at the group's shared service centres to support our component auditors.

We identified two reporting components which, in our view, required an audit of their complete financial information, due to their significance to the group. Those reporting components were North America and USL. A further 12 reporting components had an audit of their complete financial information, either due to their size or their risk characteristics, which included six operating and three treasury reporting components. We audited specific balances and transactions at a further six reporting components, and obtained reporting over the financial information of Moët Hennessy, the group's principal associate, from its auditor, primarily to ensure appropriate audit coverage. The work performed at each of the five shared services centres, including testing of transaction processing and controls, supported the financial information of the reporting components they service.

Certain specific audit procedures over central corporate functions and areas of significant judgement, including goodwill and intangible assets, business combinations, taxation, and material provisions and contingent liabilities, were performed at the group's head office. We also performed work centrally on systems and IT general controls, consolidation journals and the one-off transactions undertaken by the group during the year.

Together, the central and component locations at which work was performed by the group engagement team and component auditors accounted for 71% of group net sales, 84% of group total assets, and 63% of group profit before tax and exceptional items, with work performed by the group engagement team over exceptional items contributing a further 1% coverage over group profit before tax (total of 64%). At the group level, we also carried out analytical and other procedures on the reporting components not covered by the procedures described above.

Where the work was performed by component auditors, including by our shared service centre auditors, we determined the level of involvement we needed to have in the audit work at those locations to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the group financial statements as a whole. We issued formal, written instructions to component auditors setting out the work to be performed by each of them and maintained regular communication throughout the audit cycle. These interactions included attending component clearance meetings and holding regular conference calls, as well as reviewing and assessing matters reported.

Senior members of the group engagement team also visited 13 component locations (in eight countries) in scope for an audit of their complete financial information, as well as four of the shared centre locations and four of the components (two countries) where audits of specific balances and transactions took place. These visits included meetings with local management and with the component auditors, as well as certain operating site tours. The group engagement partners also attended the year-end clearance meetings for North America and USL, and the group engagement team reviewed the audit working papers for these components and certain other components.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£193 million (2017: £179 million).	£96 million (2017: £97 million). For the purposes of the audit of the group financial statements, we applied a lower materiality of £21 million (2017: £20 million) to all balances and transactions, other than those which eliminated on consolidation in the group financial statements.
How we determined it	5% of profit before taxation and exceptional items (as defined in note 4 to the group financial statements).	Materiality of £96 million for the company financial statements was based on 0.5% of net assets. Our lower materiality of £21 million for the line items set out above was based on our calculation and allocation of component materiality for the group audit.
Rationale for benchmark applied	We consider an adjusted measure to be one of the principal considerations for the members of Diageo plc in assessing the recurring financial performance of the group as it best represents results from underlying operations.	The results of procedures performed over balances and transactions contributing to the group's overall results were used to support our group opinion. Balances and transactions that eliminate on consolidation were audited to a higher materiality. We consider a net asset measure to reflect the nature of the company, which primarily acts as a holding company for the group's investments and holds certain liabilities on the balance sheet.

For each component in the scope of our group audit, we allocated a materiality that is less than our overall group materiality. The range of materiality allocated across components was between £10 million and £140 million. Certain components were audited to a local statutory audit materiality that was also less than our overall group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £10 million (2017: £7 million) for both the group and company as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the directors' identification of any material uncertainties to the group's and the company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the group's and company's ability to continue as a going concern.
We are required to report if the directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the year ended 30 June 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the group and company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report. (CA06)

The directors' assessment of the prospects of the group and of the principal risks that would threaten the solvency or liquidity of the group

We have nothing material to add or draw attention to regarding:

- The directors' confirmation on page 66 of the Annual Report that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The directors' explanation on page 19 of the Annual Report as to how they have assessed the prospects of the group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the directors' statement that they have carried out a robust assessment of the principal risks facing the group and statement in relation to the longer-term viability of the group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the 'Code'); and considering whether the statements are consistent with the knowledge and understanding of the group and company and their environment obtained in the course of the audit. (Listing Rules).

Other Code provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the directors, on page 67, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the group's and company's position and performance, business model and strategy is materially inconsistent with our knowledge of the group and company obtained in the course of performing our audit.
- The section of the Annual Report on page 69 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The directors' statement relating to the company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

- As explained more fully in the Responsibility statement set out on page 67, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.
- In preparing the financial statements, the directors are responsible for assessing the group's and the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

- Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
- A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: **www.frc.org.uk/auditorsresponsibilities**. This description forms part of our auditor's report.

Use of this report

- This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- We have not received all the information and explanations we require for our audit; or
- Adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- Certain disclosures of directors' remuneration specified by law are not made; or
- The company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns.
- We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 23 September 2015 to audit the financial statements for the year ended 30 June 2016 and subsequent financial periods. The period of total uninterrupted engagement is three years, covering the years ended 30 June 2016 to 30 June 2018.

Ian Chambers (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
25 July 2018

Consolidated income statement

	Notes	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Sales	2	**18,432**	18,114	15,641
Excise duties	3	**(6,269)**	(6,064)	(5,156)
Net sales	2	**12,163**	12,050	10,485
Cost of sales	3	**(4,634)**	(4,680)	(4,251)
Gross profit		**7,529**	7,370	6,234
Marketing	3	**(1,882)**	(1,798)	(1,562)
Other operating expenses	3	**(1,956)**	(2,013)	(1,831)
Operating profit		**3,691**	3,559	2,841
Non-operating items	4	**–**	20	123
Finance income	5	**243**	235	262
Finance charges	5	**(503)**	(564)	(589)
Share of after tax results of associates and joint ventures	6	**309**	309	221
Profit before taxation		**3,740**	3,559	2,858
Taxation	7	**(596)**	(732)	(496)
Profit from continuing operations		**3,144**	2,827	2,362
Discontinued operations	8	**–**	(55)	–
Profit for the year		**3,144**	2,772	2,362

Attributable to:			
Equity shareholders of the parent company – continuing operations	**3,022**	2,717	2,244
Equity shareholders of the parent company – discontinued operations	**–**	(55)	–
Non-controlling interests – continuing operations	**122**	110	118
	3,144	2,772	2,362

Weighted average number of shares	**million**	million	million
Shares in issue excluding own shares	**2,484**	2,512	2,508
Dilutive potential ordinary shares	**11**	11	10
	2,495	2,523	2,518

Basic earnings per share	**pence**	pence	pence
Continuing operations	**121.7**	108.2	89.5
Discontinued operations	**–**	(2.2)	–
	121.7	106.0	89.5
Diluted earnings per share			
Continuing operations	**121.1**	107.7	89.1
Discontinued operations	**–**	(2.2)	–
	121.1	105.5	89.1

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of comprehensive income

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million	Year ended 30 June 2016 £ million
Other comprehensive income			
Items that will not be recycled subsequently to the income statement			
Net remeasurement of post employment plans			
– group	456	649	(851)
– associates and joint ventures	2	(8)	(4)
– non-controlling interests	1	3	(1)
Tax on post employment plans	(91)	(122)	166
	368	522	(690)
Items that may be recycled subsequently to the income statement			
Exchange differences on translation of foreign operations			
– group	(631)	105	1,217
– associates and joint ventures	3	120	325
– non-controlling interests	(72)	35	176
Net investment hedges	91	(224)	(843)
Exchange gain/(loss) recycled to the income statement			
– on translation of foreign operations	–	–	133
– on net investment hedges	–	–	(82)
Tax on exchange differences – group	7	(2)	(8)
Tax on exchange differences – non-controlling interests	2	–	4
Effective portion of changes in fair value of cash flow hedges			
– hedge of foreign currency debt of the group	(64)	(8)	249
– transaction exposure hedging of the group	22	(26)	(221)
– hedges by associates and joint ventures	(15)	5	3
– recycled to income statement – hedge of foreign currency debt of the group	6	(42)	(211)
– recycled to income statement – transaction exposure hedging of the group	(7)	142	68
– recycled to income statement – commodity price risk of the group	–	1	(2)
Tax on effective portion of changes in fair value of cash flow hedges	14	(3)	3
Fair value movements on available-for-sale investments			
– group	–	–	4
– non-controlling interests	–	–	4
– recycled to income statement – group	–	–	(15)
– recycled to income statement – non-controlling interests	–	–	(13)
Tax on available-for-sale fair value movements	–	–	4
Hyperinflation adjustment	11	47	6
Tax on hyperinflation adjustment	(11)	(21)	(2)
	(644)	129	799
Other comprehensive (loss)/profit, net of tax, for the year	(276)	651	109
Profit for the year	3,144	2,772	2,362
Total comprehensive income for the year	2,868	3,423	2,471
Attributable to:			
Equity shareholders of the parent company – continuing operations	2,815	3,330	2,183
Equity shareholders of the parent company – discontinued operations	–	(55)	–
Non-controlling interests	53	148	288
Total comprehensive income for the year	2,868	3,423	2,471

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated balance sheet

		30 June 2018		30 June 2017	
	Notes	£ million	£ million	£ million	£ million
Non-current assets					
Intangible assets	10	12,572		12,566	
Property, plant and equipment	11	4,089		4,014	
Biological assets		23		21	
Investments in associates and joint ventures	6	3,009		2,824	
Other investments	12	46		31	
Other receivables	14	46		58	
Other financial assets	15	182		267	
Deferred tax assets	7	122		134	
Post employment benefit assets	13	935		281	
			21,024		20,196
Current assets					
Inventories	14	5,015		4,788	
Trade and other receivables	14	2,678		2,592	
Corporate tax receivable		65		–	
Assets held for sale		24		–	
Other financial assets	15	35		81	
Cash and cash equivalents	16	874		1,191	
			8,691		8,652
Total assets			29,715		28,848
Current liabilities					
Borrowings and bank overdrafts	16	(1,828)		(2,459)	
Other financial liabilities	15	(230)		(215)	
Trade and other payables	14	(3,950)		(3,563)	
Corporate tax payable		(243)		(294)	
Provisions	14	(109)		(129)	
			(6,360)		(6,660)
Non-current liabilities					
Borrowings	16	(8,074)		(6,583)	
Other financial liabilities	15	(212)		(383)	
Other payables	14	(209)		(24)	
Provisions	14	(288)		(286)	
Deferred tax liabilities	7	(1,987)		(2,112)	
Post employment benefit liabilities	13	(872)		(772)	
			(11,642)		(10,160)
Total liabilities			(18,002)		(16,820)
Net assets			11,713		12,028
Equity					
Share capital	17	780		797	
Share premium		1,349		1,348	
Other reserves		2,133		2,693	
Retained earnings		5,686		5,475	
Equity attributable to equity shareholders of the parent company			9,948		10,313
Non-controlling interests	17		1,765		1,715
Total equity			11,713		12,028

The accompanying notes are an integral part of these consolidated financial statements.

These consolidated financial statements were approved by a duly appointed and authorised committee of the Board of Directors on 25 July 2018 and were signed on its behalf by Ivan Menezes and Kathryn Mikells, Directors.

Consolidated statement of changes in equity

	Share capital £ million	Share premium £ million	Capital redemption reserve £ million	Hedging and exchange reserve £ million	Retained earnings/(deficit) Own shares £ million	Retained earnings/(deficit) Other retained earnings £ million	Retained earnings/(deficit) Total £ million	Equity attributable to parent company shareholders £ million	Non-controlling interests £ million	Total equity £ million
At 30 June 2015	797	1,346	3,146	(1,152)	(2,228)	5,862	3,634	7,771	1,485	9,256
Profit for the year	–	–	–	–	–	2,244	2,244	2,244	118	2,362
Other comprehensive income/(loss)	–	–	–	631	–	(692)	(692)	(61)	170	109
Employee share schemes	–	–	–	–	39	(38)	1	1	–	1
Share-based incentive plans	–	–	–	–	–	29	29	29	–	29
Share-based incentive plans in respect of associates	–	–	–	–	–	1	1	1	–	1
Tax on share-based incentive plans	–	–	–	–	–	10	10	10	–	10
Shares issued	–	1	–	–	–	–	–	1	–	1
Disposal of non-controlling interests	–	–	–	–	–	–	–	–	(24)	(24)
Purchase of non-controlling interests	–	–	–	–	–	(18)	(18)	(18)	(3)	(21)
Purchase of rights issue of non-controlling interests	–	–	–	–	–	(5)	(5)	(5)	5	–
Dividends paid	–	–	–	–	–	(1,443)	(1,443)	(1,443)	(101)	(1,544)
At 30 June 2016	797	1,347	3,146	(521)	(2,189)	5,950	3,761	8,530	1,650	10,180
Profit for the year	–	–	–	–	–	2,662	2,662	2,662	110	2,772
Other comprehensive income	–	–	–	68	–	545	545	613	38	651
Employee share schemes	–	–	–	–	13	(23)	(10)	(10)	–	(10)
Share-based incentive plans	–	–	–	–	–	34	34	34	–	34
Share-based incentive plans in respect of associates	–	–	–	–	–	3	3	3	–	3
Tax on share-based incentive plans	–	–	–	–	–	12	12	12	–	12
Shares issued	–	1	–	–	–	–	–	1	–	1
Purchase of non-controlling interest by associates	–	–	–	–	–	(5)	(5)	(5)	–	(5)
Change in fair value of put option	–	–	–	–	–	(12)	(12)	(12)	–	(12)
Dividends paid	–	–	–	–	–	(1,515)	(1,515)	(1,515)	(83)	(1,598)
At 30 June 2017	797	1,348	3,146	(453)	(2,176)	7,651	5,475	10,313	1,715	12,028
Adoption of IFRS 15 (note 1)	–	–	–	–	–	(89)	(89)	(89)	(2)	(91)
Adoption of IFRS 9 by associate	–	–	–	(3)	–	3	3	–	–	–
Profit for the year	–	–	–	–	–	3,022	3,022	3,022	122	3,144
Other comprehensive (loss)/income	–	–	–	(574)	–	367	367	(207)	(69)	(276)
Employee share schemes	–	–	–	–	32	(7)	25	25	–	25
Share-based incentive plans	–	–	–	–	–	39	39	39	–	39
Share-based incentive plans in respect of associates	–	–	–	–	–	4	4	4	–	4
Tax on share-based incentive plans	–	–	–	–	–	(2)	(2)	(2)	–	(2)
Shares issued	–	1	–	–	–	–	–	1	–	1
Purchase of non-controlling interest	–	–	–	–	–	(72)	(72)	(72)	70	(2)
Disposal of non-controlling interests	–	–	–	–	–	–	–	–	(1)	(1)
Purchase of rights issue of non-controlling interests	–	–	–	–	–	(5)	(5)	(5)	31	26
Change in fair value of put option	–	–	–	–	–	7	7	7	–	7
Share buyback programme	(17)	–	17	–	–	(1,507)	(1,507)	(1,507)	–	(1,507)
Dividends declared	–	–	–	–	–	(1,581)	(1,581)	(1,581)	(101)	(1,682)
At 30 June 2018	780	1,349	3,163	(1,030)	(2,144)	7,830	5,686	9,948	1,765	11,713

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated statement of cash flows

		Year ended 30 June 2018		Year ended 30 June 2017		Year ended 30 June 2016	
	Notes	£ million	£ million	£ million	£ million	£ million	£ million
Cash flows from operating activities							
Profit for the year		3,144		2,772		2,362	
Discontinued operations		–		55		–	
Taxation		596		732		496	
Share of after tax results of associates and joint ventures		(309)		(309)		(221)	
Net finance charges		260		329		327	
Non-operating items		–		(20)		(123)	
Operating profit			3,691		3,559		2,841
Increase in inventories		(271)		(159)		(95)	
(Increase)/decrease in trade and other receivables		(202)		89		(86)	
Increase in trade and other payables and provisions		314		221		128	
Net (increase)/decrease in working capital			(159)		151		(53)
Depreciation, amortisation and impairment		493		361		473	
Dividends received		159		223		173	
Post employment payments less amounts included in operating profit		(108)		(111)		(59)	
Other items		10		(6)		(15)	
			554		467		572
Cash generated from operations			4,086		4,177		3,360
Interest received		167		180		174	
Interest paid		(418)		(493)		(479)	
Taxation paid		(751)		(732)		(507)	
			(1,002)		(1,045)		(812)
Net cash inflow from operating activities			3,084		3,132		2,548
Cash flows from investing activities							
Disposal of property, plant and equipment and computer software		40		46		57	
Purchase of property, plant and equipment and computer software		(584)		(518)		(506)	
Movements in loans and other investments		(17)		3		(2)	
Sale of businesses	9	4		(52)		1,062	
Acquisition of businesses	9	(594)		(31)		(15)	
Net cash (outflow)/inflow from investing activities			(1,151)		(552)		596
Cash flows from financing activities							
Share buyback programme	17	(1,507)		–		–	
Proceeds from issue of share capital		1		1		1	
Net sale/(purchase) of own shares for share schemes		8		(41)		(1)	
Dividends paid to non-controlling interests		(80)		(83)		(101)	
Purchase of shares of non-controlling interests	9	–		–		(21)	
Rights issue proceeds from non-controlling interests		26		–		–	
Proceeds from bonds	16	2,612		–		–	
Repayment of bonds	16	(1,571)		(1,234)		(1,003)	
Net movements in other borrowings	16	(26)		414		(233)	
Equity dividends paid	17	(1,581)		(1,515)		(1,443)	
Net cash outflow from financing activities			(2,118)		(2,458)		(2,801)
Net (decrease)/increase in net cash and cash equivalents	16		(185)		122		343
Exchange differences			(39)		(14)		84
Net cash and cash equivalents at beginning of the year			917		809		382
Net cash and cash equivalents at end of the year			693		917		809
Net cash and cash equivalents consist of:							
Cash and cash equivalents	16		874		1,191		1,089
Bank overdrafts	16		(181)		(274)		(280)
			693		917		809

The accompanying notes are an integral part of these consolidated financial statements.

Accounting information and policies

Introduction

This section describes the basis of preparation of the consolidated financial statements and the group's accounting policies that are applicable to the financial statements as a whole. Accounting policies, critical accounting estimates and judgements that are specific to a note are included in the note to which they relate. This section also explains new accounting standards, amendments and interpretations, that the group has adopted in the current financial year or will adopt in subsequent years.

1. Accounting information and policies

(a) Basis of preparation

The consolidated financial statements are prepared in accordance with the Companies Act 2006 and International Financial Reporting Standards (IFRS) and related interpretations as adopted for use in the European Union (EU) and as issued by the International Accounting Standards Board (IASB). IFRS as adopted by the EU differs in certain respects from IFRS as issued by the IASB. The differences have no impact on the group's consolidated financial statements for the years presented. The consolidated financial statements are prepared on a going concern basis under the historical cost convention, unless stated otherwise in the relevant accounting policy.

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

(b) Going concern

The consolidated financial statements are prepared on a going concern basis.

(c) Consolidation

The consolidated financial statements include the results of the company and its subsidiaries together with the group's attributable share of the results of associates and joint ventures. A subsidiary is an entity controlled by Diageo plc. The group controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Where the group has the ability to exercise joint control over an entity but has rights to specified assets and obligations for liabilities of that entity, the entity is included on the basis of the group's rights over those assets and liabilities.

(d) Foreign currencies

Items included in the financial statements of the group's subsidiaries, associates and joint ventures are measured using the currency of the primary economic environment in which each entity operates (its functional currency). The consolidated financial statements are presented in sterling, which is the functional currency of the parent company.

The income statements and cash flows of non-sterling entities are translated into sterling at weighted average rates of exchange, other than substantial transactions that are translated at the rate on the date of the transaction. Exchange differences arising on the retranslation to closing rates are taken to the exchange reserve.

Assets and liabilities are translated at closing rates. Exchange differences arising on the retranslation at closing rates of the opening balance sheets of overseas entities are taken to the exchange reserve, as are exchange differences arising on foreign currency borrowings and financial instruments designated as net investment hedges, to the extent that they are effective. Tax charges and credits arising on such items are also taken to the exchange reserve. Gains and losses accumulated in the exchange reserve are recycled to the income statement when the foreign operation is sold. Other exchange differences are taken to the income statement. Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction.

The principal foreign exchange rates used in the translation of financial statements for the three years ended 30 June 2018, expressed in US dollars and euros per £1, were as follows:

	2018	2017	2016
US dollar			
Income statement and cash flows(i)	**1.35**	1.27	1.48
Assets and liabilities(ii)	**1.32**	1.30	1.33
Euro			
Income statement and cash flows(i)	**1.13**	1.16	1.34
Assets and liabilities(ii)	**1.13**	1.14	1.20

(i) Weighted average rates
(ii) Year end rates

The group uses foreign exchange hedges to mitigate the effect of exchange rate movements. For further information see note 15.

(e) Critical accounting estimates and judgements

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgements, are set out in detail in the relevant notes:

- Exceptional items – management judgement whether exceptional or not – page 114
- Taxation – management judgement of whether a provision is required and the recoverability of deferred tax assets and management estimate of amount of corporate tax payable or receivable – page 117
- Brands, goodwill and other intangibles – management judgement of the assets to be recognised and synergies resulting from an acquisition and management estimate in determining future cash flows and appropriate applicable assumptions to support the intangible asset value – page 122
- Post employment benefits – management judgement in determining whether a surplus can be recovered and management estimate in determining the assumptions in calculating the liabilities of the funds – page 126
- Contingent liabilities and legal proceedings – management judgement in assessing the likelihood of whether a liability will arise – page 143

Venezuela is a hyper-inflationary economy where the government maintains a regime of strict currency controls with multiple foreign currency rate systems. Access to US dollars on these exchange systems is very limited. The foreign currency denominated transactions and balances of the group's Venezuelan operations are translated into the local functional currency (Venezuelan bolivar) at the rate they are expected to be settled, applying the most appropriate official exchange rate (DICOM). For consolidation purposes, the group converts its Venezuelan operations using management's estimate of the exchange rate considering forecast inflation and the most appropriate official exchange rate. The exchange rate used to translate the results of the group's the Venezuelan operations was VEF/GBP 3,858,826 for the year ended 30 June 2018 (2017 – VEF/GBP 6,110).

The following table presents the contribution of the group's Venezuelan operations to the consolidated income statement, cash flow statement and net assets for the year ended 30 June 2018 and with the amounts that would have resulted if the official DICOM exchange rate had been applied:

	At estimated exchange rate 3,858,826 VEF/GBP £ million	At DICOM exchange rate 151,800 VEF/GBP £ million
Net sales	1	27
Operating profit	–	16
Other finance income – hyperinflation adjustment	18	458
Net cash inflow from operating activities	1	12
Net assets	69	1,744

(f) New accounting standards and interpretations

The following amendments to the accounting standards, issued by the IASB which have been endorsed by the EU, have been adopted by the group from 1 July 2017 with no impact on the group's consolidated results, financial position or disclosures:

- Amendments to IAS 7 – Disclosure initiative
- Amendment to IAS 12 – Recognition of deferred tax assets for unrealised losses
- Amendment to IFRS 12 – Disclosure of interests in other entities

The following standards issued by the IASB and endorsed by the EU have been early adopted by the group from 1 July 2017:

IFRS 9 – Financial instruments replaces IAS 39 (Financial instruments – Recognition and measurement) and addresses the classification and measurement of financial instruments, introduces new principles for hedge accounting and a new forward-looking impairment model for financial assets.

The adoption of IFRS 9 hedge accounting principles did not result in a restatement of the group's results and the impact on the year ended 30 June 2018 is not material. The adoption of IFRS 9 did not result in any changes in the measurement or classification of financial instruments as at 1 July 2017. All classes of financial assets and financial liabilities had as at 1 July 2017 the same carrying values under IFRS 9 as they had under IAS 39.

Diageo's principal associate, Moët Hennessy has adopted IFRS 9. This has no impact on Diageo's share of the net assets of Moët Hennessy but resulted in a decrease in the group's hedging reserve of £3 million with a corresponding increase in retained earnings. This change has been disclosed as a movement in the year ended 30 June 2018.

IFRS 15 – Revenue from contracts with customers provides enhanced detail on the principle of recognising revenue to reflect the concept that revenue should be recognised when the control of goods or services is transferred to the customer at a value that the company is expected to receive. It replaces the separate models for goods, services and construction contracts under previous IFRS (IAS 11, IAS 18 and related interpretations) which was based on the concept of the transfer of risks and rewards. It also provides further guidance on the initial measurement of sales on contracts which have discounts, rebates and consignment inventories by identifying separate performance obligations that may apply.

During the year ended 30 June 2017 the group carried out a detailed review of the recognition criteria for revenue applying the requirements of IFRS 15 to ensure that the same principles were being applied consistently across the group. This review in particular examined promotional and marketing support payments made to customers post the initial sale of product, the timing of the recognition of sales made where a third party manufactures or modifies a product on behalf of Diageo and consignment inventories. On application of IFRS 15 some changes in accounting policy resulted, principally in respect of variable consideration receivable where the criteria applied for deducting future promotional payments from the initial revenue recognition was more stringent than under the former accounting policy. Management have also ensured that this policy is being adopted consistently across the group. The revised accounting policy establishes that revenue is recognised to the extent that it is highly probable that a reversal in the amount of revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently settled. This means that Diageo, under the revised accounting policy, deducts from the initial revenue recognised any future promotional payments to direct and indirect customers unless it is highly probable that they will not be incurred.

Diageo has adopted the modified retrospective transition method, recognising the cumulative effect of initially applying IFRS15 as an adjustment to the balance of retained earnings as at 1 July 2017.

Retained earnings at 1 July 2017 has been debited by £89 million. The adjustment comprised an increase in creditors of £116 million, a decrease in debtors of £9 million, an increase in inventories of £8 million, a decrease in non-controlling interests of £2 million and an increase in deferred tax assets of £26 million. The changes in accounting policy that resulted in these adjustments are principally in respect of variable consideration where the criteria for deducting future promotional payments from the initial revenue recognition is more stringent than under the former accounting policy. The revised accounting policy establishes that revenue is recognised to the extent that it is highly probable that a reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently settled. This means that Diageo, under the new accounting policy, deducts from the initial revenue recognised any future promotional payments unless it is highly probable that they will not be incurred.

For the year ended 30 June 2018, as a result of applying the new accounting policy, sales increased by £11 million, operating profit increased by £12 million, taxation was £3 million higher and profit for the year increased by £9 million. The operating profit benefit in the year was more than offset by the impact to sales and profit of working capital efficiencies, including inventory reductions, delivered by Diageo's customers.

Consideration was also given to the disclosure of revenue into different categories. It was determined that all revenue would be disclosed as 'sale of goods' as revenue from other sources was immaterial.

IFRIC agenda decision – In October 2017 the IFRIC clarified that interest and penalties in respect of corporate taxes should generally be accounted for under IAS 37 rather than IAS 12 and therefore not be disclosed in the income statement within 'Taxation'. For comparative years Diageo disclosed interest and penalties in respect of corporate taxes as part of 'Taxation' in the consolidated income statement and consolidated balance sheet. As a result of the clarification by the IFRIC Diageo has changed its accounting policy from 1 July 2017. In addition, for consistency, Diageo has changed its treatment of interest arising on indirect tax. For the year ended 30 June 2018, £10 million of interest and £2 million of penalties in respect of corporate tax and indirect taxes was charged to other finance charges and operating profit, respectively. At 30 June 2017, the cumulative interest and penalties in respect of corporate tax included in 'Corporate tax payable' in the consolidated balance sheet was £37 million. At 30 June 2018 the cumulative interest in respect of corporate taxes is included in interest payable (£34 million) and penalties within other payables (£2 million). Interest and penalties in respect of indirect taxes in the consolidated balance sheet are immaterial. Comparatives have not been restated as the amounts are immaterial.

The following standard issued by the IASB and endorsed by the EU, has not yet been adopted by the group:

IFRS 16 – Leases (effective in the year ending 30 June 2020) sets out the principles for the recognition, measurement, presentation and disclosure of leases for both the lessee and the lessor. It eliminates the classification of leases as either operating leases or finance leases currently required under IAS 17 and introduces a single lessee accounting model where the lessee is required to recognise assets and liabilities for all material leases. All material leases will be recognised on the balance sheet as right of use assets and depreciated on a straight line basis. The liability, recognised as part of net borrowings, will be measured at a discounted value and any interest will be charged to finance charges in the income statement. Therefore, the charge to the income statement for the operating lease payment will be replaced with depreciation on the right of use asset and the interest charge inherent in the lease.

The group will implement IFRS 16 from 1 July 2019 by applying the modified retrospective method, meaning that the comparative figures in the financial statements for the year ending 30 June 2020 will not be restated to show the impact of IFRS 16. The operating leases which will be recorded on the balance sheet following implementation of IFRS 16 are principally in respect of warehouses, office buildings, plant and machinery, cars and distribution vehicles. The group has decided to reduce the complexity of implementation to take advantage of a number of practical expedients on transition on 1 July 2019 namely:

(i) to measure the right of use asset at the same value as the lease liability
(ii) to apply the short term and low value exemptions
(iii) to treat, wherever possible, services provided as an income statement item and only capitalise the lease payment amounts in respect of the asset

The anticipated impact of the standard on the group is not yet known though is not expected to be material on the income statement or net assets though assets and liabilities will be grossed up for the net present value of the outstanding operating lease liabilities as at 1 July 2019. See note 19 for information on gross operating lease commitments.

The following standard, issued by the IASB has not been endorsed by the EU and has not been adopted by the group:

IFRS 17 – Insurance contracts (effective in the year ending 30 June 2022) is ultimately intended to replace IFRS 4.

Based on a preliminary assessment the group believes that the adoption of IFRS 17 will not have a significant impact on its consolidated results or financial position.

There are a number of other amendments and clarifications to IFRS, effective in future years, which are not expected to significantly impact the group's consolidated results or financial position.

Results for the year

Introduction

This section explains the results and performance of the group for the three years ended 30 June 2018. Disclosures are provided for segmental information, operating costs, exceptional items, finance income and charges, the group's share of results of associates and joint ventures, taxation and discontinued operations. For associates, joint ventures and taxation, balance sheet disclosures are also provided in this section.

2. Segmental information

Accounting policies

Sales comprise revenue from contracts with customers from the sale of goods, royalties and rents receivable. Revenue from the sale of goods includes excise and other duties which the group pays as principal but excludes duties and taxes collected on behalf of third parties, such as value added tax. Sales are recognised as or when performance obligations are satisfied by transferring control of a good or service to the customer. Generally the transfer of control of goods occurs at the time of despatch but in some countries and for some customers may be on delivery. The group includes in sales the net consideration to which it expects to be entitled. Sales are recognised to the extent that it is highly probable that a significant reversal will not occur. Therefore, sales are stated net of expected price discounts, allowances for customer loyalty and certain promotional activities and similar items. Generally, payment of the transaction price is due within credit terms that are consistent with industry practices, with no element of financing.

Net sales are sales less excise duties. Diageo incurs excise duties throughout the world. In the majority of countries excise duties are effectively a production tax which becomes payable when the product is removed from bonded premises and is not directly related to the value of sales. It is generally not included as a separate item on external invoices; increases in excise duty are not always passed on to the customer and where a customer fails to pay for product received the group cannot reclaim the excise duty. The group therefore recognises excise duty, unless it regards itself as an agent of the regulatory authorities, as a cost to the group.

Advertising costs, point of sale materials and sponsorship payments are charged to marketing in operating profit when the company has a right of access to the goods or services acquired.

Diageo is an international manufacturer and distributor of premium drinks. Diageo also owns a number of investments in associates and joint ventures as set out in note 6.

The segmental information presented is consistent with management reporting provided to the Executive Committee (the chief operating decision maker).

The Executive Committee considers the business principally from a geographical perspective based on the location of third party sales and the business analysis is presented by geographical segment. In addition to these geographical selling segments, a further segment reviewed by the Executive Committee is the International Supply Centre (ISC), which manufactures products for other group companies and includes the production sites in the United Kingdom, Ireland, Italy and Guatemala.

Continuing operations also include the Corporate function. Corporate revenues and costs are in respect of central costs, including finance, marketing, corporate relations, human resources and legal, as well as certain information systems, facilities and employee costs that are not allocable to the geographical segments or to the ISC. They also include rents receivable and payable in respect of properties not used by the group in the manufacture, sale or distribution of premium drinks.

Diageo uses shared services operations, including captive and outsourced centres, to deliver transaction processing activities for markets and operational entities. These centres are located in Hungary, Kenya, Colombia, the Philippines and India. The captive business service centre in Budapest also performs certain central finance activities, including elements of financial planning and reporting and treasury. The costs of shared service operations are recharged to the regions.

The segmental information for net sales and operating profit before the impact of acquisitions and disposals, ISC allocation and exceptional items is reported at budgeted exchange rates in line with management reporting. For management reporting purposes the group measures the current year at, and restates the prior year net sales and operating profit to, the current year's budgeted exchange rates. These exchange rates are set prior to the financial year as part of the financial planning process and provide a consistent exchange rate to measure the performance of the business throughout the year. The adjustments required to retranslate the segmental information to actual exchange rates and to reconcile it to the group's reported results are shown in the following tables. The comparative segmental information, prior to retranslation, has not been restated at the current year's budgeted exchange rates but is presented at the budgeted rates for the respective years.

In addition, for management reporting purposes Diageo presents separately the results of acquisitions and disposals completed in the current and prior year from the results of the geographical segments. The impact of acquisitions and disposals on net sales and operating profit is disclosed under the appropriate geographical segments in the following tables at budgeted exchange rates.

(a) Segmental information for the consolidated income statement – continuing operations

	North America £ million	Europe and Turkey[ii] £ million	Africa £ million	Latin America and Caribbean £ million	Asia Pacific £ million	ISC £ million	Eliminate inter-segment sales £ million	Total operating segments £ million	Corporate and other £ million	Total £ million
2018										
Sales	4,671	5,232	2,083	1,352	5,042	1,457	(1,457)	18,380	52	18,432
Net sales										
At budgeted exchange rates[i]	4,138	2,821	1,467	1,064	2,555	1,512	(1,425)	12,132	48	12,180
Acquisitions and disposals	50	–	–	–	–	–	–	50	–	50
ISC allocation	11	53	4	11	8	(87)	–	–	–	–
Retranslation to actual exchange rates	(83)	58	20	(6)	(60)	32	(32)	(71)	4	(67)
Net sales	4,116	2,932	1,491	1,069	2,503	1,457	(1,457)	12,111	52	12,163
Operating profit/(loss)										
At budgeted exchange rates[i]	1,925	941	180	298	588	112	–	4,044	(160)	3,884
Acquisitions and disposals	4	–	–	–	–	–	–	4	–	4
ISC allocation	14	67	5	14	12	(112)	–	–	–	–
Retranslation to actual exchange rates	(61)	20	6	(4)	(32)	–	–	(71)	2	(69)
Operating profit/(loss) before exceptional items	1,882	1,028	191	308	568	–	–	3,977	(158)	3,819
Exceptional items	–	–	(128)	–	–	–	–	(128)	–	(128)
Operating profit/(loss)	1,882	1,028	63	308	568	–	–	3,849	(158)	3,691
Non-operating items										–
Net finance charges										(260)
Share of after tax results of associates and joint ventures										
– Moët Hennessy										305
– Other										4
Profit before taxation										3,740

	North America £ million	Europe and Turkey[ii] £ million	Africa £ million	Latin America and Caribbean £ million	Asia Pacific £ million	ISC £ million	Eliminate inter-segment sales £ million	Total operating segments £ million	Corporate and other £ million	Total £ million
2017										
Sales	4,725	4,985	2,132	1,303	4,923	1,390	(1,390)	18,068	46	18,114
Net sales										
At budgeted exchange rates[i]	3,523	2,474	1,240	873	1,977	1,418	(1,324)	10,181	39	10,220
Acquisitions and disposals	–	2	15	7	41	–	–	65	–	65
ISC allocation	11	60	4	11	8	(94)	–	–	–	–
Retranslation to actual exchange rates	627	288	297	153	393	66	(66)	1,758	7	1,765
Net sales	4,161	2,824	1,556	1,044	2,419	1,390	(1,390)	12,004	46	12,050
Operating profit/(loss)										
At budgeted exchange rates[i]	1,648	741	159	195	375	116	–	3,234	(169)	3,065
Acquisitions and disposals	–	–	(8)	–	–	–	–	(8)	(1)	(9)
ISC allocation	14	72	5	13	12	(116)	–	–	–	–
Retranslation to actual exchange rates	237	123	62	42	100	–	–	564	(19)	545
Operating profit/(loss) before exceptional items	1,899	936	218	250	487	–	–	3,790	(189)	3,601
Exceptional items	–	(33)	–	–	(9)	–	–	(42)	–	(42)
Operating profit/(loss)	1,899	903	218	250	478	–	–	3,748	(189)	3,559
Non-operating items										20
Net finance charges										(329)
Share of after tax results of associates and joint ventures										
– Moët Hennessy										302
– Other										7
Profit before taxation										3,559

	North America £ million	Europe and Turkey(ii) £ million	Africa £ million	Latin America and Caribbean £ million	Asia Pacific £ million	ISC £ million	Eliminate inter-segment sales £ million	Total operating segments £ million	Corporate and other £ million	Total £ million
2016										
Sales	4,037	4,593	1,875	1,078	4,022	1,355	(1,355)	15,605	36	15,641
Net sales										
At budgeted exchange rates(i)	3,282	2,481	1,286	901	2,114	1,452	(1,373)	10,143	38	10,181
Acquisitions and disposals	106	75	74	59	9	–	–	323	–	323
ISC allocation	10	50	4	8	7	(79)	–	–	–	–
Retranslation to actual exchange rates	167	(62)	37	(105)	(54)	(18)	18	(17)	(2)	(19)
Net sales	3,565	2,544	1,401	863	2,076	1,355	(1,355)	10,449	36	10,485
Operating profit/(loss)										
At budgeted exchange rates(i)	1,459	738	212	221	399	112	–	3,141	(149)	2,992
Acquisitions and disposals	24	7	(8)	13	1	–	–	37	–	37
ISC allocation	14	70	6	11	11	(112)	–	–	–	–
Retranslation to actual exchange rates	54	(14)	2	(46)	(16)	–	–	(20)	(1)	(21)
Operating profit/(loss) before exceptional items	1,551	801	212	199	395	–	–	3,158	(150)	3,008
Exceptional items	–	–	–	(118)	(49)	–	–	(167)	–	(167)
Operating profit/(loss)	1,551	801	212	81	346	–	–	2,991	(150)	2,841
Non-operating items										123
Net finance charges										(327)
Share of after tax results of associates and joint ventures										
– Moët Hennessy										217
– Other										4
Profit before taxation										2,858

(i) These items represent the IFRS 8 performance measures for the geographical and ISC segments.
(ii) The Europe and Turkey region was formerly named 'Europe, Russia and Turkey'. Countries included in the region have not changed.

(1) The net sales figures for ISC reported to the Executive Committee primarily comprise inter-segment sales and these are eliminated in a separate column in the above segmental analysis. Apart from sales by the ISC segment to the other operating segments, inter-segmental sales are not material.
(2) The group's net finance charges are managed centrally and are not attributable to individual operating segments.
(3) Approximately 40% of annual net sales occur in the last four months of each calendar year.
(4) In the year ended 30 June 2017 Diageo changed its internal reporting structure to reflect changes made to management responsibilities. As a result of this change, Lebanon, other Middle East countries and North African countries which were formerly reported in the Asia Pacific and Africa regions respectively are now included in the Europe and Turkey region. In addition, the result of the Travel Retail operations have been reallocated to the geographical regions to better reflect the region in which the sale to the customer is made. The information for year ended 30 June 2016 has not been restated as the amounts involved are not material.

(b) Other segmental information

	North America £ million	Europe and Turkey(i) £ million	Africa £ million	Latin America and Caribbean £ million	Asia Pacific £ million	ISC £ million	Corporate and other £ million	Total £ million
2018								
Capital expenditure	132	22	163	44	44	131	48	584
Depreciation and intangible asset amortisation	(44)	(20)	(77)	(7)	(42)	(110)	(68)	(368)
Exceptional accelerated depreciation and impairment	–	–	(35)	–	–	–	–	(35)
Exceptional impairment of intangible assets	–	–	(90)	–	–	–	–	(90)
2017								
Capital expenditure	112	27	126	34	48	125	46	518
Depreciation and intangible asset amortisation	(41)	(21)	(77)	(7)	(42)	(107)	(66)	(361)
2016								
Capital expenditure	105	29	107	20	52	150	43	506
Depreciation and intangible asset amortisation	(39)	(21)	(83)	(10)	(35)	(106)	(61)	(355)
Exceptional accelerated depreciation and impairment	–	–	–	(14)	–	(8)	–	(22)
Exceptional impairment of intangible assets	–	–	–	(104)	–	–	–	(104)

(i) The Europe and Turkey region was formerly named 'Europe, Russia and Turkey'. Countries included in the region have not changed.

(c) Category and geographical analysis

	Category analysis						Geographic analysis					
	Spirits £ million	Beer £ million	Wine £ million	Ready to drink £ million	Other[(iv)] £ million	Total £ million	Great Britain £ million	United States £ million	Nether-lands £ million	India £ million	Rest of World £ million	Total £ million
2018												
Sales[(i)]	14,605	2,647	81	854	245	18,432	1,630	4,310	63	3,086	9,343	18,432
Non-current assets[(ii), (iii)]	–	–	–	–	–	–	1,717	4,221	2,367	3,688	7,792	19,785
2017												
Sales[(i)]	14,241	2,635	81	854	303	18,114	1,558	4,366	62	3,070	9,058	18,114
Non-current assets[(ii), (iii)]	–	–	–	–	–	–	1,678	4,012	2,392	4,009	7,410	19,501
2016												
Sales[(i)]	11,993	2,486	265	726	171	15,641	1,672	3,729	56	2,465	7,719	15,641
Non-current assets[(ii), (iii)]	–	–	–	–	–	–	1,679	3,859	2,350	3,764	7,224	18,876

(i) The geographical analysis of sales is based on the location of third party customers.
(ii) The geographical analysis of non-current assets is based on the geographical location of the assets and comprises intangible assets, property, plant and equipment, biological assets, investments in associates and joint ventures, other investments and non-current other receivables.
(iii) The management information provided to the chief operating decision maker does not include an analysis of assets and liabilities by category and therefore is not disclosed.
(iv) In the two years ended 30 June 2018 and 30 June 2017 'Other' includes the group's sorghum beer business which in the year ended 30 June 2016 was included in 'Beer'.

3. Operating costs

	2018 £ million	2017 £ million	2016 £ million
Excise duties	6,269	6,064	5,156
Cost of sales	4,634	4,680	4,251
Marketing	1,882	1,798	1,562
Other operating expenses	1,956	2,013	1,831
	14,741	14,555	12,800
Comprising:			
Excise duties – Great Britain	853	774	853
– United States	548	558	468
– India	2,094	2,073	1,588
– Other	2,774	2,659	2,247
Increase in inventories	(296)	(146)	(100)
Raw materials and consumables	3,052	2,813	2,548
Marketing	1,882	1,798	1,562
Other external charges	1,849	2,124	1,767
Staff costs	1,509	1,583	1,475
Depreciation, amortisation and impairment	493	361	473
Gains on disposal of properties	(9)	(7)	(39)
Net foreign exchange losses/(gains)	6	(16)	1
Other operating income [(i)]	(14)	(19)	(43)
	14,741	14,555	12,800

(i) In the year ended 30 June 2016 Diageo sold 8.5 million shares in United Breweries Limited resulting in a gain of £28 million.

(a) Other external charges

Other external charges include operating lease rentals for plant and equipment of £21 million (2017 – £20 million; 2016 – £29 million), other operating lease rentals (mainly properties) of £87 million (2017 – £96 million; 2016 – £72 million), research and development expenditure in respect of new drinks products and package design in the year leading up to product launch of £36 million (2017 – £33 million; 2016 – £28 million) and maintenance and repairs of £117 million (2017 – £100 million; 2016 – £91 million).

(b) Auditor fees

Other external charges include the fees of the principal auditor of the group, PricewaterhouseCoopers LLP and its affiliates (PwC) are analysed below.

	2018 £ million	2017 £ million	2016 £ million
Audit of these financial statements	3.3	3.1	3.4
Audit of financial statements of subsidiaries	3.3	3.4	2.3
Audit related assurance services[(i)]	1.6	1.6	1.4
Total audit fees (Audit fees)	8.2	8.1	7.1
Other services relevant to taxation (Tax fees)[(ii)]	0.1	0.3	0.5
Other assurance services (Audit related fees)[(iii)]	0.6	0.5	0.4
All other non-audit fees (All other fees)[(iv)]	1.0	0.9	0.9
	9.9	9.8	8.9

(i) Audit related assurance services are principally in respect of reporting under section 404 of the US Sarbanes-Oxley Act and the review of the interim financial information.
(ii) Other services relevant to taxation principally comprise tax advice.
(iii) Other assurance services comprise the aggregate fees for assurance and related services that are related to the performance of the audit or review of the financial statements and are not reported under 'total audit fees'.
(iv) All other non-audit fees are principally in respect of immigration and advisory services.

(1) Disclosure requirements for auditor fees in the United States are different from those required in the United Kingdom. The terminology by category required in the United States is disclosed in brackets in the above table. All figures are the same for the disclosures in the United Kingdom and the United States apart from £0.4 million (2017 – £0.3 million; 2016 – £0.3 million) of the cost in respect of the review of the interim financial information which would be included in audit related fees in the United States rather than audit fees.

Audit services provided by firms other than PwC for the year ended 30 June 2018 were £0.1 million (2017 – £0.5 million; 2016 – £0.9 million). PwC fees for audit services in respect of employee pension plans were £0.3 million for the year ended 30 June 2018 (2017 – £0.3 million; 2016 – £0.2 million).

(c) Staff costs and average number of employees

	2018 £ million	2017 £ million	2016 £ million
Aggregate remuneration			
Wages and salaries	**1,272**	1,330	1,236
Share-based incentive plans	**40**	34	28
Employer's social security	**95**	93	85
Employer's pension			
– defined benefit plans	**73**	95	99
– defined contribution plans	**18**	17	16
Other post employment plans	**11**	14	11
	1,509	1,583	1,475

The average number of employees on a full time equivalent basis (excluding employees of associates and joint ventures) was as follows:

	2018	2017	2016
North America	**2,406**	2,251	2,477
Europe and Turkey	**3,747**	4,074	4,164
Africa	**4,625**	4,898	5,381
Latin America and Caribbean	**2,536**	2,573	3,013
Asia Pacific	**8,008**	8,690	9,711
ISC	**4,227**	4,244	4,188
Corporate and other[i]	**4,368**	3,703	3,144
	29,917	30,433	32,078

(i) The increase in 'Corporate and other' in the years ended 30 June 2018 and 30 June 2017 is primarily due to the creation of a worldwide service centre in India where roles have been transferred from the geographical regions.

At 30 June 2018 the group had, on a full time equivalent basis, 29,362 (2017 – 30,051; 2016 – 31,485) employees. The average number of employees of the group, including part time employees, for the year was 30,761 (2017 – 31,472; 2016 – 32,969).

(d) Exceptional operating items

Included in the table above are exceptional operating items as follows:

	2018 £ million	2017 £ million	2016 £ million
Other external charges	**–**	42	49
Decrease in inventories	**3**	–	–
Depreciation, amortisation and impairment			
– Brand, goodwill and tangible asset impairment	**125**	–	118
Total exceptional operating costs (note 4)	**128**	42	167
Other operating expenses	**128**	42	167
Total exceptional operating costs (note 4)	**128**	42	167

4. Exceptional items

Accounting policies

Critical accounting judgements

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

Operating items

Exceptional operating items are those that are considered to be material and are part of the operating activities of the group such as impairment of intangible assets and fixed assets, duty settlements, property disposals and changes in post employment plans.

Non-operating items

Gains and losses on the sale of businesses, brands or distribution rights, step up gains and losses that arise when an investment becomes an associate or an associate becomes a subsidiary and other material, unusual non recurring items, that are not in respect of the production, marketing and distribution of premium drinks, are disclosed as non-operating exceptional items below operating profit in the consolidated income statement.

It is believed that separate disclosure of exceptional items and the classification between operating and non-operating further helps investors to understand the performance of the group.

	2018 £ million	2017 £ million	2016 £ million
Items included in operating profit			
Brand, goodwill, tangible and other assets impairment (a)	(128)	–	(118)
Competition authority investigation in Turkey (b)	–	(33)	–
Customer claim in India (c)	–	(32)	–
Disengagement agreements relating to United Spirits Limited (d)	–	23	(49)
	(128)	(42)	(167)
Non-operating items			
Sale of businesses			
Wines in the United States and Percy Fox (e)	–	20	(191)
Argentina (f)	–	–	(38)
South African associate interests (g)	–	–	(27)
Jamaica, Singapore and Malaysia beer interests (h)	–	–	457
Kenya – glass business (CGI) (i)	–	–	14
Other			
Provision for a receivable related to a loan guarantee (j)	–	–	(92)
	–	20	123
Exceptional items before taxation	(128)	(22)	(44)
Items included in taxation (note 7 (b))	203	4	56
Exceptional items in continuing operations	75	(18)	12
Discontinued operations net of taxation (note 8)	–	(55)	–
Total exceptional items	75	(73)	12
Attributable to:			
Equity shareholders of the parent company	75	(64)	2
Non-controlling interests	–	(9)	10
Total exceptional items	75	(73)	12

(a) In the year ended 30 June 2018, an impairment charge of £128 million in respect of the Meta brand, Ethiopian tangible fixed assets, associated spare parts reported in inventory and goodwill allocated to the Africa Regional Markets cash-generating unit has been recognised in other operating exceptional expenses. Forecast cash flow assumptions were reduced principally due to the devaluation of the Ethiopian birr increasing costs of imported raw materials and products, an increased competitive environment and political unrest in Ethiopia. For further information see note 10 (d).

In the year ended 30 June 2016, an impairment charge in respect of the Ypióca brand and related tangible fixed assets and goodwill allocated to the Paraguay, Uruguay and Brazil (PUB) cash-generating unit of £62 million, £14 million and £42 million, respectively, was charged to other operating expenses. Forecast cash flow assumptions were reduced principally due to a challenging economic environment in Brazil and significant adverse changes in local tax regulation.

(b) In the year ended 30 June 2017, TRY150 million (£33 million) was charged to exceptional items in respect of the Turkish Competition Authority investigation into certain of Mey İçki's trading practices in Turkey.

(c) During the year ended 30 June 2017 United Spirits Limited received a claim, followed by a debit note, from a customer in India in respect of differential pricing charged over a number of years in respect of products sold to that customer primarily for the period prior to the acquisition of United Spirits Limited by Diageo. The group made a provision of INR2,678 million (£32 million) in exceptional items against the current receivable from the customer.

(d) On 25 February 2016, in relation to an agreement entered into with Dr Vijay Mallya (Dr Mallya) and described further at note 18(c) (25 February Agreement), the group incurred an exceptional operating charge of £49 million. This included provisions for payments to Dr Mallya of, in aggregate, $75 million (£53 million) over a five year period in consideration for (i) his resignation and the termination of his appointment and governance rights and his relinquishing of the rights and benefits attached to his position as Chairman and Non-Executive Director of United Spirits Limited (USL); (ii) his agreement to five-year global non-compete (excluding the United Kingdom), non-interference, non-solicitation and standstill undertakings; and (iii) his agreement that he and his affiliates would not pursue any claims against Diageo, USL and their affiliates. Separately, other arrangements entered into on 25 February 2016 resulted in a net gain of £4 million, comprising the gain upon termination of certain other agreements that were the subject of prior provisions, less legal fees directly attributable to the 25 February Agreement. In the year ended 30 June 2016 a payment of $40 million (£28 million) was made to Dr Mallya as the first instalment due under the 25 February Agreement. Owing to various reasons, including breaches of several provisions of the 25 February 2016 Agreement by Dr Mallya, Diageo believes that it was not liable to pay any further instalments under that agreement and accordingly the outstanding provision of $29 million (£23 million) was credited back to the income statement in the year ended 30 June 2017.

(e) On 1 January 2016, Diageo completed the sale of the majority of its wine interests in the United States and its UK based Percy Fox businesses to Treasury Wine Estates. Together with the sale of the group's other wine interests in the United States the transactions resulted in a loss before taxation on disposal of £191 million in the year ended 30 June 2016.

In the year ended 30 June 2017 the guarantee in respect of the lease payments to Realty Income Corporation was settled and the working capital on disposal was agreed with Treasury Wine Estates resulting in a net £20 million exceptional gain.

(f) On 29 January 2016, Diageo disposed of its interests in Argentina to Grupo Peñaflor. The transaction resulted in a loss before taxation of £38 million including a cumulative exchange loss of £20 million, in respect of prior years, recycled from other comprehensive income and other directly attributable costs of £7 million.

(g) On 1 December 2015, Diageo disposed of its 42.25% equity interests in DHN Drinks, its 25% equity stake in Sedibeng Breweries Limited and its 15.01% equity stake in Namibia Breweries Limited (South African associate interests) to Heineken. The net cash consideration received was £120 million, which included the repayment of £31 million in respect of loans previously made to DHN Drinks and Sedibeng Breweries Limited. A loss before taxation of £27 million, including a £30 million cumulative exchange loss, in respect of prior years, recycled from other comprehensive income, was accounted for in the income statement.

(h) On 7 October 2015, Diageo disposed of its 57.87% shareholding in D&G (Jamaican Red Stripe business) and its 49.99% stake in GAPL Pte Limited (Singapore and Malaysian beer businesses) to Heineken resulting in a gain before taxation of £457 million.

(i) On 30 September 2015, the group completed the disposal of its shareholding in Central Glass Industries Limited (CGI), a Kenyan glass bottle manufacturer.

(j) During the year ended 30 June 2016 a guarantee provided by Diageo for a loan of $135 million (£92 million) given by Standard Chartered Bank (SCB) to Watson Limited was called and $135 million was paid to SCB. The underlying security package for the loan is currently being contested in court and a provision of $135 million was made in the year ended 30 June 2016.

5. Finance income and charges

Accounting policies

Net interest includes interest income and charges in respect of financial instruments and the results of hedging transactions used to manage interest rate risk.

Finance charges directly attributable to the acquisition, construction or production of a qualifying asset, being an asset that necessarily takes a substantial period of time to get ready for its intended use or sale, are added to the cost of that asset. Borrowing costs which are not capitalised are recognised in the income statement based on the effective interest method. All other finance charges are recognised primarily in the income statement in the year in which they are incurred.

Net other finance charges include items in respect of post employment plans, the discount unwind of long term obligations and hyperinflation charges. The results of operations in hyperinflationary economies are adjusted to reflect the changes in the purchasing power of the local currency of the entity before being translated to sterling.

The impact of derivatives, excluding cash flow hedges that are in respect of commodity risk management or those that are used to hedge the currency risk of highly probable future currency cash flows, is included in interest income or interest charge.

	2018 £ million	2017 £ million	2016 £ million
Interest income	155	148	153
Fair value gain on financial instruments	61	76	88
Total interest income(i)	**216**	224	241
Interest charge on bank loans and overdrafts	(53)	(72)	(67)
Interest charge on finance leases	(9)	(11)	(13)
Interest charge on all other borrowings	(333)	(368)	(379)
Fair value loss on financial instruments	(62)	(67)	(91)
Total interest charges(i)	**(457)**	(518)	(550)
Net interest charges	**(241)**	(294)	(309)
Net finance income in respect of post employment plans in surplus (note 13)	9	2	18
Hyperinflation adjustment in respect of Venezuela (note 1)	18	9	–
Other finance income	–	–	3
Total other finance income	**27**	11	21
Net finance charge in respect of post employment plans in deficit (note 13)	(20)	(27)	(23)
Unwinding of discounts	(14)	(8)	(11)
Change in financial liability (Level 3)	–	(8)	–
Hyperinflation adjustment in respect of Venezuela (note 1)	–	–	(1)
Other finance charges	(12)	(3)	(4)
Total other finance charges	**(46)**	(46)	(39)
Net other finance charges	**(19)**	(35)	(18)

(i) Includes £73 million interest income and £(394) million interest charge in respect of financial assets and liabilities that are not measured at fair value through the income statement (2017 – £91 million income and £(467) million charge, 2016 – £84 million income and £(451) million charge).

6. Investments in associates and joint ventures

Accounting policies

An associate is an undertaking in which the group has a long term equity interest and over which it has the power to exercise significant influence. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. The group's interest in the net assets of associates and joint ventures is reported in investments in the consolidated balance sheet and its interest in their results (net of tax) is included in the consolidated income statement below the group's operating profit. Associates and joint ventures are initially recorded at cost including transaction costs. Investments in associates and joint ventures are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The impairment review compares the net carrying value with the recoverable amount, where the recoverable amount is the higher of the value in use calculated as the present value of the group's share of the associate's future cash flows and its fair value less costs to sell.

Diageo's principal associate is Moët Hennessy, SAS (Moët Hennessy) of which Diageo owns 34%. Moët Hennessy is 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 champagne and cognac brands.

A number of joint distribution arrangements have been established with LVMH in Asia Pacific and France, principally covering distribution of Diageo's Scotch whisky and gin premium brands and Moët Hennessy's champagne and cognac premium brands. 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 non-controlling shareholder in Moët Hennessy.

(a) An analysis of the movement in the group's investments in associates and joint ventures is as follows:

	Moët Hennessy £ million	Others £ million	Total £ million
Cost less provisions			
At 30 June 2016	2,445	83	2,528
Exchange differences	117	3	120
Additions	–	10	10
Share of profit after tax	302	7	309
Dividends	(218)	(5)	(223)
Share of tax attributable to shareholders	85	–	85
Other	(5)	–	(5)
At 30 June 2017	**2,726**	**98**	**2,824**
Exchange differences	3	–	3
Additions	–	41	41
Share of profit after tax	305	4	309
Dividends	(150)	(9)	(159)
Other	(9)	–	(9)
At 30 June 2018	**2,875**	**134**	**3,009**

(1) Investment in associates balance includes loans given to and preference shares invested in associates of £59 million (2017 – £27 million; 2016 – £19 million).

(b) Income statement information for the three years ended 30 June 2018 and balance sheet information as at 30 June 2018 and 30 June 2017 of Moët Hennessy is as follows:

	2018 £ million	2017 £ million	2016 £ million
Sales	4,445	4,356	3,491
Profit for the year	897	888	638
Total comprehensive income	799	838	509

Moët Hennessy prepares its financial statements under IFRS as endorsed by the EU in euros to 31 December each year. The results are adjusted for alignment to Diageo accounting policies and are a major part of the Wines & Spirits division of LVMH. The results are translated at £1 = €1.13 (2017 – £1 = €1.16; 2016 – £1 = €1.34).

	2018 £ million	2017 £ million
Non-current assets	4,251	4,160
Current assets	7,395	6,897
Total assets	11,646	11,057
Non-current liabilities	(972)	(973)
Current liabilities	(2,218)	(2,067)
Total liabilities	(3,190)	(3,040)
Net assets	**8,456**	8,017

(1) Including acquisition fair value adjustments principally in respect of Moët Hennessy's brands and translated at £1 = €1.13 (2017 – £1 = €1.14).

(c) Information on transactions between the group and its associates and joint ventures is disclosed in note 20.

(d) Investments in associates and joint ventures comprise the cost of shares less goodwill written off on acquisitions prior to 1 July 1998 of £1,239 million (2017 – £1,196 million), plus the group's share of post acquisition reserves of £1,770 million (2017 – £1,628 million).

(e) The associates and joint ventures have not reported any material contingent liabilities in their latest financial statements.

7. Taxation

Accounting policies

Current tax is based on taxable profit for the year. Taxable profit is different from accounting profit due to temporary differences between accounting and tax treatments, and due to items that are never taxable or tax deductible. Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, tax benefits are reviewed each year to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. Tax provisions are included in current liabilities. Penalties and interest on tax liabilities for the year ended 30 June 2018 are included in operating profit and finance charges, respectively. In prior years penalties and interest on tax liabilities were provided for in the tax charge.

Full provision for ***deferred tax*** is made for temporary differences between the carrying value of assets and liabilities for financial reporting purposes and their value for tax purposes. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of recovery or settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the assets will not be realised in the future. No deferred tax liability is provided in respect of any future remittance of earnings of foreign subsidiaries where the group is able to control the remittance of earnings and it is probable that such earnings will not be remitted in the foreseeable future, or where no liability would arise on the remittance.

Critical accounting estimates and judgements

The group is required to estimate the corporate tax in each of the many jurisdictions in which it operates. Manangement is required to estimate the amount that should be recognised as a tax liability or tax asset in many countries which are subject to tax audits which by their nature are often complex and can take several years to resolve. Current tax balances and tax provisions are based on management's judgement and interpretation of country specific tax law and the likelihood of settlement. However the actual tax liabilities could differ from the provision and in such event the group would be required to make an adjustment in a subsequent period which could have a material impact on the group's profit for the year.

The evaluation of deferred tax assets recoverability requires judgements to be made regarding the availability of future taxable income.

(a) Analysis of taxation charge for the year

	United Kingdom			Rest of world			Total		
	2018 £ million	2017 £ million	2016 £ million	**2018 £ million**	2017 £ million	2016 £ million	**2018 £ million**	2017 £ million	**2016 £ million**
Current tax									
Current year	**131**	50	61	**503**	541	515	**634**	591	576
Adjustments in respect of prior years	**71**	4	–	**(2)**	16	63	**69**	20	63
	202	54	61	**501**	557	578	**703**	611	639
Deferred tax									
Origination and reversal of temporary differences	**40**	40	26	**127**	94	(109)	**167**	134	(83)
Changes in tax rates(i)	**(11)**	5	6	**(360)**	(14)	1	**(371)**	(9)	7
Adjustments in respect of prior years	**95**	13	2	**2**	(17)	(69)	**97**	(4)	(67)
	124	58	34	**(231)**	63	(177)	**(107)**	121	(143)
Taxation on profit from continuing operations	**326**	112	95	**270**	620	401	**596**	732	496

(i) Includes the impact as a consequence of the reduction in the US Federal tax rate (from 35% to 21%) enacted by the Tax Cuts and Jobs Act (TCJA) in the United States.

(b) Exceptional tax (credits)/charges

The taxation charge includes the following exceptional items:

	2018 £ million	2017 £ million	2016 £ million
US tax reform(i)	**(354)**	–	–
UK transfer pricing settlement(ii)	**143**	–	–
UK industrial building allowance(iii)	**21**	–	–
Brand and tangible asset impairment	**(13)**	–	(10)
Sale of businesses	**–**	7	(49)
Customer claim in India	**–**	(11)	–
Disengagement agreements relating to United Spirits Limited	**–**	–	3
	(203)	(4)	(56)

(i) The exceptional tax credit of £354 million ($478 million) resulted from applying the Tax Cuts and Jobs Act (TCJA), enacted on 22 December 2017, in the United States. The credit principally arose on remeasuring the deferred tax liabilities in respect of intangibles and other assets for the change in the US Federal tax rate from 35% to 21%, resulting in an exceptional tax credit of £363 million ($490 million), which is partially offset by £9 million ($12 million) exceptional tax charge in respect of repatriation of untaxed foreign earnings. In addition, there was a one-off charge of £11 million ($15 million) to other comprehensive income and equity, in respect of the remeasurement of the deferred tax assets on post employment liabilities and share-based incentive plans as a result of applying the provisions of the TCJA.

(ii) In its interim announcement for the six months ended 31 December 2017, Diageo reported that discussions were being held with HMRC to seek clarity on Diageo's transfer pricing and related issues, and that a preliminary assessment for diverted profits tax notice had been issued. Final charging notices were issued in August 2017 and Diageo paid £107 million in respect of the two years ended 30 June 2016. Diageo agreed in June 2018 with HMRC that diverted profits tax does not apply and at the same time has reached resolution on the transfer pricing issues being discussed. The agreement in respect of transfer pricing covers the period from 1 July 2014 to 30 June 2017 and has resulted in an additional UK tax charge of £143 million. In the year ended 30 June 2018 an additional tax charge of £47 million has been recognised in current tax which is based on the approach agreed with HMRC.

(iii) A deferred tax asset of £21 million has been written off in respect of the difference between the book value and tax written value of industrial buildings in the United Kingdom.

(c) Taxation rate reconciliation and factors that may affect future tax charges

	2018 £ million	2017 £ million	2016 £ million
Profit from continuing operations before taxation	**3,740**	3,559	2,858
Notional charge at UK corporation tax rate of 19% (2017 – 19.75%; 2016 – 20%)	**711**	703	571
Elimination of notional tax on share of after tax results of associates and joint ventures	**(58)**	(60)	(44)
Differences in overseas tax rates(i)	**134**	162	50
Effect of intra-group financing	**(61)**	(64)	(97)
Non taxable gain on disposals of businesses	**–**	–	(90)
Other tax rate and tax base differences	**(109)**	(100)	(87)
Other items not chargeable	**(79)**	(78)	(66)
Impairment	**16**	–	21
Non deductible losses on disposal of businesses	**–**	(1)	24
Other non deductible exceptional items	**9**	7	31
Other items not deductible(ii)	**238**	156	180
Changes in tax rates	**(371)**	(9)	7
Adjustments in respect of prior years	**166**	16	(4)
Taxation on profit from continuing operations	**596**	732	496

(i) Changes in overseas tax rates are mainly due to the application of the TCJA. Excludes impact of remeasurement of deferred tax liabilities due to US tax reform, which is included in changes in tax rates in the table above.

(ii) Other items not deductible include irrecoverable withholding tax, controlled foreign companies charge and additional state and local taxes.

The table above reconciles the notional taxation charge calculated at the UK tax rate, to the actual total tax charge. As a group operating in multiple countries, the actual tax rates applicable to profits in those countries are different from the UK tax rate. The impact is shown in the table above as differences in overseas tax rates. The group's worldwide business leads to the consideration of a number of important factors which may affect future tax charges, such as: the levels and mix of profitability in different jurisdictions, transfer pricing regulations, tax rates imposed and tax regime reforms, acquisitions, disposals, restructuring activities, and settlements or agreements with tax authorities.

Significant ongoing changes in the international tax environment and an increase in global tax audit activity means that tax uncertainties and associated risks have been gradually increasing. In the medium term, these risks could result in an increase in tax liabilities or adjustments to the carrying value of deferred tax assets and liabilities. See note 18 (g).

The principal change in the reported tax rate for the year ended 30 June 2018 is principally driven by the changes enacted by the Tax Cuts and Jobs Act (TCJA) in the United States on 22 December 2017 and effective from 1 January 2018.

The group has a number of ongoing tax audits worldwide for which provisions are recognised based on best estimates and management's judgments concerning the ultimate outcome of the audit. As at 30 June 2018 the ongoing audits that are provided for individually are not expected to result in a material tax liability. The current tax asset of £65 million (2017 – £ nil) and tax liability of £243 million (2017 – £294 million) includes £231 million (2017 – £287 million) of provisions for tax uncertainties.

(d) Deferred tax assets and liabilities

The amounts of deferred tax accounted for in the consolidated balance sheet comprise the following net deferred tax assets/(liabilities):

	Property, plant and equipment £ million	Intangible assets £ million	Post employment plans £ million	Tax losses £ million	Other temporary differences[(i)] £ million	Total £ million
At 30 June 2016	(126)	(2,201)	240	60	343	(1,684)
Exchange differences	6	(51)	5	2	8	(30)
Recognised in income statement – continuing operations	(60)	(25)	(3)	(25)	(8)	(121)
Recognised in other comprehensive income and equity	–	–	(130)	6	(21)	(145)
Discontinued operations	–	–	–	–	2	2
At 30 June 2017	(180)	(2,277)	112	43	324	(1,978)
Exchange differences	7	89	(2)	(1)	(11)	82
Recognised in income statement – continuing operations	(134)	(14)	(9)	(15)	(84)	(256)
Reclassification	(4)	–	(1)	–	5	–
Recognised in other comprehensive income and equity	–	–	(105)	5	35	(65)
Tax rate change-recognised in income statement	19	390	(16)	–	(30)	363
Tax rate change-recognised in other comprehensive income and equity	–	–	(6)	–	(5)	(11)
At 30 June 2018	(292)	(1,812)	(27)	32	234	(1,865)

(i) Deferred tax on other temporary differences includes thalidomide provisions, restructuring provisions, share-based payments and intra group sales of products.

After offsetting deferred tax assets and liabilities where appropriate within territories, the net deferred tax liability comprises:

	2018 £ million	2017 £ million
Deferred tax assets	122	134
Deferred tax liabilities	(1,987)	(2,112)
	(1,865)	(1,978)

The deferred tax assets of £122 million includes £40 million (2017 – £63 million) arising in jurisdictions with prior year taxable losses. The majority of the asset is in respect of Ireland, where the amounts arose from timing differences on pension funding payments. It is considered more likely than not that there will be sufficient future taxable profits to realise these deferred tax assets, the majority of which can be carried forward indefinitely.

(e) Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following tax losses:

	2018 £ million	2017 £ million
Capital losses – indefinite	69	67
Trading losses – indefinite	92	80
Trading losses – expiry dates up to 2026	55	60
	216	207

(f) Unrecognised deferred tax liabilities

UK legislation largely exempts overseas dividends remitted from UK tax. A tax liability is more likely to arise in respect of withholding taxes levied by the overseas jurisdiction. Deferred tax is provided where there is an intention to distribute earnings, and a tax liability arises. It is impractical to estimate the amount of unrecognised deferred tax liabilities in respect of these unremitted earnings.

The aggregate amount of temporary differences in respect of investments in subsidiaries, branches, interests in associates and joint ventures for which deferred tax liabilities have not been recognised is approximately £12 billion (2017 – £13.7 billion).

8. Discontinued operations

Accounting policies

Discontinued operations comprise disposal groups where they represent a major line of business or geographical area of operations or business activities that the group no longer participates in or did not form part of the group's operations.

In the year ended 30 June 2017 discontinued operations comprised £55 million (net of deferred tax of £9 million), of additional amounts payable to the UK Thalidomide Trust, updates to the discount and inflation rates applied to the existing thalidomide provision and legal costs. Cash payments in the year ended 30 June 2017 in respect of the agreement were £31 million.

Operating assets and liabilities

Introduction

This section describes the assets used to generate the group's performance and the liabilities incurred. Liabilities relating to the group's financing activities are included in section 'Risk management and capital structure' and balance sheet information in respect of associates, joint ventures and taxation are covered in section 'Results for the year'. This section also provides detailed disclosures on the group's recent acquisitions and disposals, performance and financial position of its defined benefit post employment plans.

9. Acquisition and sale of businesses and purchase of non-controlling interests

Accounting policies

The consolidated financial statements include the results of the company and its subsidiaries together with the group's attributable share of the results of associates and joint ventures. The results of subsidiaries acquired or sold are included in the income statement from, or up to, the date that control passes.

Business combinations are accounted for using the acquisition method. Identifiable assets, liabilities and contingent liabilities acquired are measured at fair value at acquisition date. The consideration payable is measured at fair value and includes the fair value of any contingent consideration.

On the acquisition of a business, or of an interest in an associate or joint venture, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets including identifiable intangible assets and contingent liabilities acquired. Directly attributable acquisition costs in respect of subsidiary companies acquired are recognised in other external charges as incurred.

The non-controlling interests on the date of acquisition can be measured either at the fair value or at the non-controlling shareholder's proportion of the net fair value of the identifiable assets assumed. This choice is made separately for each acquisition.

Where the group has issued a put option over shares held by a non-controlling interest, the group derecognises the non-controlling interests and instead recognises a contingent deferred consideration liability for the estimated amount likely to be paid to the non-controlling interest on the exercise of those options. Movements in the estimated liability in respect of put options are recognised in retained earnings.

Transactions with non-controlling interests are recorded directly in retained earnings.

For all entities in which the company, directly or indirectly, owns equity a judgement is made to determine whether the investor controls the investee and therefore should fully consolidate the investee. An assessment is carried out to determine whether the group has the exposure or rights to the variable returns of the investee and has the ability to affect those returns through its power over the investee. To establish control an analysis is carried out of the substantive and protective rights that the group and the other investors hold. This assessment is dependent on the activities and purpose of the investee and the rights of the other shareholders, such as which party controls the board, executive committee and material policies of the investee. Determining whether the rights that the group holds are substantive requires management judgement.

Where less than 50% of the equity of an investee is held, and the group holds significantly more voting rights than any other vote holder or organised group of vote holders this may be an indicator of de facto control. An assessment is needed to determine all the factors relevant to the relationship with the investee to ascertain whether control has been established and whether the investee should be consolidated as a subsidiary. Where voting power and returns from an investment are split equally between two entities then the arrangement is accounted for as a joint venture.

On an acquisition fair values are attributed to the assets and liabilities acquired. This may involve material judgement to determine these values.

(a) Acquisition of businesses

Fair value of net assets acquired and cash consideration paid in respect of the acquisition of businesses and the purchase of shares of non-controlling interests in the three years ended 30 June 2018 were as follows:

	Net assets acquired and consideration				
	Casamigos £ million	Other £ million	2018 £ million	2017 £ million	2016 £ million
Brands and other intangibles	469	9	478	–	26
Inventories	4	–	4	–	–
Other working capital	5	(3)	2	–	–
Current tax	–	–	–	–	(1)
Deferred tax	–	–	–	–	(11)
Cash	6	–	6	–	–
Fair value of assets and liabilities	484	6	490	–	14
Goodwill arising on acquisition	237	12	249	–	(14)
Consideration payable	721	18	739	–	–
Satisfied by:					
Cash consideration paid	549	6	555	–	–
Contingent consideration payable	172	12	184	–	–
	721	18	739	–	–
Cash consideration paid for Casamigos	549	–	549	–	–
Cash consideration paid for other subsidiaries	–	6	6	–	–
Cash consideration paid for investments in associates	–	12	12	6	10
Cash consideration paid in respect of prior year acquisitions	–	22	22	23	4
Capital injection in associates	–	11	11	2	1
Cash acquired	(6)	–	(6)	–	–
Net cash outflow on acquisition of businesses	543	51	594	31	15
Purchase of shares of non-controlling interests	–	–	–	–	21
Total net cash outflow	543	51	594	31	36

Casamigos

On 15 August 2017 Diageo completed the purchase of 100% of the share capital of Casamigos Tequila, LLC (Casamigos), a super premium tequila based in the United States, for $1,000 million (£777 million) of which $300 million (£233 million) was contingent on Casamigos achieving certain performance targets. Casamigos contributed £55 million to sales, £49 million to net sales, £4 million to operating profit (net of transaction costs of £4 million) and £3 million profit after tax in the year ended 30 June 2018.

It is expected that the goodwill will be deductible for tax purposes. The net present value of the contingent consideration payable was $221 million (£172 million) at the date of acquisition and is expected to be paid in tranches over the next ten years. The goodwill arising on the acquisition of Casamigos represents expected revenue and cost synergies and the acquired workforce.

Other

On 14 March 2018 Diageo completed the acquisition of Belsazar GmbH, a premium aperitif from Germany's Black Forest.

On 2 May 2018 Diageo acquired 100% of the intellectual property of Pierde Almas, an ultra premium mezcal.

Prior year acquisitions

In the two years ended 30 June 2017, Diageo has made a number of small acquisitions of brands, distribution rights and equity interests in various drinks businesses for a consideration of £16 million.

(b) Sale of businesses

In the two years ended 30 June 2018 and 30 June 2017 there were no significant disposals completed by the group. In the year ended 30 June 2016 the group completed the sale of Diageo's Jamaica, Singapore and Malaysian beer interests to Heineken for a net consideration £510 million. The group also completed the sale of its wine interests in the United States and its UK based Percy Fox businesses for a consideration of £397 million. In addition, the group disposed of its South African associate interests, its shareholding in Central Glass Industries Limited (CGI), the Bouvet wine business in France and the group's subsidiary in Argentina for aggregate consideration of £159 million.

10. Intangible assets

Accounting policies

Acquired intangible assets are held on the consolidated balance sheet at cost less accumulated amortisation and impairment losses. Acquired brands and other intangible assets are initially recognised at fair value when they are controlled through contractual or other legal rights, or are separable from the rest of the business, and the fair value can be reliably measured. Where these assets are regarded as having indefinite useful economic lives, they are not amortised.

Goodwill represents the excess of the aggregate of the consideration transferred, the value of any non-controlling interests and the fair value of any previously held equity interest in the subsidiary acquired over the fair value of the identifiable net assets acquired. Goodwill arising on acquisitions prior to 1 July 1998 was eliminated against reserves, and this goodwill has not been reinstated. Goodwill arising subsequent to 1 July 1998 has been capitalised.

Amortisation and impairment of intangible assets is based on their useful economic lives and are amortised on a straight-line basis over those lives and reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. Goodwill and intangible assets that are regarded as having indefinite useful economic lives are not amortised and are reviewed for impairment at least annually or when there is an indication that the assets may be impaired. Impairment reviews compare the net carrying value with the recoverable amount (where recoverable amount is the higher of fair value less cost to sell and value in use). Amortisation and any impairment write downs are charged to other operating expenses in the income statement.

Computer software is amortised on a straight-line basis to estimated residual value over its expected useful life. Residual values and useful lives are reviewed each year. Subject to these reviews, the estimated useful lives are up to eight years.

Critical accounting estimates and judgements

Assessment of the recoverable amount of an intangible asset, the useful economic life of an asset, or that an asset has an indefinite life, requires management judgement.

Impairment reviews are carried out to ensure that intangible assets, including brands, are not carried at above their recoverable amounts. The tests are dependent on management's estimates in respect of the forecasting of future cash flows. Judgement is required in determining the cash-generating units, the discount rates applicable to the future cash flows and what expected growth rates are reasonable. Such estimates and judgements are subject to change as a result of changing economic conditions and actual cash flows may differ from forecasts.

	Brands £ million	Goodwill £ million	Other intangibles £ million	Computer software £ million	Total £ million
Cost					
At 30 June 2016	8,656	2,767	1,472	568	13,463
Exchange differences	159	24	34	4	221
Additions	–	–	–	47	47
Disposals	–	–	–	(41)	(41)
At 30 June 2017	8,815	2,791	1,506	578	13,690
Exchange differences	(347)	(252)	(24)	(7)	(630)
Additions	478	249	–	35	762
Disposals	–	–	–	(2)	(2)
At 30 June 2018	**8,946**	**2,788**	**1,482**	**604**	**13,820**
Amortisation and impairment					
At 30 June 2016	577	68	68	380	1,093
Exchange differences	9	–	1	3	13
Amortisation for the year	–	–	3	53	56
Disposals	–	–	–	(38)	(38)
At 30 June 2017	586	68	72	398	1,124
Exchange differences	(10)	(8)	–	(5)	(23)
Amortisation for the year	–	–	3	55	58
Exceptional impairment	40	50	–	–	90
Disposals	–	–	–	(1)	(1)
At 30 June 2018	**616**	**110**	**75**	**447**	**1,248**
Carrying amount					
At 30 June 2018	**8,330**	**2,678**	**1,407**	**157**	**12,572**
At 30 June 2017	8,229	2,723	1,434	180	12,566
At 30 June 2016	8,079	2,699	1,404	188	12,370

(a) Brands

At 30 June 2018, the principal acquired brands, all of which are regarded as having indefinite useful economic lives, are as follows:

	Principal markets	2018 £ million	2017 £ million
Crown Royal whisky	United States	1,109	1,126
McDowell's No.1 whisky, rum and brandy	India	1,077	1,156
Captain Morgan	Global	910	924
Johnnie Walker whisky	Global	625	625
Smirnoff vodka	Global	624	634
Windsor Premier whisky	Korea	591	583
Casamigos tequila	United States	458	–
Yenì Raki	Turkey	280	372
Shui Jing Fang Chinese white spirit	Greater China	259	257
Signature whisky	India	202	218
Don Julio tequila	United States	195	216
Bell's whisky	United Kingdom	179	179
Black Dog whisky	India	171	184
Seagram's 7 Crown whiskey	United States	169	171
Antiquity whisky	India	167	180
Zacapa rum	Global	145	147
Seagram's VO whisky	United States	144	146
Gordon's gin	Europe	119	119
Bagpiper whisky	India	116	124
Old Parr whisky	Global	101	101
Other brands		689	767
		8,330	8,229

The brands are protected by trademarks, which are renewable indefinitely, in all of the major markets where they are sold. There are not believed to be any legal, regulatory or contractual provisions that limit the useful lives of these brands. The nature of the premium drinks industry is that obsolescence is not a common issue, with indefinite brand lives being commonplace, and Diageo has a number of brands that were originally created more than 100 years ago. Accordingly, the Directors believe that it is appropriate that the brands are treated as having indefinite lives for accounting purposes and are therefore not amortised.

(b) Goodwill

For the purposes of impairment testing, goodwill has been attributed to the following cash-generating units:

	2018 £ million	2017 £ million
North America	390	207
Europe and Turkey		
– Europe (excluding Turkey)	170	154
– Turkey	284	377
Africa – Africa Regional Markets	27	93
Latin America and Caribbean – Mexico	133	103
Asia Pacific		
– Greater China	131	130
– India	1,462	1,572
Other cash-generating units	81	87
	2,678	2,723

Goodwill has arisen on the acquisition of businesses and includes synergies arising from cost savings, the opportunity to utilise Diageo's distribution network to leverage marketing of the acquired products and the extension of the group's portfolio of brands in new markets around the world.

(c) Other intangibles

Other intangibles principally comprise distribution rights. Diageo owns the global distribution rights for Ketel One vodka products in perpetuity, and the Directors believe that it is appropriate to treat these rights as having an indefinite life for accounting purposes. The carrying value at 30 June 2018 was £1,363 million (2017 – £1,385 million).

(d) Impairment testing

Impairment tests are performed annually, or more frequently if events or circumstances indicate that the carrying amount may not be recoverable. Recoverable amounts are calculated based on the value in use approach. The value in use calculations are based on discounted forecast cash flows using the assumption that cash flows continue in perpetuity at the terminal growth rate of each country or region. The individual brands and their associated tangible fixed assets are aggregated and tested as separate cash-generating unit. Separate tests are carried out for each cash-generating unit (brand and attributable tangible fixed assets) and for each of the markets. Goodwill is attributed to each of the markets.

Cash flows

Cash flows are forecast for each cash-generating unit for the financial year, which is approved by management and reflects expectations of sales growth, operating costs and margin, based on past experience and external sources of information.

Discount rates

The discount rates used are the weighted average cost of capital which reflects the returns on government bonds and an equity risk premium adjusted for the drinks industry specific to the cash-generating units. Further risk premiums are applied according to management's assessment of the risks in respect of the cash flows for a particular asset or cash-generating unit. The group applies post-tax discount rates to post-tax cash flows as the valuation calculated using this method closely approximates to applying pre-tax discount rates to pre-tax cash flows.

Long term growth rates, period of growth and terminal growth rates
The terminal growth rates applied at the end of the forecast period are the long term annual inflation rate of the country adjusted to take into account circumstances specific to the asset or cash-generating unit. For some intangible assets, management expects to achieve growth, driven by Diageo's sales, marketing and distribution expertise, which is significantly in excess of the terminal growth rates for the applicable countries or regions. In these circumstances, the recoverable amount is calculated based on a five-year detailed plan and extended by up to an additional ten years using the annual growth rate of the real gross domestic product (GDP) of the country or region aggregated with its inflation rate, adjusted to take into account circumstances specific to the asset or cash-generating unit. In the calculation of the terminal value, the long term annual inflation rate of the country is used as the terminal growth rate.

For goodwill, these assumptions are based on the cash-generating unit or group of units to which the goodwill is attributed. For brands, they are based on a weighted average taking into account the country or countries where sales are made.

The pre-tax discount rates and terminal growth rates used for impairment testing are as follows:

	2018		2017	
	Pre-tax discount rate %	**Terminal growth rate %**	Pre-tax discount rate %	Terminal growth rate %
North America – United States	**10**	**2**	10	2
Europe and Turkey				
– Europe	**7**	**2**	8	2
– Turkey	**16**	**5**	16	5
Africa				
– Africa Regional Markets	**25**	**5**	21	4
– Ethiopia	**24**	**8**	24	8
– South Africa	**16**	**5**	18	5
Latin America and Caribbean				
– Brazil	**15**	**4**	15	5
– Mexico	**16**	**3**	17	3
Asia Pacific				
– Korea	**8**	**2**	8	2
– Greater China	**9**	**2**	10	3
– India	**14**	**5**	14	6

In the year ended 30 June 2018, an impairment charge in respect of the Meta brand, the related tangible fixed assets, associated spare parts included in inventories and goodwill allocated to the Africa Regional Markets cash-generating unit of £40 million, £35 million, £3 million and £50 million, respectively, was charged to operating exceptional expenses. The impairment reduced the deferred tax liability, attributable to the brand and tangible fixed assets by £13 million resulting in a net exceptional loss of £115 million. Forecast cash flow assumptions were reduced principally due to the devaluation of the Ethiopian Birr increasing costs of imported raw materials and products, an increased competitive environment and political unrest in Ethiopia.

(e) Sensitivity to change in key assumptions
Impairment testing for the year ended 30 June 2018 has identified the following cash-generating units as being sensitive to reasonably possible changes in assumptions.

The table below shows the headroom at 30 June 2018 and the impairment charge that would be required if the assumptions in the calculation of their value in use were changed:

	Headroom £ million	1ppt increase in discount rate £ million	10% decrease in annual cash flow £ million	2ppt decrease in annual growth rate £ million	5ppt decrease in annual growth rate in forecast period 2019-2029 £ million
India[(i)]	823	–	–	–	(907)
Windsor Premier brand[(ii)]	170	–	–	(56)	–
Africa Regional Markets[(iii)]	–	(15)	(29)	–	–

(i) As India is a developing market, where maturity is not expected for a number of years, a management forecast growth projection was used until 2029. The only change in the key assumptions considered reasonably possible that would result in an impairment of the cash-generating unit would be a 5ppt decrease in the annual growth rates throughout the forecast period. The cumulative effect of such a change is disclosed in the table above.
(ii) The Windsor Premier brand is disclosed as sensitive due to the challenging whisky market in Korea. The only change in the key assumptions considered reasonably possible that would result in an impairment of the brand would be a 2ppt decrease in the annual growth rate in perpetuity. The cumulative effect of such a change is disclosed in the table above.
(iii) Reasonably possible changes in the key assumptions that would result in further impairment of the goodwill allocated to Africa Regional Markets cash-generating unit would be a 1ppt increase in discount rate or a 10% decrease in annual cash flows.

It remains possible that changes in assumptions could arise in excess of those indicated in the table above.

For all intangibles with an indefinite life, other than those disclosed in the table above, management has concluded that no reasonable possible change in the key assumptions on which it has determined the recoverable amounts would cause their carrying values to exceed their recoverable amounts.

11. Property, plant and equipment

Accounting policies

Land and buildings are stated at cost less accumulated depreciation. Freehold land is not depreciated. Leaseholds are generally depreciated over the unexpired period of the lease. Other property, plant and equipment are depreciated on a straight-line basis to estimated residual values over their expected useful lives, and these values and lives are reviewed each year. Subject to these reviews, the estimated useful lives fall within the following ranges: buildings – 10 to 50 years; within plant and equipment casks and containers – 15 to 50 years; other plant and equipment – 5 to 25 years; fixtures and fittings – 5 to 10 years; and returnable bottles and crates – 5 to 10 years.

Reviews are carried out if there is an indication that assets may be impaired, to ensure that property, plant and equipment are not carried at above their recoverable amounts.

Government grants

Government grants are not recognised until there is reasonable assurance that the group will comply with the conditions pursuant to which they have been granted and that the grants will be received. Government grants in respect of property, plant and equipment are deducted from the asset that they relate to, reducing the depreciation expense charged to the income statement.

Leases

Where the group has substantially all the risks and rewards of ownership of an asset subject to a lease, the lease is treated as a finance lease. Assets held under finance leases are recognised as assets of the group at their fair value at the inception of the lease. The corresponding liability to the lessor is included in other financial liabilities on the consolidated balance sheet. Lease payments are apportioned between interest expense and a reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Other leases are treated as operating leases, with payments and receipts taken to the income statement on a straight-line basis over the life of the lease.

	Land and buildings £ million	Plant and equipment £ million	Fixtures and fittings £ million	Returnable bottles and crates £ million	Under construction £ million	Total £ million
Cost						
At 30 June 2016	1,483	3,783	122	516	310	6,214
Exchange differences	39	(12)	(1)	(14)	–	12
Additions	39	117	14	28	261	459
Disposals	(28)	(90)	(10)	(24)	(3)	(155)
Transfers	95	160	2	17	(274)	–
At 30 June 2017	1,628	3,958	127	523	294	6,530
Exchange differences	(36)	(73)	(6)	(9)	(7)	(131)
Sale of businesses	(2)	–	–	–	–	(2)
Additions	20	138	7	27	372	564
Disposals	(38)	(84)	(6)	(25)	(4)	(157)
Transfers	13	163	4	18	(223)	(25)
At 30 June 2018	1,585	4,102	126	534	432	6,779
Depreciation						
At 30 June 2016	400	1,513	80	340	–	2,333
Exchange differences	3	(5)	–	(7)	–	(9)
Depreciation charge for the year	57	196	13	39	–	305
Disposals	(12)	(73)	(7)	(21)	–	(113)
At 30 June 2017	448	1,631	86	351	–	2,516
Exchange differences	(10)	(32)	(4)	(4)	–	(50)
Depreciation charge for the year	48	210	15	37	–	310
Exceptional impairment	–	26	–	9	–	35
Sale of businesses	(1)	–	–	–	–	(1)
Disposals	(18)	(74)	(6)	(22)	–	(120)
At 30 June 2018	467	1,761	91	371	–	2,690
Carrying amount						
At 30 June 2018	1,118	2,341	35	163	432	4,089
At 30 June 2017	1,180	2,327	41	172	294	4,014
At 30 June 2016	1,083	2,270	42	176	310	3,881

(a) The net book value of land and buildings comprises freeholds of £1,073 million (2017 – £1,128 million), long leaseholds of £25 million (2017 – £31 million) and short leaseholds of £20 million (2017 – £21 million). Depreciation was not charged on £147 million (2017 – £196 million) of land.

(b) At 30 June 2018, tangible fixed assets held under finance leases amounted to £231 million (2017 – £250 million), principally in respect of plant and equipment. Depreciation on assets held under finance leases was £16 million (2017 – £15 million).

(c) Property, plant and equipment is net of a government grant of £140 million (2017 – £142 million) received in prior years in respect of the construction of a rum distillery in the United States Virgin Islands.

(d) Transfers in the year ended 30 June 2018 include £25 million transferred to assets held for sale.

(e) In the year ended 30 June 2018, an exceptional accelerated depreciation and impairment of £35 million in respect of Ethiopian tangible fixed assets was charged to other operating exceptional expenses. For further information see note 10(d).

12. Other investments

Accounting policies

Other investments are such equity investments that are not classified as investments in associates or joint arrangements nor investments in subsidiaries. They are included in non-current assets. Subsequent to initial measurement, other investments are stated at fair value. Gains and losses arising from the changes in fair value are recognised in the income statement or in other comprehensive income on a case by case basis. Accumulated gains and losses included in other comprehensive income are not recycled to the income statement. Dividends from other investments are recognised in the consolidated income statement.

Loans receivable are non-derivative financial assets that are not classified as equity investments. They are subsequently measured either at amortised cost using the effective interest method less allowance for impairment or at fair value with gains and losses arising from changes in fair value recognised in the income statement or in other comprehensive income that are recycled to the income statement on the de-recognition of the asset. Allowances for expected credit losses are made based on the risk of non-payment taking into account ageing, previous experience, economic conditions and forward looking data. Such allowances are measured as either 12-months expected credit losses or lifetime expected credit losses depending on changes in the credit quality of the counterparty.

	Loans £ million	Others £ million	Total £ million
Cost less allowances or fair value			
At 30 June 2016	23	8	31
Exchange differences	1	–	1
Additions	2	–	2
Repayments and disposals	(5)	–	(5)
Fair value adjustment	–	2	2
At 30 June 2017	21	10	31
Exchange differences	(1)	2	1
Additions	21	–	21
Repayments and disposals	(2)	(2)	(4)
Fair value adjustment	(4)	1	(3)
At 30 June 2018	35	11	46

a. At 30 June 2018, loans comprise £35 million (2017 – £18 million; 2016 – £21 million) of loans to customers and other third parties, after allowances of £108 million (2017 – £110 million; 2016 – £98 million), and £nil (2017 – £3 million; 2016 – £2 million) of loans to associates.

b. Loans include a loan of $135 million (£104 million) provided by Standard Chartered Bank (SCB) to Watson Limited and guaranteed by a subsidiary of the group. The loan became due in May 2015 and was paid to SCB by Diageo in January 2016. The amount receivable from Watson Limited in respect of the guarantee has been fully provided for.

13. Post employment benefits

Accounting policies

The group's principal pension funds are defined benefit plans. In addition, the group has defined contribution plans, unfunded post employment medical benefit liabilities and other unfunded defined benefit post employment liabilities. For post employment plans, other than defined contribution plans, the amount charged to operating profit is the cost of accruing pension benefits promised to employees over the year, plus any changes arising on benefits granted to members by the group during the year. Net finance charges comprise the net deficit/asset on the plans at the beginning of the year, adjusted for cash flows in the year, multiplied by the discount rate for plan liabilities. The differences between the fair value of the plans' assets and the present value of the plans' liabilities are disclosed as an asset or liability on the consolidated balance sheet. Any differences due to changes in assumptions or experience are recognised in other comprehensive income. The amount of any pension fund asset recognised on the balance sheet is limited to any future refunds from the plan or the present value of reductions in future contributions to the plan.

Contributions payable by the group in respect of defined contribution plans are charged to operating profit as incurred.

Critical accounting estimates and judgements

Application of IAS 19 requires the exercise of estimate and judgement in relation to various assumptions.

Diageo determines the assumptions on a country by country basis in conjunction with its actuaries. Estimates are required in respect of uncertain future events including the life expectancy of members of the funds, salary and pension increases, future inflation rates, discount rates and employee and pensioner demographics. The application of different assumptions could have a significant effect on the amounts reflected in the income statement, other comprehensive income and the balance sheet. There may be interdependencies between the assumptions.

Where there is an accounting surplus on a defined benefit plan management judgement is necessary to determine whether the group can obtain a refund of the surplus by reducing future contributions to the plan.

(a) Post employment benefit plans

The group operates a number of pension plans throughout the world, devised in accordance with local conditions and practices. The majority of the plans are defined benefit plans and are funded by payments to separately administered trusts or insurance companies. The group also operates a number of plans that are generally unfunded, primarily in the United States, which provide employees post employment medical benefits.

The principal plans are in the United Kingdom, Ireland and the United States where benefits are based on employees' length of service and salary at retirement. All valuations were performed by independent actuaries using the projected unit credit method to determine pension costs. The most recent funding valuations of the significant defined benefit plans were carried out as follows:

Principal plans	Date of valuation
United Kingdom(i)	1 April 2015
Ireland(ii)	31 December 2015
United States	1 January 2018

(i) The triennial valuation of the Diageo Pension Scheme (the UK Scheme) as at 1 April 2018 is in progress and the results of this valuation are expected to be agreed by Diageo and the trustee later in calendar year 2018. The Diageo Pension Scheme (the UK Scheme) closed to new members in November 2005. Employees who have joined Diageo in the United Kingdom since the defined benefit scheme closed had been eligible to become members of the Diageo Lifestyle Plan (a cash balance defined benefit pension plan) until 1 January 2018. Since then new employees have been eligible to become members of a Diageo administered defined contribution plan. From 1 April 2018 there were changes to the future benefits earnt by employees in the UK Scheme. The changes impact the ongoing service cost but not the benefits earnt by the members as at 31 March 2018.
(ii) The Guinness Ireland Group Pension Scheme in Ireland (the Irish Scheme) closed to new members in May 2013. Employees who have joined Diageo in Ireland since the defined benefit scheme closed have been eligible to become members of Diageo administered defined contribution plans.

The assets of the UK and Irish pension plans are held in separate trusts administered by trustees who are required to act in the best interests of the plans' beneficiaries. For the UK Scheme, the trustee is Diageo Pension Trust Limited. As required by legislation, one-third of the directors of the Trust are nominated by the members of the UK Scheme, member nominated directors are appointed from both the pensioner member community and the active member community. For the Irish Scheme Diageo Ireland makes four nominations and appoints three further candidates nominated by representative groupings.

The amounts charged to the consolidated income statement for the group's defined benefit post employment plans and the consolidated statement of comprehensive income for the three years ended 30 June 2018 are as follows:

	2018 £ million	2017 £ million	2016 £ million
Current service cost and administrative expenses	(123)	(133)	(112)
Past service gains	33	14	1
Gains on curtailments and settlements	6	10	1
Charge to operating profit	(84)	(109)	(110)
Net finance charge in respect of post employment plans	(11)	(25)	(5)
Charge before taxation(i)	(95)	(134)	(115)
Actual returns less amounts included in finance income	312	973	61
Experience (losses) / gains	(30)	58	91
Changes in financial assumptions	108	(466)	(1,066)
Changes in demographic assumptions	69	86	62
Other comprehensive income/(loss)	459	651	(852)
Changes in the surplus restriction	(2)	1	–
Total other comprehensive income/ (loss)	457	652	(852)

(i) The charge before taxation in respect of the following countries is:

	2018 £ million	2017 £ million	2016 £ million
United Kingdom	(49)	(67)	(50)
Ireland	1	(15)	(19)
United States	(29)	(34)	(27)
Other	(18)	(18)	(19)
	(95)	(134)	(115)

In addition to the charge in respect of defined benefit post employment plans, contributions to the group's defined contribution plans were £18 million (2017 – £17 million; 2016 – £16 million).

The movement in the net (deficit)/surplus for the two years ended 30 June 2018 is set out below:

	Plan assets £ million	Plan liabilities £ million	Net (deficit)/ surplus £ million
At 30 June 2016	8,256	(9,447)	(1,191)
Exchange differences	99	(135)	(36)
Charge before taxation	173	(307)	(134)
Other comprehensive income/(loss)(i)	973	(322)	651
Contributions by the group	220	–	220
Employee contributions	8	(8)	–
Benefits paid	(503)	503	–
At 30 June 2017	9,226	(9,716)	(490)
Exchange differences	(1)	1	–
Charge before taxation	227	(322)	(95)
Other comprehensive income(i)	312	147	459
Contributions by the group	192	–	192
Employee contributions	6	(6)	–
Benefits paid	(652)	652	–
At 30 June 2018	9,310	(9,244)	66

(i) Excludes surplus restriction.

The plan assets and liabilities by type of post employment benefit and country is as follows:

	2018		2017	
	Plan assets £ million	Plan liabilities £ million	Plan assets £ million	Plan liabilities £ million
Pensions				
United Kingdom	6,792	(6,032)	6,789	(6,680)
Ireland	1,745	(2,148)	1,663	(1,952)
United States	525	(505)	522	(516)
Other	180	(215)	178	(215)
Post employment medical	1	(259)	2	(263)
Other post employment	67	(85)	72	(90)
	9,310	(9,244)	9,226	(9,716)

The balance sheet analysis of the post employment plans is as follows:

	2018		2017	
	Non-current assets(i) £ million	Non-current liabilities £ million	Non-current assets(i) £ million	Non-current liabilities £ million
Funded plans	935	(593)	281	(492)
Unfunded plans	–	(279)	–	(280)
	935	(872)	281	(772)

(i) Includes surplus restriction of £3 million (2017 – £1 million).

(b) Principal risks and assumptions

The material post employment plans are not exposed to any unusual, entity specific or scheme specific risks but there are general risks:
Inflation – the majority of the plans' obligations are linked to inflation. Higher inflation will lead to increased liabilities which is partially offset by the plans holding inflation linked gilts, swaps and caps against the level of inflationary increases.

Interest rate – The plan liabilities are determined using discount rates derived from yields on AA-rated corporate bonds. A decrease in corporate bond yields will increase plan liabilities though this will be partially offset by an increase in the value of the bonds held by the post employment plans.

Mortality – The majority of the obligations are to provide benefits for the life of the members and their partners, so any increase in life expectancy will result in an increase in the plans' liabilities.

Asset returns – Assets held by the pension plans are invested in a diversified portfolio of equities, bonds and other assets. Volatility in asset values will lead to movements in the net deficit/surplus reported in the consolidated balance sheet for post employment plans which in addition will also impact the post employment expense in the consolidated income statement.

The following weighted average assumptions were used to determine the group's deficit/surplus in the main post employment plans at 30 June in the relevant year. The assumptions used to calculate the charge/credit in the consolidated income statement for the year ended 30 June are based on the assumptions disclosed as at the previous 30 June.

	United Kingdom			Ireland			United States[i]		
	2018 %	2017 %	2016 %	**2018 %**	2017 %	2016 %	**2018 %**	2017 %	2016 %
Rate of general increase in salaries[ii]	**4.3**	4.4	4.0	**3.2**	3.0	2.8	**–**	–	–
Rate of increase to pensions in payment	**3.3**	3.4	3.1	**2.0**	1.7	1.6	**–**	–	–
Rate of increase to deferred pensions	**2.1**	2.2	1.8	**1.8**	1.6	1.4	**–**	–	–
Discount rate for plan liabilities	**2.8**	2.6	2.9	**1.7**	2.1	1.4	**4.1**	3.7	3.5
Inflation – CPI	**2.1**	2.2	1.8	**1.8**	1.6	1.4	**2.1**	1.8	1.4
Inflation – RPI	**3.1**	3.2	2.8	**–**	–	–	**–**	–	–

(i) The salary increase assumption in the United States is not a significant assumption as only a minimal amount of members' pension entitlement is dependent on a member's projected final salary.
(ii) The salary increase assumptions include an allowance for age related promotional salary increases.

For the principal UK and Irish pension funds, the table below illustrates the expected age at death of an average worker who retires currently at the age of 65, and one who is currently aged 45 and subsequently retires at the age of 65:

	United Kingdom[i]			Ireland[ii]			United States		
	2018 Age	2017 Age	2016 Age	**2018 Age**	2017 Age	2016 Age	**2018 Age**	2017 Age	2016 Age
Retiring currently at age 65									
Male	**86.1**	86.3	86.4	**86.4**	86.3	86.2	**86.0**	85.9	86.3
Female	**88.4**	88.1	88.3	**89.2**	89.0	88.9	**88.0**	87.9	88.3
Currently aged 45, retiring at age 65									
Male	**88.2**	88.2	88.6	**89.4**	89.2	89.1	**87.6**	87.5	88.0
Female	**90.5**	90.5	91.2	**92.1**	91.9	91.8	**89.6**	89.5	89.9

(i) Based on the CMI's latest SAPS mortality tables with scaling factors based on the experience of the plan and where people live, with suitable future improvements.
(ii) Based on the '00' series of mortality tables with scaling factors based on the experience of the plan and with suitable future improvements.

For the significant assumptions, the following sensitivity analyses estimate the potential impacts on the consolidated income statement for the year ended 30 June 2018 and on the plan liabilities at 30 June 2018:

	United Kingdom			Ireland			United States and other		
Benefit/(cost)	Operating profit £ million	Profit after taxation £ million	Plan liabilities[i] £ million	Operating profit £ million	Profit after taxation £ million	Plan liabilities[i] £ million	Operating profit £ million	Profit after taxation £ million	Plan liabilities[i] £ million
Effect of 0.5% increase in discount rate	5	21	**512**	3	4	**190**	1	1	**32**
Effect of 0.5% decrease in discount rate	(6)	(19)	**(575)**	(4)	(4)	**(220)**	(1)	(1)	**(35)**
Effect of 0.5% increase in inflation	(5)	(15)	**(462)**	(4)	(6)	**(197)**	–	(1)	**(12)**
Effect of 0.5% decrease in inflation	5	13	**408**	3	5	**169**	–	1	**11**
Effect of one year increase in life expectancy	(1)	(6)	**(259)**	(1)	(2)	**(89)**	–	(1)	**(25)**

(i) The estimated effect on the liabilities excludes the impact of any interest rate and inflation swaps held by the pension plans.

(1) The sensitivity analyses above have been determined based on reasonably possible changes of the respective assumptions and may not be representative of the actual change. Each sensitivity is calculated on a change in the key assumption while holding all other assumptions constant. The sensitivity to inflation includes the impact on all inflation linked assumptions (e.g. pension increases and salary increases where appropriate).

Guaranteed minimum pension in the United Kingdom
Prior to 6 April 1997, individuals who contracted out of the UK State Second Pension were entitled to a Guaranteed Minimum Pension (GMP). Men accrued GMP at different rates on different terms to women. There is a current court case, not involving Diageo, challenging the potential unequal treatment of GMP for men and women which may lead to additional liabilities in the DPS. No allowance has been made for any additional provision which may be required in relation to GMP equalisation in the IAS 19 defined benefit obligation as at 30 June 2018 as it not possible to meaningfully quantify any additional provision pending the outcome of the legal proceedings.

(c) Investment and hedging strategy
The investment strategy for the group's funded post employment plans is determined locally by the trustees of the plan and/or Diageo, as appropriate, and takes account of the relevant statutory requirements. The objective of the investment strategy is to achieve a target rate of return in excess of the movement on the liabilities, whilst taking an acceptable level of investment risk relative to the liabilities. This objective is implemented by using the funds of the plans to invest in a variety of asset classes that are expected over the long term to deliver a target rate of return. The majority of the investment strategies have significant amounts allocated to equities, with the intention that this will result in the ongoing cost to the group of the post employment plans being lower over the long term, within acceptable boundaries of risk. Significant amounts are invested in bonds in order to provide a natural hedge against movements in the liabilities of the plans. At 30 June 2018, approximately 42% and 79% (2017 – 38% and 78%) of the UK Scheme's liabilities were hedged against future movements in interest rates and inflation, respectively, through the combined effect of bonds and swaps. At 30 June 2018, approximately 45% and 72% (2017 – 36% and 68%) of the Irish Scheme's liabilities were hedged against future movements in interest rates and inflation, respectively, through the combined effect of bonds and swaps.

The discount rates used are based on the yields of high quality fixed income investments. For the UK plans, which represent approximately 65% of total plan liabilities, the discount rate is determined by reference to the yield curves of AA-rated corporate bonds for which the timing and amount of cash outflows are similar to those of the plans. A similar process is used to determine the discount rates used for the non-UK plans.

An analysis of the fair value of the plan assets is as follows:

				2018				2017
	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million	United Kingdom £ million	Ireland £ million	United States and other £ million	Total £ million
Equities								
Quoted	758	316	242	1,316	902	367	296	1,565
Unquoted and private equity	399	1	18	418	365	2	19	386
Bonds								
Fixed-interest government	133	103	42	278	193	153	50	396
Inflation-linked government	1,063	262	1	1,326	1,036	182	–	1,218
Investment grade corporate	934	344	363	1,641	998	277	337	1,612
Non-investment grade	147	49	16	212	230	51	17	298
Loan securities	1,112	303	–	1,415	956	222	–	1,178
Repurchase agreements	2,799	–	–	2,799	2,812	–	–	2,812
Liability driven investment (LDI)	139	50	–	189	122	69	–	191
Property – unquoted	689	94	1	784	641	121	1	763
Hedge funds	68	138	–	206	–	151	–	151
Interest rate and inflation swaps	(1,415)	70	–	(1,345)	(1,440)	41	–	(1,399)
Cash and other	(34)	15	90	71	(26)	27	54	55
Total bid value of assets	6,792	1,745	773	9,310	6,789	1,663	774	9,226

(1) The asset classes include some cash holdings that are temporary. This cash is likely to be invested imminently and so has been included in the asset class where it is anticipated to be invested in the long term.
(2) At 30 June 2017 the Irish Scheme's plan assets included £0.5 million invested in the ordinary shares of Diageo plc.

Total cash contributions by the group to all post employment plans in the year ending 30 June 2019 are estimated to be approximately £200 million.

(d) Deficit funding arrangements
UK plans
In the year ended 30 June 2011 the group established a Pension Funding Partnership (PFP) in respect of the UK Scheme. Whisky inventory was transferred into the partnership but the group retains control over the partnership which at 30 June 2018 held inventory with a book value of £647 million (2017 – £532 million). The partnership is fully consolidated in the group financial statements. The UK Scheme has a limited interest in the partnership and, as a partner, is entitled to a distribution from the profits of the partnership which for the year ended 30 June 2018 was £25 million (2017 – £25 million) and is expected to be approximately the same amount for the next six years.

In 2024 the group will be required, dependent upon the funding position of the UK Scheme at that time, to pay an amount not greater than the actuarial deficit at that time, up to a maximum of £430 million in cash, to purchase the UK Scheme's interest in the partnership. If the UK Scheme is in surplus at an actuarial triennial valuation without allowing for the value of the PFP, then Diageo can exit the PFP with the agreement of the trustees. The group has also agreed to make conditional contributions if the deficit at the 2018 actuarial triennial valuation is in excess of £84 million. These additional contributions would be payable to the UK Scheme by 31 March 2019, or within one month of completion of the 2018 valuation if later.

Irish plans
The group has also agreed a deficit funding arrangement with the trustees of the Irish Scheme under which it contributes to the Irish Scheme €23 million (£20 million) per annum until the year ending 30 June 2028. The agreement also provides for additional cash contributions into escrow of up to €135 million (£119 million) if the deficit is not reduced at each triennial valuation to agreed limits up to 2027. As part of this funding plan, Diageo has also granted to the Irish Scheme a contingent asset comprising mortgages over certain land and buildings and fixed and floating charges over certain receivables of the group up to a value of €200 million (£177 million). Following the actuarial triennial valuation as of 31 December 2015, the group made additional cash contributions of €32 million (£28 million) during the year ended 30 June 2017, €9 million (£8 million) in the year ended 30 June 2018 and is expected to pay €9 million (£8 million) in the year ending 30 June 2019. The group has also agreed to make conditional payments up to a maximum of €29 million (£26 million) if the deficit on the plan is greater than €232 million (£205 million) at the 2018 actuarial triennial valuation. Any conditional payments would be made equally over the three years after the 31 December 2018 actuarial triennial valuation has been agreed.

(e) Timing of benefit payments
The following table provides information on the timing of the benefit payments and the average duration of the defined benefit obligations and the distribution of the timing of benefit payments:

	United Kingdom		Ireland		United States	
	2018 £ million	2017 £ million	**2018 £ million**	2017 £ million	**2018 £ million**	2017 £ million
Maturity analysis of benefits expected to be paid						
Within one year	**575**	347	**75**	76	**49**	57
Between 1 to 5 years	**1,144**	1,079	**370**	374	**187**	243
Between 6 to 15 years	**2,575**	2,800	**751**	742	**380**	366
Between 16 to 25 years	**2,196**	2,511	**727**	701	**242**	234
Beyond 25 years	**3,325**	4,201	**1,260**	1,170	**207**	198
Total	**9,815**	10,938	**3,183**	3,063	**1,065**	1,098
	years	years	**years**	years	**years**	years
Average duration of the defined benefit obligation	**19**	19	**19**	19	**10**	10

The projected benefit payments are based on the assumptions underlying the assessment of the obligations, including inflation. They are disclosed undiscounted and therefore appear large relative to the discounted value of the plan liabilities recognised in the consolidated balance sheet. They are in respect of benefits that have accrued at the balance sheet date and make no allowance for any benefits accrued subsequently.

(f) Related party disclosures
Information on transactions between the group and its pension plans is given in note 20.

14. Working capital

Accounting policies
Inventories are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, an appropriate proportion of production and other overheads, but not borrowing costs. Cost is calculated at the weighted average cost incurred in acquiring inventories. Maturing inventories which are retained for more than one year are classified as current assets, as they are expected to be realised in the normal operating cycle.

Trade and other receivables are initially recognised at fair value less transaction costs and subsequently carried at amortised cost less any allowance for discounts and doubtful debts. Trade receivables arise from contracts with customers, and are recognised when performance obligations are satisfied, and the consideration due is unconditional as only the passage of time is required before the payment is received. Allowance losses are calculated by reviewing lifetime expected credit losses using historic and forward-looking data on credit risk.

Trade and other payables are initially recognised at fair value including transaction costs and subsequently carried at amortised costs.

Provisions are liabilities of uncertain timing or amount. A provision is recognised if, as a result of a past event, the group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are calculated on a discounted basis. The carrying amounts of provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

(a) Inventories

	2018 £ million	2017 £ million
Raw materials and consumables	321	327
Work in progress	44	45
Maturing inventories	4,028	3,820
Finished goods and goods for resale	622	596
	5,015	4,788

Maturing inventories include whisk(e)y, rum, tequila and Chinese white spirits. The following amounts of inventories are expected to be utilised after more than one year:

	2018 £ million	2017 £ million
Raw materials and consumables	12	8
Maturing inventories	3,253	3,194
	3,265	3,202

Inventories are disclosed net of provisions for obsolescence, an analysis of which is as follows:

	2018 £ million	2017 £ million	2016 £ million
Balance at beginning of the year	88	73	53
Exchange differences	(2)	(1)	5
Income statement charge	–	41	33
Utilised	(15)	(25)	(15)
Sale of businesses	–	–	(3)
	71	88	73

(b) Trade and other receivables

	2018		2017	
	Current assets £ million	Non-current assets £ million	Current assets £ million	Non-current assets £ million
Trade receivables	2,152	–	2,130	–
Interest receivable	14	–	19	–
Other receivables	335	38	244	45
Prepayments	157	8	159	13
Accrued income	20	–	40	–
	2,678	46	2,592	58

At 30 June 2018, approximately 13%, 20% and 12% of the group's trade receivables of £2,152 million are due from counterparties based in the United Kingdom, the United States and India, respectively. Accrued income primarily represents amounts receivable from customers in respect of performance obligations satisfied but not yet invoiced.

The aged analysis of trade receivables, net of allowances, is as follows:

	2018 £ million	2017 £ million
Not overdue	2,067	2,026
Overdue 1 – 30 days	19	28
Overdue 31 – 60 days	19	19
Overdue 61 – 90 days	13	11
Overdue 91 – 180 days	21	21
Overdue more than 180 days	13	25
	2,152	2,130

Trade and other receivables are disclosed net of allowance for doubtful debts, an analysis of which is as follows:

	2018 £ million	2017 £ million	2016 £ million
Balance at beginning of the year	129	83	71
Exchange differences	(4)	(1)	5
Income statement charge	18	54	15
Written off	(46)	(7)	(8)
	97	129	83

The write-off for the year ended 30 June 2018 includes £32 million in respect of a claim made by a customer in India which was charged to the income statement in the year ended 30 June 2017. See note 4(c).

(c) Trade and other payables

	2018		2017	
	Current liabilities £ million	Non-current liabilities £ million	Current liabilities £ million	Non-current liabilities £ million
Trade payables	1,514	–	1,365	–
Interest payable	104	–	75	–
Tax and social security excluding income tax	638	2	543	2
Other payables	471	204	487	16
Accruals	1,165	3	1,064	6
Deferred income	37	–	29	–
Dividend payable	21	–	–	–
	3,950	209	3,563	24

Interest payable at 30 June 2018 includes interest on non-derivative financial instruments of £100 million (2017 – £68 million). Deferred income represents amounts paid by customers in respect of performance obligations not yet satisfied. Non-current liabilities includes £175 million in respect of the net present value of contingent consideration in respect of the acquisition of Casamigos.

(d) Provisions

	Thalidomide £ million	Other £ million	Total £ million
At 30 June 2017	223	192	415
Exchange differences	–	(12)	(12)
Disposal of businesses	–	(1)	(1)
Provisions charged during the year	–	53	53
Provisions utilised during the year	(13)	(50)	(63)
Transfers to other payables	–	(2)	(2)
Unwinding of discounts	7	–	7
At 30 June 2018	217	180	397
Current liabilities	14	95	109
Non-current liabilities	203	85	288
	217	180	397

(a) Provisions have been established in respect of the discounted value of the group's commitment to the UK and Australian Thalidomide Trusts. These provisions will be utilised over the period of the commitments up to 2037.

(b) The largest item in other provisions at 30 June 2018 is £48 million in respect of employee deferred compensation plans which will be utilised when employees leave the group.

Risk management and capital structure

Introduction

This section sets out the policies and procedures applied to manage the group's capital structure and the financial risks the group is exposed to. Diageo considers the following components of its balance sheet to be capital: borrowings and equity. Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels.

15. Financial instruments and risk management

Accounting policies

Financial assets and liabilities are initially recorded at fair value including, where permitted by IFRS 9, any directly attributable transaction costs. For those financial assets that are not subsequently held at fair value, the group assesses whether there is evidence of impairment at each balance sheet date.

The group classifies its financial assets and liabilities into the following categories: financial assets and liabilities at amortised cost, financial assets and liabilities at fair value through profit and loss and financial assets at fair value through other comprehensive income.

The accounting policies for ***other investments*** and loans are described in note 12, for ***trade and other receivables and payables*** in note 14 and for ***cash and cash equivalents*** in note 16.

Financial assets and liabilities at fair value through profit or loss include derivative assets and liabilities. Where financial assets or liabilities are eligible to be carried at either amortised cost or fair value through other comprehensive income the group does not apply the fair value option.

Derivative financial instruments are carried at fair value using a discounted cash flow model based on market data applied consistently for similar types of instruments. Gains and losses on derivatives that do not qualify for hedge accounting treatment are taken to the income statement as they arise.

Other financial liabilities are carried at amortised cost unless they are part of a fair value hedge relationship. The difference between the initial carrying amount of the financial liabilities and their redemption value is recognised in the income statement over the contractual terms using the effective interest rate method.

Hedge accounting

The group designates and documents certain derivatives as hedging instruments against changes in fair value of recognised assets and liabilities (fair value hedges), highly probable forecast transactions or the cash flow risk from a change in exchange or interest rates (cash flow hedges) and hedges of net investments in foreign operations (net investment hedges). The designated portion of the hedging instruments is included in other financial assets and liabilities on the consolidated balance sheet. The effectiveness of such hedges is assessed at inception and at least on a quarterly basis, using prospective testing. Methods used for testing effectiveness include dollar offset, critical terms, regression analysis and hypothetical models.

Fair value hedges are used to manage the currency and/or interest rate risks to which the fair value of certain assets and liabilities are exposed. Changes in the fair value of the derivatives are recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.

If such a hedge relationship no longer meets hedge accounting criteria, fair value movements on the derivative continue to be taken to the income statement while any fair value adjustments made to the underlying hedged item to that date are amortised through the income statement over its remaining life using the effective interest rate method.

Cash flow hedges are used to hedge the foreign currency risk of highly probable future foreign currency cash flows, as well as the cash flow risk from changes in exchange or interest rates. The effective portion of the gain or loss on the hedges is recognised in other comprehensive income, while any ineffective part is recognised in the income statement. Amounts recorded in other comprehensive income are recycled to the income statement in the same period in which the underlying foreign currency or interest exposure affects the income statement.

Net investment hedges take the form of either foreign currency borrowings or derivatives. Foreign exchange differences arising on translation of net investments are recorded in other comprehensive income and included in the exchange reserve. Liabilities used as hedging instruments are revalued at closing exchange rates and the resulting gains or losses are also recognised in other comprehensive income to the extent that they are effective, with any ineffectiveness taken to the income statement. Foreign exchange contracts hedging net investments are carried at fair value. Effective fair value movements are recognised in other comprehensive income, with any ineffectiveness taken to the income statement.

The group's funding, liquidity and exposure to foreign currency and interest rate risks are managed by the group's treasury department. The treasury department uses a range of financial instruments to manage these underlying risks.

Treasury operations are conducted within a framework of board approved policies and guidelines, which are recommended and monitored by the finance committee, chaired by the Chief Financial Officer. The policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk which are periodically reviewed by the Board following, for example, significant business, strategic or accounting changes. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board approved strategies. Transactions arising from the application of this flexibility are carried at fair value, gains or losses are taken to the income statement as they arise and are separately monitored on a daily basis using Value at Risk analysis. In the years ended 30 June 2018 and 30 June 2017 gains and losses on these transactions were not material. The group does not use derivatives for speculative purposes. All transactions in derivative financial instruments are initially undertaken to manage the risks arising from underlying business activities.

The group purchases insurance for commercial or, where required, for legal or contractual reasons. In addition, the group retains insurable risk where external insurance is not considered an economic means of mitigating these risks.

The finance committee receives a monthly report on the key activities of the treasury department, which would identify any exposures which differ from the defined benchmarks, should they arise.

(a) Currency risk

The group presents its consolidated financial statements in sterling and conducts business in many currencies. As a result, it is subject to foreign currency risk due to exchange rate movements, which will affect the group's transactions and the translation of the results and underlying net assets of its operations. To manage the currency risk the group uses certain financial instruments. Where hedge accounting is applied, hedges are documented and tested for effectiveness on an ongoing basis. Diageo expects hedges entered into to continue to be effective and therefore does not expect the impact of ineffectiveness on the consolidated income statement to be material.

Hedge of net investment in foreign operations

The group hedges a certain portion of its exposure to fluctuations in the sterling value of its foreign operations by designating borrowings held in foreign currencies and using foreign currency spots, forwards, swaps and other financial derivatives. For the year ended 30 June 2018 the group's policy was to maintain total net investment Value at Risk below £1.5 billion, where Value at Risk is defined as the maximum amount of loss over a one-year period with a 95% probability confidence level.

At 30 June 2018 foreign currency borrowings and financial derivatives designated in net investment hedge relationships amounted to £5,238 million (2017 – £6,746 million).

Hedge of foreign currency debt

The group uses cross currency interest rate swaps to hedge the foreign currency risk associated with certain foreign currency denominated borrowings.

Transaction exposure hedging

The group's policy is to hedge up to 24 months forecast transactional foreign currency risk on the net US dollar exposure of the group targeting 75% coverage for the current financial year and up to 18 months for other currency pairs. The group's exposure to foreign currency risk arising principally on forecasted sales transactions is managed using forward agreements.

(b) Interest rate risk

The group has an exposure to interest rate risk, arising principally on changes in US dollar, euro and sterling interest rates. To manage interest rate risk, the group manages its proportion of fixed to floating rate borrowings within limits approved by the Board, primarily through issuing fixed and floating rate borrowings and commercial paper, and by utilising interest rate swaps. These practices aim to minimise the group's net finance charges with acceptable year on year volatility. To facilitate operational efficiency and effective hedge accounting, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of forecast net borrowings. For these calculations, net borrowings exclude interest rate related fair value adjustments. The majority of the group's existing interest rate derivatives are designated as hedges and are expected to be effective. Fair value of these derivatives is recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability. The group's net borrowings interest rate profile as at 30 June 2018 and 2017 is as follows:

	2018		2017	
	£ million	**%**	£ million	%
Fixed rate	**4,739**	**52**	4,443	57
Floating rate(i)	**4,245**	**47**	3,336	42
Impact of financial derivatives and fair value adjustments	**107**	**1**	113	1
Net borrowings	**9,091**	**100**	7,892	100

(i) The floating rate portion of net borrowings includes cash and cash equivalents, collaterals, floating rate loans and bonds, bank overdrafts and finance lease obligations.

The table below sets out the average monthly net borrowings and effective interest rate:

Average monthly net borrowings			Effective interest rate		
2018 £ million	2017 £ million	2016 £ million	**2018 %**	2017 %	2016 %
9,063	8,771	9,245	**2.6**	3.5	3.3

(1) For this calculation, net interest charge excludes fair value adjustments to derivative financial instruments and borrowings and average monthly net borrowings includes the impact of interest rate swaps that are no longer in a hedge relationship but excludes the market value adjustment for cross currency interest rate swaps.

(c) Commodity price risk

Commodity price risk is managed in line with the principles approved by the Board either through long term purchase contracts with suppliers or, where appropriate, derivative contracts. The group policy is to maintain the Value at Risk of commodity price risk arisen from commodity exposures below 75 bps of forecast gross margin in any given financial year. Where derivative contracts are used the commodity price risk exposure is hedged up to 24 months of forecast volume through exchange-traded and over-the-counter contracts (futures, forwards, swaps and options) and cash flow hedge accounting is applied.

(d) Market risk sensitivity analysis

The group uses a sensitivity analysis that estimates the impacts on the consolidated income statement and other comprehensive income of either an instantaneous increase or decrease of 0.5% in market interest rates or a 10% strengthening or weakening in sterling against all other currencies, from the rates applicable at 30 June 2018 and 30 June 2017, for each class of financial instruments with all other variables remaining constant. The sensitivity analysis excludes the impact of market risks on the net post employment benefit liabilities and assets, and corporate tax payable. This analysis is for illustrative purposes only, as in practice interest and foreign exchange rates rarely change in isolation.

The sensitivity analysis estimates the impact of changes in interest and foreign exchange rates. All hedges are expected to be highly effective for this analysis and it considers the impact of all financial instruments including financial derivatives, cash and cash equivalents, borrowings and other financial assets and liabilities. The results of the sensitivity analysis should not be considered as projections of likely future events, gains or losses as actual results in the future may differ materially due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below.

	Impact on income statement gain/(loss)		Impact on consolidated comprehensive income gain/(loss)[(i) (ii)]	
	2018 £ million	2017 £ million	**2018 £ million**	2017 £ million
0.5% decrease in interest rates	**(19)**	(20)	**(18)**	(12)
0.5% increase in interest rates	**19**	20	**19**	13
10% weakening of sterling	**(15)**	(19)	**(833)**	(835)
10% strengthening of sterling	**11**	16	**680**	684

(i) The impact on foreign currency borrowings and derivatives in net investment hedges is largely offset by the foreign exchange difference arising on the translation of net investments.
(ii) The impact on the consolidated statement of comprehensive income includes the impact on the income statement.

(e) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the group. Credit risk arises on cash balances (including bank deposits and cash and cash equivalents), derivative financial instruments and credit exposures to customers, including outstanding loans, trade and other receivables, financial guarantees and committed transactions.

The carrying amount of financial assets represents the group's exposure to credit risk at the balance sheet date as disclosed in section (i), excluding the impact of any collateral held or other credit enhancements. A financial asset is in default when the counterparty fails to pay its contractual obligations. Financial assets are written off when there is no reasonable expectation of recovery.

Credit risk is managed separately for financial and business related credit exposures.

Financial credit risk

Diageo aims to minimise its financial credit risk through the application of risk management policies approved and monitored by the Board. Counterparties are predominantly limited to major banks and financial institutions, primarily with a long term credit rating within the A band or better, and the policy restricts the exposure to any one counterparty by setting credit limits taking into account the credit quality of the counterparty. The group's policy is designed to ensure that individual counterparty limits are adhered to and that there are no significant concentrations of credit risk. The Board also defines the types of financial instruments which may be transacted. The credit risk arising through the use of financial instruments for currency and interest rate risk management is estimated with reference to the fair value of contracts with a positive value, rather than the notional amount of the instruments themselves. Diageo annually reviews the credit limits applied and regularly monitors the counterparties' credit quality reflecting market credit conditions.

When derivative transactions are undertaken with bank counterparties, the group may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the benefit of the other if the net valuations of the derivatives are above a predetermined threshold. At 30 June 2018, the collateral held under these agreements amounted to $71 million (£54 million) (2017 – $96 million (£74 million)).

Business related credit risk

Loan, trade and other receivables exposures are managed locally in the operating units where they arise and active risk management is applied, focusing on country risk, credit limits, ongoing credit evaluation and monitoring procedures. There is no significant concentration of credit risk with respect to loans, trade and other receivables as the group has a large number of customers which are internationally dispersed.

(f) Liquidity risk

Liquidity risk is the risk that Diageo may encounter difficulties in meeting its obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The group uses short term commercial paper to finance its day-to-day operations. The group's policy with regard to the expected maturity profile of borrowings is to limit the amount of such borrowings maturing within 12 months to 50% of gross borrowings less money market demand deposits, and the level of commercial paper to 30% of gross borrowings less money market demand deposits. In addition, the group's policy is to maintain backstop facilities with relationship banks to support commercial paper obligations.

The following tables provide an analysis of the anticipated contractual cash flows including interest payable for the group's financial liabilities and derivative instruments on an undiscounted basis. Where interest payments are calculated at a floating rate, rates of each cash flow until maturity of the instruments are calculated based on the forward yield curve prevailing at the respective year ends. The gross cash flows of cross currency swaps are presented for the purposes of this table. All other derivative contracts are presented on a net basis. Financial assets and liabilities are presented gross in the consolidated balance sheet, although in practice, the group uses netting arrangements to reduce its liquidity requirements on these instruments.

Contractual cash flows

	Due within 1 year £ million	Due between 1 and 3 years £ million	Due between 3 and 5 years £ million	Due after 5 years £ million	Total £ million	Carrying amount at balance sheet date £ million
2018						
Borrowings(i)	(1,828)	(2,055)	(2,117)	(3,950)	(9,950)	(9,902)
Interest on borrowings(i), (iii)	(341)	(472)	(382)	(1,385)	(2,580)	(100)
Finance lease capital repayments	(30)	(66)	(34)	(25)	(155)	(155)
Finance lease future interest payments	(7)	(9)	(5)	(1)	(22)	–
Trade and other financial liabilities(ii)	(3,117)	(28)	(1)	(230)	(3,376)	(3,318)
Non-derivative financial liabilities	(5,323)	(2,630)	(2,539)	(5,591)	(16,083)	(13,475)
Cross currency swaps (gross)						
– Receivable	60	121	840	1,487	2,508	–
– Payable	(41)	(83)	(824)	(1,070)	(2,018)	–
Other derivative instruments (net)	(1)	(30)	(2)	5	(28)	–
Derivative instruments (iii)	18	8	14	422	462	90
2017						
Borrowings(i)	(2,458)	(1,253)	(1,350)	(3,998)	(9,059)	(9,042)
Interest on borrowings(i), (iii)	(334)	(421)	(366)	(1,461)	(2,582)	(68)
Finance lease capital repayments	(26)	(74)	(41)	(42)	(183)	(183)
Finance lease future interest payments	(9)	(12)	(7)	(3)	(31)	–
Trade and other financial liabilities(ii)	(2,693)	(34)	(173)	(3)	(2,903)	(2,889)
Non-derivative financial liabilities	(5,520)	(1,794)	(1,937)	(5,507)	(14,758)	(12,182)
Cross currency swaps (gross)						
– Receivable	61	122	122	2,302	2,607	–
– Payable	(41)	(82)	(82)	(1,853)	(2,058)	–
Other derivative instruments (net)	(94)	13	2	–	(79)	–
Derivative instruments(iii)	(74)	53	42	449	470	110

(i) For the purpose of these tables above, borrowings are defined as gross borrowings excluding finance lease liabilities and fair value of derivative instruments as disclosed in note 16.
(ii) Primarily consists of trade and other payables that meet the definition of financial liabilities under IAS 32.
(iii) Carrying amount of interest on borrowings and interest on derivatives and interest on other payable is included within interest payable in note 14.

The group had available undrawn committed bank facilities as follows:

	2018 £ million	2017 £ million
Expiring within one year	788	481
Expiring between one and two years	–	900
Expiring after two years	1,864	1,219
	2,652	2,600

The facilities can be used for general corporate purposes and, together with cash and cash equivalents, support the group's commercial paper programmes.

There are no financial covenants on the group's material short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges.

The committed bank facilities are subject to a single financial covenant, being minimum interest cover ratio of two times (defined as the ratio of operating profit before exceptional items, aggregated with share of after tax results of associates and joint ventures, to net interest). They are also subject to pari passu ranking and negative pledge covenants.

Any non-compliance with covenants underlying Diageo's financing arrangements could, if not waived, constitute an event of default with respect to any such arrangements, and any non-compliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain borrowings and the inability to access committed facilities. Diageo was in full compliance with its financial, pari passu ranking and negative pledge covenants in respect of its material short and long term borrowings throughout each of the years presented.

$900 million (£682 million) of the $3.5 billion (£2,652 million) available undrawn committed bank facilities have been ring-fenced, as a backstop to Diageo's normal funding sources, for the cost of acquiring the shares in Sichuan Shuijingfang Company Limited until settlement is completed.

(g) Fair value measurements

Fair value measurements of financial instruments are presented through the use of a three-level fair value hierarchy that prioritises the valuation techniques used in fair value calculations.

The group maintains policies and procedures to value instruments using the most relevant data available. If multiple inputs that fall into different levels of the hierarchy are used in the valuation of an instrument, the instrument is categorised on the basis of the most subjective input.

Foreign currency forwards and swaps, cross currency swaps and interest rate swaps are valued using discounted cash flow models. These models use inputs at levels 1 and 2, such as exchange rates and interest rates. These market inputs are used in the discounted cash flow calculation incorporating the instrument's term, notional amount and discount rate, and taking credit risk into account. As significant inputs to the valuation are observable in active markets, these instruments are categorised as level 2 in the hierarchy.

Other financial liabilities include a put option, which does not expire, held by Industrias Licoreras de Guatemala (ILG) to sell the remaining 50% equity stake in Rum Creations & Products Inc, the owner of the Zacapa rum brand, to Diageo. The liability is fair valued and as at 30 June 2018 £164 million (30 June 2017 – £183 million) was recognised with changes in fair value included in retained earnings. For further information on accounting policies see note 9. As the valuation of this option uses assumptions not observable in the market, it is categorised as level 3 in the hierarchy. As at 30 June 2018 because it is unknown when or if ILG will exercise the option the liability is measured as if the exercise date is on the last day of the next financial year considering forecast future performance (in prior years the potential liability also assumed a possible exercise date).

The option is sensitive to reasonably possible changes in assumptions. If the option were to be exercised two years later, the fair value of the liability would increase by approximately £30 million.

The group's financial assets and liabilities measured at fair value are categorised as follows:

	2018 £ million	2017 (restated[(i)]) £ million
Derivative assets	217	348
Derivative liabilities	(123)	(232)
Valuation techniques based on observable market input (Level 2)	94	116
Financial assets – other	89	39
Financial liabilities – other	(164)	(183)
Valuation techniques based on unobservable market input (Level 3)	(75)	(144)

(i) Restated to include loans and advances to associates and third parties.

The movements in level 3 instruments, measured on a recurring basis, are as follows:

	Financial liabilities – other	
	2018 £ million	2017 £ million
At 1 July	(183)	(165)
Net losses included in the income statement	–	(8)
Net gains/(losses) included in exchange in other comprehensive income	3	(4)
Net gains/(losses) included in retained earnings	7	(12)
Settlement of liabilities	9	6
At 30 June	(164)	(183)

In the year ended 30 June 2018 the £50 million (30 June 2017 – £39 million) movement in financial assets – other instruments is due to additions.

There were no transfers between levels during the two years ended 30 June 2018 and 30 June 2017.

(h) Results of hedge relationships

The group targets a one-to-one hedge ratio. Strengths of the economic relationship between the hedged item and the hedging instrument is analysed on an ongoing basis. Ineffectiveness can arise from subsequent change in the forecast transactions as a result of timing, cash flows or value except when the critical terms of the hedging instrument and hedged item are closely aligned. The change in the credit risk of the hedging instruments or the hedged items is not expected to be the primary factor in the economic relationship.

The notional amounts, contractual maturities and rates of the hedging instruments designated in hedging relationships as of 30 June 2018 by the main risk categories are as follows:

	Notional amounts £ million	Maturity	Range of hedged rates
2018			
Net investment hedges			
Derivatives in net investment hedges of foreign operations	1,068	July 2018	US dollar 1.32
Cash flow hedges			
Derivatives in cash flow hedge (foreign currency debt)	1,553	April 2023–April 2043	US dollar 1.22–1.88
Derivatives in cash flow hedge (foreign exchange risk)	1,197	September 2018–December 2019	US dollar 1.24–1.47, euro 1.06–1.18
Derivatives in cash flow hedge (commodity price risk)	30	July 2018–March 2020	Corn 152.76 – 164.17 USD/t Aluminium 2058.75–2204 USD/MT
Fair value hedges			
Derivatives in fair value hedge (interest rate risk)	3,597	July 2018–May 2028	(0.26)-3.09%
2017			
Net investment hedges			
Derivatives in net investment hedges of foreign operations	1,919	July 2017	US dollar 1.26–1.30, euro 1.14
Cash flow hedges			
Derivatives in cash flow hedge (foreign currency debt)	1,577	April 2023–April 2043	US dollar 1.22–1.88
Derivatives in cash flow hedge (foreign exchange risk)	893	July 2017–Dec 2018	US dollar 1.23–1.51, euro 1.09–1.31
Derivatives in cash flow hedge (commodity price risk)	8	July 2017–June 2018	Corn 141.73 USD/t Aluminium 1912–1931 USD/MT
Fair value hedges			
Derivatives in fair value hedge (interest rate risk)	3,305	October 2017–April 2023	0.93–2.12%

For hedges of the cash flow risk from a change in forward exchange rates using cross currency interest rate swaps, the retranslation of the related bond principal to closing exchange rates and recognition of interest on the related bonds will affect the income statement in each year until the related bonds mature in 2023, 2036 and 2043. Exchange retranslation and the interest on the hedged bonds in the income statement are expected to offset those on the cross currency swaps in each of the years.

In respect of cash flow hedging instruments, a loss of £57 million (2017 – £29 million loss; 2016 – £31 million gain) has been recognised in other comprehensive income due to changes in fair value. A gain of £7 million has been transferred out of other comprehensive income to other operating expenses and a loss of £6 million to other finance charges, respectively (2017 – a loss of £143 million and a gain of £42 million; 2016 – a loss of £66 million and a gain of £211 million) to offset the foreign exchange impact on the underlying transactions.

For cash flow hedges of forecast transactions at 30 June 2018, based on year end interest and exchange rates, there is expected to be a loss to the income statement of £7 million in the year ending 30 June 2019 and a loss of £9 million in the year ending 30 June 2020.

For hedges, that are no longer applicable at 30 June 2018, a loss of £21 million (2017 – a loss of £21 million) in respect of hedges of foreign currency borrowings is reported in reserves. There was no significant ineffectiveness on net investment and cash flow hedges during the year ended 30 June 2018.

The loss on fair value hedging instruments for the year was £12 million (2017 – a loss of £36 million) and the gain on the hedged item attributable to the hedged risk was £12 million (2017 – a gain of £43 million). At 30 June 2018 the accumulated fair value changes on the hedged items is £17 million (2017 – £5 million).

(i) Reconciliation of financial instruments

The table below sets out the group's accounting classification of each class of financial assets and liabilities:

	Fair value through income statement £ million	Fair value through other comprehensive income £ million	Assets and liabilities at amortised cost £ million	Not categorised as a financial instrument £ million	Total £ million	Current £ million	Non-current £ million
2018							
Other investments and loans(i)	89	–	14	2	105	–	105
Trade and other receivables	–	–	2,429	295	2,724	2,678	46
Cash and cash equivalents	–	–	874	–	874	874	–
Derivatives in fair value hedge (interest rate risk)	7	–	–	–	7	–	7
Derivatives in cash flow hedge (foreign currency debt)	160	–	–	–	160	–	160
Derivatives in cash flow hedge (foreign currency exchange risk)	9	–	–	–	9	9	–
Derivatives in net investment hedge	1	–	–	–	1	1	–
Other instruments at fair value	40	–	–	–	40	25	15
Total other financial assets	217	–	–	–	217	35	182
Total financial assets	306	–	3,317	297	3,920	3,587	333
Borrowings(ii)	–	–	(9,902)	–	(9,902)	(1,828)	(8,074)
Trade and other payables	–	–	(3,258)	(901)	(4,159)	(3,950)	(209)
Derivatives in fair value hedge (interest rate risk)	(22)	–	–	–	(22)	–	(22)
Derivatives in cash flow hedge (foreign currency debt)	(48)	–	–	–	(48)	–	(48)
Derivatives in cash flow hedge (foreign currency exchange risk)	(25)	–	–	–	(25)	(9)	(16)
Derivatives in net investment hedge	(4)	–	–	–	(4)	(4)	–
Other instruments at fair value	(188)	–	–	–	(188)	(186)	(2)
Finance leases	–	–	(155)	–	(155)	(31)	(124)
Total other financial liabilities	(287)	–	(155)	–	(442)	(230)	(212)
Total financial liabilities	(287)	–	(13,315)	(901)	(14,503)	(6,008)	(8,495)
Total net financial assets/(liabilities)	19	–	(9,998)	(604)	(10,583)	(2,421)	(8,162)
2017							
Other investments and loans(iii)	39	–	17	2	58	–	58
Trade and other receivables	–	–	2,406	244	2,650	2,592	58
Cash and cash equivalents	–	–	1,191	–	1,191	1,191	–
Derivatives in cash flow hedge (foreign currency debt)	217	–	–	–	217	–	217
Derivatives in cash flow hedge (foreign currency exchange risk)	17	–	–	–	17	8	9
Derivatives in net investment hedge	49	–	–	–	49	49	–
Other instruments at fair value	65	–	–	–	65	24	41
Total other financial assets	348	–	–	–	348	81	267
Total financial assets	387	–	3,614	246	4,247	3,864	383
Borrowings(ii)	–	–	(9,042)	–	(9,042)	(2,459)	(6,583)
Trade and other payables	–	–	(2,780)	(807)	(3,587)	(3,563)	(24)
Derivatives in fair value hedge (interest rate risk)	(2)	–	–	–	(2)	(1)	(1)
Derivatives in cash flow hedge (foreign currency debt)	(24)	–	–	–	(24)	–	(24)
Derivatives in cash flow hedge (foreign currency exchange risk)	(48)	–	–	–	(48)	(47)	(1)
Derivatives in net investment hedge	(6)	–	–	–	(6)	(6)	–
Other instruments at fair value	(335)	–	–	–	(335)	(135)	(200)
Finance leases	–	–	(183)	–	(183)	(26)	(157)
Total other financial liabilities	(415)	–	(183)	–	(598)	(215)	(383)
Total financial liabilities	(415)	–	(12,005)	(807)	(13,227)	(6,237)	(6,990)
Total net financial assets/(liabilities)	(28)	–	(8,391)	(561)	(8,980)	(2,373)	(6,607)

(i) Other investments and loans are including those in relation to associates.
(ii) Borrowings are defined as gross borrowings excluding finance lease liabilities and the fair value of derivate instruments.
(iii) Restated to include loans and advances to associates and third parties.

At 30 June 2018 and 30 June 2017, the carrying values of cash and cash equivalents, other financial assets and liabilities approximate to fair values. At 30 June 2018 the fair value of borrowings, based on unadjusted quoted market data, was £10,304 million (2017 – £9,641 million).

(j) Capital management

The group's management is committed to enhancing shareholder value in the long term, both by investing in the businesses and brands so as to deliver continued improvement in the return from those investments and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels. This is achieved by targeting an adjusted net borrowings (net borrowings aggregated with post employment benefit liabilities) to EBITDA leverage of 2.5 – 3.0 times, this range for Diageo being currently broadly consistent with an A band credit rating. Diageo would consider operating outside of this range in order to effect strategic initiatives within its stated goals, which could have an impact on its rating. If Diageo's leverage was to be negatively impacted by the financing of an acquisition, it would seek over time to return to the range of 2.5 – 3.0 times. The group regularly assesses its debt and equity capital levels against its stated policy for capital structure. For the year ended 30 June 2018 the adjusted net borrowings to adjusted EBITDA ratio was 2.2 times. For this calculation net borrowings are adjusted by post employment benefit liabilities (as at 30 June 2018 – £872 million) whilst adjusted EBITDA (year ended 30 June 2018 – £4,496 million) comprises operating profit excluding exceptional operating items and depreciation, amortisation and impairment and includes share of after tax results of associates and joint ventures.

16. Net borrowings

Accounting policies

Borrowings are initially recognised at fair value net of transaction costs and are subsequently reported at amortised cost. Certain bonds are designated as being part of a fair value hedge relationship. In these cases, the amortised cost is adjusted for the fair value of the risk being hedged, with changes in value recognised in the income statement. The fair value adjustment is calculated using a discounted cash flow technique based on unadjusted market data.

Bank overdrafts form an integral part of the group's cash management and are included as a component of net cash and cash equivalents in the consolidated statement of cash flows.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less, including money market deposits, commercial paper and investments.

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

	2018 £ million	2017 £ million
Bank overdrafts	181	274
Commercial paper	98	–
Bank and other loans	300	495
Credit support obligations	54	74
US$ 1,250 million 5.75% bonds due 2017	–	962
US$ 650 million 1.125% bonds due 2018	–	499
US$ 200 million 4.85% medium term notes due 2018	–	154
€ 500 million 1.125% bonds due 2019	444	–
€ 850 million 1.125% bonds due 2019	751	–
Fair value adjustment to borrowings	–	1
Borrowings due within one year	**1,828**	2,459
€ 500 million 1.125% bonds due 2019	–	441
€ 850 million 1.125% bonds due 2019	–	745
US$ 696 million 4.828% bonds due 2020	508	508
US$ 500 million floating bonds due 2020	378	–
US$ 500 million 3% bonds due 2020	378	–
€ 775 million 0% bonds due 2020	685	–
US$ 1,000 million 2.875% bonds due 2022[i]	755	766
US$ 300 million 8% bonds due 2022[i]	226	229
US$ 1,350 million 2.625% bonds due 2023	1,020	1,035
US$ 500 million 3.5% bonds due 2023	377	–
€ 500 million 1.75% bonds due 2024	440	436
€ 500 million 0.5% bonds due 2024	439	–
€ 850 million 2.375% bonds due 2026	747	740
US$ 500 million 3.875% bonds due 2028	376	–
US$ 400 million 7.45% bonds due 2035[i]	303	308
US$ 600 million 5.875% bonds due 2036	450	456
US$ 500 million 4.25% bonds due 2042[i]	374	380
US$ 500 million 3.875% bonds due 2043	372	377
Bank and other loans	234	119
Fair value adjustment to borrowings	12	43
Borrowings due after one year	**8,074**	6,583
Total borrowings before derivative financial instruments	9,902	9,042
Fair value of foreign currency derivatives	(107)	(144)
Fair value of interest rate hedging instruments	15	2
Finance lease liabilities	155	183
Gross borrowings	**9,965**	9,083
Less: Cash and cash equivalents	(874)	(1,191)
Net borrowings	**9,091**	7,892

(i) SEC-registered debt issued on an unsecured basis by Diageo Investment Corporation, a 100% owned finance subsidiary of Diageo plc.

(1) The interest rates shown are those contracted on the underlying borrowings before taking into account any interest rate hedges (see note 15).
(2) Bonds are stated net of unamortised finance costs of £60 million (2017 – £61 million; 2016 – £72 million).
(3) Bonds are reported above at amortised cost with a fair value adjustment shown separately.
(4) All bonds, medium term notes and commercial paper issued on an unsecured basis by the group's 100% owned subsidiaries are fully and unconditionally guaranteed on an unsecured basis by Diageo plc.

Gross borrowings before derivative financial instruments are expected to mature as follows:

	2018 £ million	2017 £ million	2016 £ million
Within one year	1,828	2,459	2,058
Between one and three years	2,033	1,255	2,896
Between three and five years	2,111	1,324	537
Beyond five years	3,930	4,004	4,638
	9,902	9,042	10,129

During the year the following bonds were issued and repaid:

	2018 £ million	2017 £ million	2016 £ million
Issued			
€ denominated	1,136	–	–
US$ denominated	1,476	–	–
Repaid			
US$ denominated	(1,571)	(1,234)	(1,003)
	1,041	(1,234)	(1,003)

(a) Reconciliation of movement in net borrowings

	2018 £ million	2017 £ million
At beginning of the year	7,892	8,635
Net decrease/(increase) in cash and cash equivalents before exchange	185	(122)
Net increase/(decrease) in bonds and other borrowings	1,015	(820)
Change in net borrowings from cash flows	1,200	(942)
Exchange differences on net borrowings	(80)	205
Other non-cash items(i)	79	(6)
Net borrowings at end of the year	9,091	7,892

(i) In the year ended 30 June 2018 other non-cash items are principally in respect of changes in the fair value of borrowings.

(b) Analysis of net borrowings by currency

	2018		2017	
	Cash and cash equivalents £ million	Gross borrowings(i) £ million	Cash and cash equivalents £ million	Gross borrowings(i) £ million
US dollar	95	297	576	(2,492)
Euro	91	(2,505)	69	(1,965)
Sterling(ii)	38	(7,383)	51	(4,214)
Indian rupee	25	(313)	16	(405)
Chinese yuan	293	(160)	110	(30)
Kenyan shilling	16	(107)	15	(115)
Mexican peso	13	(58)	6	24
Turkish lira(ii)	105	(9)	133	(27)
Other	198	273	215	141
Total	874	(9,965)	1,191	(9,083)

(i) Includes foreign currency forwards and swaps and finance leases.
(ii) Includes £13 million (Sterling) and £87 million (Turkish lira) cash and cash equivalents in cash-pooling arrangements (2017 – £29 million (Sterling) and £128 million (Turkish lira)).

17. Equity

Accounting policies

Own shares represent shares and share options of Diageo plc that are held in treasury or by employee share trusts for the purpose of fulfilling obligations in respect of various employee share plans or were acquired as part of a share buyback programme. Own shares are treated as a deduction from equity until the shares are cancelled, reissued or disposed of and when vest are transferred from own shares to retained earnings at their weighted average cost.

Share based payments include share awards and options granted to directors and employees. The fair value of equity settled share options and share grants is initially measured at grant date based on the binomial or Monte Carlo models and is charged to the income statement over the vesting period. For equity settled shares the credit is included in retained earnings. Cancellations of share options are treated as an acceleration of the vesting period and any outstanding charge is recognised in operating profit immediately. Any surplus or deficit arising on the sale of the Diageo plc shares held by the group is included as a movement in equity.

Dividends are included in the financial statements in the year in which they are approved.

(a) Allotted and fully paid share capital – ordinary shares of 28 101/108 pence each

	Number of shares million	Nominal value £ million
At 30 June 2018	2,695	780
At 30 June 2017 and 30 June 2016	2,754	797

(b) Hedging and exchange reserve

	Hedging reserve £ million	Exchange reserve £ million	Total £ million
At 30 June 2015	21	(1,173)	(1,152)
Other comprehensive income	(111)	742	631
At 30 June 2016	(90)	(431)	(521)
Other comprehensive income	69	(1)	68
At 30 June 2017	(21)	(432)	(453)
Other comprehensive income	(44)	(530)	(574)
Adoption of IFRS 9 by associate	(3)	–	(3)
At 30 June 2018	(68)	(962)	(1,030)

(c) Own shares

Movements in own shares

	Number of shares million	Purchase consideration £ million
At 30 June 2015	248	2,228
Share trust arrangements	(1)	(6)
Shares purchased employee share plans	2	42
Shares used to satisfy options	(5)	(75)
At 30 June 2016	244	2,189
Share trust arrangements	(3)	(32)
Shares purchased employee share plans	5	101
Shares used to satisfy options	(5)	(82)
At 30 June 2017	241	2,176
Share trust arrangements	(1)	(9)
Shares purchased employee share plans	2	66
Shares used to satisfy options	(4)	(89)
Shares purchased – share buyback programme	59	1,507
Shares cancelled	(59)	(1,507)
At 30 June 2018	**238**	**2,144**

Share trust arrangements

At 30 June 2018 the employee share trusts owned 4 million of ordinary shares in Diageo plc at a cost of £72 million and market value of £106 million (2017 – 5 million shares at a cost of £81 million, market value £107 million; 2016 – 7 million shares at a cost of £113 million, market value £155 million). Dividends receivable by the employee share trusts on the shares are waived and the trustee abstains from voting.

Purchase of own shares

Authorisation was given by shareholders on 20 September 2017 to purchase a maximum of 251,773,000 shares at a minimum price of $28^{101}/_{108}$ pence and a maximum price of the higher of (a) 105% of the average of the middle market quotations for an ordinary share for the five preceding business days and (b) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange at the time the purchase is carried out. The programme expires at the conclusion of the next Annual General Meeting or on 19 December 2018, if earlier.

During the year ended 30 June 2018, as part of the employee share schemes, the company purchased 2.5 million ordinary shares, nominal value of £1 million (2017 – 5 million ordinary shares, nominal value of £1 million; 2016 – 2 million ordinary shares, nominal value of £1 million), representing approximately 0.1% (2017 – 0.2%; 2016 – 0.1%) of the issued ordinary share capital (excluding treasury shares).

Shares were either directly granted to employees as part of employee share schemes or held as treasury shares and used to hedge share scheme grants to employees during the course of the year. The consideration paid for purchase of own shares was £66 million (excluding expenses) in the year ended 30 June 2018.

In addition, in the year ended 30 June 2018 the group purchased 58.9 million ordinary shares (representing approximately 2.1% of the issued ordinary share capital) at an average price of £25.43 per share, and an aggregate cost of £1,507 million (including £9 million of transaction costs) under a share buyback programme. The shares purchased under the share buyback programme were cancelled.

The monthly breakdown of all shares purchased and the average price paid per share (excluding expenses) for the year ended 30 June 2018 were as follows:

Calendar month	Number of shares purchased	Average price paid pence	Authorised purchases unutilised at month end
September 2017	7,918,187	2521	243,854,813
October 2017	8,287,168	2535	235,567,645
November 2017	8,168,860	2587	227,398,785
December 2017	6,903,910	2638	220,494,875
January 2018	8,822,763	2628	211,672,112
February 2018	20,146,596	2474	191,525,516
March 2018	1,234,920	2491	190,290,596
Total	**61,482,404**	**2544**	**190,290,596**

(d) Dividends

	2018 £ million	2017 £ million	2016 £ million
Amounts recognised as distributions to equity shareholders in the year			
Final dividend for the year ended 30 June 2017			
38.5 pence per share (2016 – 36.6 pence; 2015 – 34.9 pence)	968	920	876
Interim dividend for the year ended 30 June 2018			
24.9 pence per share (2017 – 23.7 pence; 2016 – 22.6 pence)	613	595	567
	1,581	1,515	1,443

The proposed final dividend of £1,004 million (40.4 pence per share) for the year ended 30 June 2018 was approved by the Board of Directors on 25 July 2018. As this was after the balance sheet date and the dividend is subject to approval by shareholders at the Annual General Meeting, this dividend has not been included as a liability in these consolidated financial statements. There are no corporate tax consequences arising from this treatment.

Dividends are waived on all treasury shares owned by the company and all shares owned by the employee share trusts.

(e) Non-controlling interests

Diageo consolidates USL, a company incorporated in India, with a 43.91% non-controlling interest and has a 50% controlling interest in Ketel One Worldwide B.V. (Ketel One), a company incorporated in the Netherlands. All other consolidated subsidiaries are fully owned or the non-controlling interests are not material.

Summarised financial information for USL, Ketel One and others, after fair value adjustments on acquisition, and the amounts attributable to non-controlling interests are as follows:

			2018	2017	2016
	USL £ million	Ketel One and others £ million	Total £ million	Total £ million	Total £ million
Income statement					
Sales	3,075	1,851	4,926	4,844	4,023
Net sales	981	1,450	2,431	2,412	2,138
Profit for the year	47	197	244	229	251
Other comprehensive (loss)/income(i)	(130)	(33)	(163)	116	399
Total comprehensive (loss)/income	(83)	164	81	345	650
Attributable to non-controlling interests	(36)	89	53	148	290
Balance sheet					
Non-current assets(ii)	2,223	2,750	4,973	4,975	4,825
Current assets	653	731	1,384	1,222	1,188
Non-current liabilities	(509)	(916)	(1,425)	(1,327)	(1,339)
Current liabilities	(572)	(611)	(1,183)	(1,199)	(1,193)
Net assets	1,795	1,954	3,749	3,671	3,481
Attributable to non-controlling interests	788	977	1,765	1,715	1,650
Cash flow					
Net cash inflow from operating activities	83	251	334	355	245
Net cash (outflow)/inflow from investing activities	(8)	(128)	(136)	(86)	17
Net cash outflow from financing activities	(70)	(94)	(164)	(172)	(212)
Net increase in cash and cash equivalents	5	29	34	97	50
Exchange differences	(1)	(1)	(2)	(3)	(1)
Dividends payable to non-controlling interests	–	(101)	(101)	(83)	(101)

(i) Other comprehensive income is principally in respect of exchange on translating the subsidiaries to sterling.
(ii) Ketel One includes the global distribution rights to distribute Ketel One vodka products throughout the world. The carrying value of the distribution rights at 30 June 2018 was £1,363 million (2017 – £1,385 million; 2016 – £1,354 million).

(1) In the year ended 30 June 2018 a rights issue was completed by Guinness Nigeria (GN) where Diageo's controlling equity share in GN increased from 54.32% to 58.02%. The transaction resulted in a credit of £31 million to non-controlling interests and a charge of £5 million to retained earnings.
(2) In the year ended 30 June 2018 an agreement was concluded with the minority shareholders of Serengeti Breweries Limited (SBL), a subsidiary of EABL, where an intercompany liability was forgiven and the non-controlling interest in SBL was reduced from 68.53% to 60.76%. The transaction resulted in a net charge to retained earnings of £72 million.

(f) Employee share compensation

The group uses a number of share award and option plans to grant to its directors and employees.

The annual fair value charge in respect of the equity settled plans for the three years ended 30 June 2018 is as follows:

	2018 £ million	2017 £ million	2016 £ million
Executive share award plans	33	28	24
Executive share option plans	3	3	3
Savings plans	3	3	2
	39	34	29

Executive share awards are made under the Diageo 2014 Long Term Incentive Plan (DLTIP) from September 2014 onwards. Prior to that, awards were made under the Diageo plc 2009 Executive Long Term Incentive Plan (DELTIP), the 2008 Performance Share Plan (PSP), the 2008 Senior Executive Share Option Plan (SESOP) or the 2009 Discretionary Incentive Plan (DIP). Prior to the introduction of the DLTIP, employees in associated companies were granted awards under the Diageo plc 2011 Associated Companies Share Incentive Plan (DACSIP). There was a single grant in September 2016 under the Diageo Performance Incentive plan. Under all of these plans, conditional awards can be delivered in the form of restricted shares or share options at the market value at the time of grant.

Share awards normally vest and are released on the third anniversary of the grant date. Participants do not make a payment to receive the award at grant. Executive Directors are required to hold any vested shares awarded from 2014 for a further two-year period. Share options may normally be exercised between three and ten years after the grant date. Executives in North America and Latin America and Caribbean are granted awards over the company's ADSs (one ADS is equivalent to four ordinary shares).

Performance shares under the DLTIP (previously PSP) are subject to the achievement of three equally weighted performance tests: 1) compound annual growth in profit before exceptional items over three years; 2) compound annual growth in organic net sales over three years; 3) cumulative free cash flow over a three-year period, measured at constant exchange rates. Shares awarded under the Diageo Performance Incentive plan (DPI) in September 2016 are subject to the achievement of two equally weighted performance tests over the three-year performance period. These were: 1) compound annual growth in organic net sales over three years; and 2) productivity savings over three years, with an assessment of line manager performance as an underpin. Performance share options under the DLTIP (previously SESOP) are subject to the achievement of two equally weighted performance tests: 1) a comparison of Diageo's three-year TSR with a peer group; 2) compound annual growth in profit before exceptional items over three years. Performance measures and targets are set annually by the Remuneration Committee. The vesting range is 20% or 25% (for Executive Directors and for other participants respectively) for achieving minimum performance targets, up to 100% for achieving the maximum target level. Retesting of the performance condition is not permitted.

For performance shares under the DLTIP (previously PSP) dividends are accrued on awards and are given to participants to the extent that the awards actually vest at the end of the performance period. Dividends are normally paid out in the form of shares.

For the three years ended 30 June 2018, the calculation of the fair value of each share award used the Monte Carlo pricing model and the following assumptions:

	2018	2017	2016
Risk free interest rate	0.3%	0.1%	1.0%
Expected life of the awards	37 months	36 months	37 months
Dividend yield	2.6%	3.0%	3.2%
Weighted average share price	2573 p	2130 p	1737 p
Weighted average fair value of awards granted in the year	1761 p	1427 p	1058 p
Number of awards granted in the year	2.3 million	3.6 million	3.1 million
Fair value of all awards granted in the year	£41 million	£51 million	£33 million

Transactions on schemes

Transactions on the executive share award plans for the three years ended 30 June 2018 were as follows:

	2018 Number of awards million	2017 Number of awards million	2016 Number of awards million
Balance outstanding at 1 July	7.9	7.2	7.6
Granted	2.3	3.6	3.1
Exercised/awarded	(0.7)	(1.3)	(1.6)
Forfeited/expired	(1.7)	(1.6)	(1.9)
Balance outstanding at 30 June	7.8	7.9	7.2

At 30 June 2018, 4.4 million executive share options were exercisable at a weighted average exercise price of 1621 pence.

Other financial information

This section includes additional financial information that are either required by the relevant accounting standards or management considers these to be material information for shareholders.

Introduction

18. Contingent liabilities and legal proceedings

Accounting policies
Provision is made for the anticipated settlement costs of legal or other disputes against the group where it is considered to be probable that a liability exists and a reliable estimate can be made of the likely outcome. Where it is possible that a settlement may be reached or it is not possible to make a reliable estimate of the estimated financial effect appropriate disclosure is made but no provision created.

Critical accounting judgements
Judgement is necessary in assessing the likelihood that a claim will succeed, or a liability will arise, and an estimate to quantify the possible range of any settlement. Due to the inherent uncertainty in this evaluation process, actual losses may be different from the liability originally estimated. The group may be involved in legal proceedings in respect of which it is not possible to make a reliable estimate of any expected settlement, if any. In such cases appropriate disclosure is provided but no provision is made and no contingent liability is quantified.

(a) Guarantees and related matters
As of 30 June 2018, the group has no material unprovided guarantees or indemnities in respect of liabilities of third parties.

(b) Acquisition of USL shares from UBHL, winding-up petitions against UBHL and other proceedings in relation to the USL transaction
On 4 July 2013, Diageo completed its acquisition, under a share purchase agreement with United Breweries (Holdings) Limited (UBHL) and various other sellers (the SPA), of 21,767,749 shares (14.98%) in United Spirits Limited (USL) for a total consideration of INR 31.3 billion (£349 million), including 10,141,437 shares (6.98%) from UBHL. The SPA was signed on 9 November 2012 and was part of the transaction announced by Diageo in relation to USL on that day (the Original USL Transaction). Through a series of further transactions, as of 2 July 2014, Diageo had a 54.78% investment in USL (excluding 2.38% owned by the USL Benefit Trust).

Prior to the acquisition from UBHL on 4 July 2013, the High Court of Karnataka (High Court) had granted leave to UBHL under sections 536 and 537 of the Indian Companies Act 1956 (the Leave Order) to enable the sale by UBHL to Diageo to take place (the UBHL Share Sale) notwithstanding the continued existence of five winding-up petitions that were pending against UBHL on 9 November 2012, being the date of the SPA. Additional winding-up petitions have been brought against UBHL since 9 November 2012, and the Leave Order did not extend to them. At the time of the completion of the UBHL Share Sale, the Leave Order remained subject to review on appeal. However, as stated by Diageo at the time of closing on 4 July 2013, it was considered unlikely that any appeal process in respect of the Leave Order would definitively conclude on a timely basis and, accordingly, Diageo waived the conditionality under the SPA relating to the absence of insolvency proceedings in relation to UBHL and acquired the 10,141,437 USL shares from UBHL at that time.

Following closing of the UBHL Share Sale, appeals were filed by various petitioners in respect of the Leave Order. On 20 December 2013, the division bench of the High Court set aside the Leave Order (the December 2013 Order). Following the December 2013 Order, Diageo filed special leave petitions (SLPs) in the Supreme Court of India against the December 2013 Order.

On 10 February 2014, the Supreme Court of India issued an order giving notice in respect of the SLPs and ordering that the status quo be maintained with regard to the UBHL Share Sale pending a hearing on the matter in the Supreme Court. Following a number of adjournments, the next firm hearing date for the SLPs (in respect of which leave has since been granted and which have been converted to civil appeals) is yet to be fixed.

In separate proceedings, the High Court passed a winding-up order against UBHL on 7 February 2017. On 4 March 2017, UBHL appealed against this order before a division bench of the High Court. This appeal is currently pending.

Diageo continues to believe that the acquisition price of INR 1,440 per share paid to UBHL for the USL shares is fair and reasonable as regards UBHL, UBHL's shareholders and UBHL's secured and unsecured creditors. However, adverse results for Diageo in the proceedings referred to above could, absent leave or relief in other proceedings, ultimately result in Diageo losing title to the 10,141,437 USL shares acquired from UBHL. Diageo believes it would remain in control of USL and be able to consolidate USL as a subsidiary regardless of the outcome of this litigation. There can be no certainty as to the outcome of the existing or any further related legal proceedings or the timeframe within which they would be concluded.

Diageo also has the benefit of certain contractual undertakings and commitments from the relevant sellers in relation to potential challenges to its unencumbered title to the USL shares acquired on 4 July 2013, including relating to the winding-up petitions described above and/or certain losses and costs that may be incurred in the event of third party actions relating to the acquisition of the USL shares.

(c) Continuing matters relating to the resignation of Dr Vijay Mallya from USL and USL internal inquiries

On 25 February 2016, Diageo and USL each announced that they had entered into arrangements with Dr Mallya under which he had agreed to resign from his position as a director and as chairman of USL and from his positions in USL's subsidiaries. As specified by Diageo in its announcement at that time, these arrangements ended its prior agreement with Dr Mallya regarding his position at USL, therefore bringing to an end the uncertainty relating to the governance of USL, and put in place a five-year global non-compete (excluding the United Kingdom), non-interference, non-solicitation and standstill arrangement with Dr Mallya. As part of those arrangements, USL, Diageo and Dr Mallya agreed a mutual release in relation to matters arising out of an inquiry into certain matters referred to in USL's financial statements and the qualified auditor's report for the year ended 31 March 2014 (the Initial Inquiry) which had revealed, among other things, certain diversions of USL funds. Dr Mallya also agreed not to pursue any claims against Diageo, USL and their affiliates (including under the prior agreement with Diageo). In evaluating entering into such arrangements, Diageo considered the impact of the arrangements on USL and all of USL's shareholders, and came to the view that the arrangements were in the best interests of USL and its shareholders.

Diageo's agreement with Dr Mallya (the February 2016 Agreement) provided for a payment of $75 million (£53 million) to Dr Mallya over a five year period in consideration for the five-year global non-compete, non-interference, non-solicitation and standstill commitments referred to above, his resignation from USL and the termination of his USL-related appointment and governance rights, the relinquishing of rights and benefits attached to his position at USL, and his agreement not to pursue claims against Diageo and USL. The February 2016 Agreement also provided for the release of Dr Mallya's personal obligations to indemnify (i) Diageo Holdings Netherlands B.V. (DHN) in respect of its earlier liability ($141 million (£96 million)) under a backstop guarantee of certain borrowings of Watson Limited (Watson) (a company affiliated with Dr Mallya), and (ii) Diageo Finance plc in respect of its earlier liability (£30 million) under a guarantee of certain borrowings of United Breweries Overseas Limited. $40 million (£28 million) of the $75 million (£53 million) amount was paid on signing of the February 2016 Agreement with the balance being payable in equal instalments of $7 million (£5 million) a year over five years, subject to and conditional on Dr Mallya's compliance with certain terms of the agreement. While the first two instalments of $7 million (£5 million) each would have become due on 25 February 2017 and 25 February 2018, respectively, owing to various reasons (including breaches committed by Dr Mallya and certain persons connected with him of several provisions of the February 2016 Agreement and agreements of the same date between Dr Mallya and USL), Diageo believes that it was not liable to pay such amount, and is very unlikely to become liable to pay any future instalments, to Dr Mallya. By notice to Dr Mallya and certain persons connected with him on 24 February 2017, 3 November 2017 and 23 February 2018, Diageo and other group companies have demanded from Dr Mallya the repayment of $40 million (£28 million) which was paid by Diageo on 25 February 2016, and also sought compensation from him for various losses incurred by the relevant members of the Diageo group on account of the breaches committed by him and certain persons connected with him. On 16 November 2017, Diageo and other relevant members of the Diageo group commenced claims in the High Court of Justice in England and Wales (the English High Court) against Dr Mallya in relation to certain of the matters specified in the notices of 24 February 2017 and 3 November 2017. At the same time DHN also commenced claims in the English High Court against Dr Mallya, his son Sidhartha Mallya and two companies affiliated with Dr Mallya (Watson and Continental Administration Services Limited (CASL)) for in excess of $142 million (£105 million) (plus interest) in relation to Watson's liability to DHN in respect of its borrowings referred to above and the breach of associated security documents. These additional claims are described in paragraph (d) below. Dr Mallya, Sidhartha Mallya and the relevant affiliated companies filed a defence to such claims and the additional claims on 12 March 2018, and Dr Mallya also filed a counterclaim for payment of the two $7 million (£5 million) instalment payments withheld by Diageo as described above. Diageo intends to continue to prosecute its claims and to defend the counterclaims.

As previously announced by USL, the Initial Inquiry identified certain additional parties and matters indicating the possible existence of other improper transactions. These transactions could not be fully analysed during the Initial Inquiry and, accordingly, USL, as previously announced, mandated that its Managing Director and Chief Executive Officer conduct a further inquiry into the transactions involving the additional parties and the additional matters to determine whether they also suffered from improprieties (the Additional Inquiry). USL announced the results of the Additional Inquiry in a notice to the Indian Stock Exchange dated 9 July 2016. The mutual release in relation to the Initial Inquiry agreed by Diageo and USL with Dr Mallya announced on 25 February 2016 does not extend to matters arising out of the Additional Inquiry.

As stated in USL's previous announcement, the Additional Inquiry revealed further instances of actual or potential fund diversions from USL and its Indian and overseas subsidiaries to, in most cases, Indian and overseas entities in which Dr Mallya appears to have a material direct or indirect interest, as well as other potentially improper transactions involving USL and its Indian and overseas subsidiaries.

In connection with the matters identified by the Additional Inquiry, USL has, pursuant to a detailed review of each case of such fund diversion and after obtaining expert legal advice, where appropriate, filed civil suits for recovery of funds from certain parties, including Dr Mallya, before the relevant courts in India.

The amounts identified in the Additional Inquiry have been previously provided for or expensed in the financial statements of USL or its subsidiaries for prior periods. Further, at this stage, it is not possible for the management of USL to estimate the financial impact on USL, if any, arising out of potential non-compliance with applicable laws in relation to such fund diversions.

(d) Other continuing matters relating to Dr Mallya and affiliates

DHN issued a conditional backstop guarantee on 2 August 2013 to Standard Chartered Bank (Standard Chartered) pursuant to a guarantee commitment agreement (the Guarantee Agreement). The guarantee was in respect of the liabilities of Watson, a company affiliated with Dr Mallya, under a $135 million (£92 million) facility from Standard Chartered (the Facility Agreement). The Guarantee Agreement was entered into as part of the arrangements put in place and announced at the closing of the USL transaction on 4 July 2013.

DHN's provision of the Guarantee Agreement enabled the refinancing of certain existing borrowings of Watson from a third party bank and facilitated the release by that bank of rights over certain USL shares that were to be acquired by Diageo as part of the USL transaction. The facility matured and entered into default in May 2015. In aggregate DHN paid Standard Chartered $141 million (£96 million) under this guarantee, i.e. including payments of default interest and various fees and expenses.

Watson remains liable for all amounts paid by DHN under the guarantee. Under the guarantee documentation with Standard Chartered, DHN is entitled to the benefit of the underlying security package for the loan, including: (a) certain shares in United Breweries Limited (UBL) held solely by Dr Mallya and certain other shares in UBL held by Dr Mallya jointly with his son Sidhartha Mallya, (b) Watson's interest in Orange India Holdings S.a.r.l. (Orange), the joint venture that owns the Force India Formula One (F1) team, and (c) the shareholding in Watson.

Aspects of the security package are the subject of various proceedings in India in which third parties are alleging and asserting prior rights to certain assets comprised in the security package or otherwise seeking to restrain enforcement against certain assets by Standard Chartered and/or DHN. These proceedings are ongoing and DHN will continue to vigorously pursue these matters as part of its efforts for enforcement of the underlying security and recovery of outstanding amounts. Diageo believes that the existence of any prior rights or dispute in relation to the security would be in breach of representations and warranties given by Dr Mallya to Standard Chartered at the time the security was granted and further believes that certain actions taken by Dr Mallya in relation to the proceedings described above also breached his obligations to Standard Chartered.

Under the terms of the guarantee and as a matter of law, there are arrangements to pass on to DHN the benefit of the security package upon payment under the guarantee of all amounts owed to Standard Chartered. Payment under the guarantee has now occurred as described above. To the extent possible in the context of the proceedings described above, Standard Chartered has taken certain recovery steps and is working with DHN in relation to these proceedings. DHN is actively monitoring the security package and is discussing with Standard Chartered steps to continue enforcement against the background of the proceedings described above, as well as enforcement steps in relation to elements of the security package that are unaffected by those proceedings. DHN's ability to assume or enforce security over some elements of the security package is also subject to regulatory consent. It is not at this stage possible to determine whether such consent would be forthcoming.

In addition to the Indian proceedings just described, certain of the assets comprised in the security package may also be affected by a worldwide freezing order of the English High Court granted on 24 November 2017 and continued on 8 December 2017 and 8 May 2018 in respect of the assets of Dr Mallya.The agreement with Dr Mallya referenced in paragraph (c) above does not impact the security package, which, as described above, includes shares in UBL and Watson's interest in Orange, the joint venture that owns the Force India F1 team. Watson remains liable for all amounts paid pursuant to the guarantee and DHN has the benefit of a counter-indemnity from Watson in respect of payments in connection with the guarantee. The various security providers, including Dr Mallya and Watson, acknowledged in the February 2016 Agreement referred to in paragraph (c) above that DHN is entitled to the benefit of the security package underlying the Standard Chartered facility and have also undertaken to take all necessary actions in that regard. Further, Diageo believes that the existence of any prior rights or disputes in relation to the security package would be in breach of certain confirmations given to Diageo and DHN pursuant to that agreement by Dr Mallya, Watson and certain connected persons.

On 16 November 2017, DHN commenced various claims in the English High Court for, in aggregate, in excess of $142 million (£105 million) (plus interest) in relation to these matters, including the following: (i) a claim against Watson for $141 million (£96 million) (plus interest) under Watson's counter-indemnity to DHN in respect of payments made by DHN to Standard Chartered under the guarantee referred to above; (ii) a claim against Dr Mallya and Sidhartha Mallya under various agreements creating or relating to the security package referred to above for (A) not less than $1.8 million (£1 million), being the costs incurred to date in the various Indian proceedings referred to above (plus interest), and (B) damages of $141 million (£96 million), being DHN's loss as a result of those Indian proceedings which currently prevent enforcement of the security over shares in UBL (plus interest); and (iii) a claim against CASL, as a co-surety with DHN of Watson's obligations under the Facility Agreement, for 50% of the difference between the amount claimed under (i) above and the amount (if any) that DHN is in fact able to recover from Watson, Dr Mallya and/or Sidhartha Mallya. As noted in paragraph (c), Dr Mallya, Sidhartha Mallya and the relevant affiliated companies filed a defence to these claims on 12 March 2018. As stated in paragraph (c), DHN and Diageo intends to continue to prosecute these claims.

(e) Regulatory notices in relation to USL

Following USL's earlier updates concerning the Initial Inquiry as well as in relation to the arrangements with Dr Mallya that were the subject of the 25 February 2016 announcement, USL and Diageo have received various notices from Indian regulatory authorities, including the Ministry of Corporate Affairs, Serious Fraud Investigation Office, National Stock Exchange, Income Tax Department, Enforcement Directorate, Securities and Exchange Board of India (SEBI), Bangalore police, Central Excise Intelligence and the Institute of Chartered Accountants of India. Diageo and USL are cooperating fully with the authorities in relation to these matters.

Diageo and USL have also received notices from SEBI requesting information in relation to, and explanation of the reasons for, the arrangements with Dr Mallya that were the subject of the 25 February 2016 announcement as well as, in the case of USL, in relation to the Initial Inquiry and the Additional Inquiry, and, in the case of Diageo, whether such arrangements with Dr Mallya or the Watson backstop guarantee arrangements referred to in paragraphs (c) and (d) above were part of agreements previously made with Dr Mallya at the time of the Original USL Transaction announced on 9 November 2012 and the open offer made as part of the Original USL Transaction. Diageo and USL have complied with such information requests and Diageo has confirmed that, consistent with prior disclosures, the Watson backstop guarantee arrangements and the matters described in the 25 February 2016 announcement were not the subject of any earlier agreement with Dr Mallya. In respect of the Watson backstop guarantee arrangements, SEBI issued a further notice to Diageo on 16 June 2016 that if there is any net liability incurred by Diageo (after any recovery under relevant security or other arrangements, which matters remain pending) on account of the Watson backstop guarantee, such liability, if any, would be considered to be part of the price paid for the acquisition of USL shares under the SPA which formed part of the Original USL Transaction and that, in that case, additional equivalent payments would be required to be made to those shareholders (representing 0.04% of the shares in USL) who tendered in the open offer made as part of the Original USL Transaction. Diageo is clear that the Watson backstop guarantee arrangements were not part of the price paid or agreed to be paid for any USL shares under the Original USL Transaction and therefore believes the decision in the SEBI notice to be misconceived and wrong in law and appealed against it before the Securities Appellate Tribunal, Mumbai (SAT). On 1 November 2017, SAT issued an order in respect of Diageo's appeal in which, amongst other things, it observed that the relevant officer at SEBI had neither considered Diageo's earlier reply nor provided Diageo with an opportunity to be heard, and accordingly directed SEBI to pass a fresh order after giving Diageo an opportunity to be heard. Following SAT's order, Diageo has made its further submissions in the matter, including at a personal hearing before a Deputy General Manager of SEBI.

Diageo has also responded to a show cause notice dated 12 May 2017 from SEBI arising out of the correspondence in relation to the matters described in the 25 February 2016 announcement and made its further submissions in the matter, including at a personal hearing before a Whole Time Member of SEBI.

Diageo is unable to assess if the notices or enquiries referred to above will result in enforcement action or, if this were to transpire, to quantify meaningfully the possible loss or range of loss, if any, to which any such action might give rise if determined against Diageo or USL.

(f) SEC Inquiry

Diageo has received requests for information from the US Securities and Exchange Commission (SEC) regarding its distribution in and public disclosures regarding the United States and its distribution in certain other Diageo markets as well as additional context about the Diageo group globally. Diageo is currently responding to the SEC's requests for information in this matter. Diageo is unable to assess if the inquiry will evolve into further information requests or an enforcement action or, if this were to transpire, to quantify meaningfully the possible loss or range of loss, if any, to which any such action might give rise.

(g) Tax

The international tax environment has received increased attention and seen rapid change over recent years, both at a US and European level, and by international bodies such as the Organisation for Economic Cooperation and Development (OECD). Against this backdrop, Diageo has been monitoring developments and continue to engage transparently with the tax authorities in the countries where Diageo operates to ensure that the group manages its arrangements on a sustainable basis.

In October 2017, the European Commission opened a state aid investigation into the Group Financing Exemption in the UK controlled foreign company rules. The Group Financing Exemption was introduced in legislation by the British government in 2013. In common with other UK-based international companies whose arrangements are in line with current UK CFC legislation, Diageo may be affected by the outcome of this investigation. Diageo is monitoring developments. If the preliminary findings of the European Commission's investigation into the UK legislation are upheld, Diageo calculates its maximum potential liability to be approximately £250 million. Based on its current assessment, Diageo believes that no provision is required in respect of this issue.

During the year ended 30 June 2018, Diageo reached agreement with HM Revenue & Customs in the United Kingdom in respect of transfer pricing and related issues. See note 7 (Taxation) for further information.

Diageo has also been in discussions with the French Tax Authorities over the deductibility of certain interest costs. During the year the French Tax Authorities issued assessments denying tax relief for interest costs incurred in the periods ended 30 June 2011 to 30 June 2017. Diageo believes that the interest costs are deductible and accordingly is challenging the assessments from the French Tax Authorities. Including interest and penalties, the exposure for the periods ended 30 June 2011 to 30 June 2018 is approximately €241 million (£214 million). Based on its current assessment, Diageo believes that no provision is required in respect of this issue.

(h) Other

The group has extensive international operations and is a defendant in a number of legal, customs and tax proceedings incidental to these operations, the outcome of which cannot at present be foreseen. In particular, the group is currently a defendant in various customs proceedings that challenge the declared customs value of products imported by certain Diageo companies. Diageo continues to defend its position vigorously in these proceedings.

Save as disclosed above, neither Diageo, nor any member of the Diageo group, is or has been engaged in, nor (so far as Diageo is aware) is there pending or threatened by or against it, any legal or arbitration proceedings which may have a significant effect on the financial position of the Diageo group.

19. Commitments

(a) Capital commitments

Commitments for expenditure on intangibles and property, plant and equipment not provided for in these consolidated financial statements are estimated at £161 million (2017 – £84 million; 2016 – £87 million).

On 10 July 2018 Diageo launched a partial tender offer to increase its aggregate equity stake in Sichuan Shuijingfang Company Limited (SJF). See note 22 for details of the commitment made for the acquisition of the additional equity shares in SJF.

(b) Operating lease commitments

The minimum lease rentals to be paid under non-cancellable leases, principally in respect of properties, are as follows:

	2018 £ million	2017 £ million
Payments falling due:		
Within one year	**100**	95
Between one and two years	**70**	72
Between two and three years	**48**	52
Between three and four years	**32**	40
Between four and five years	**20**	28
After five years	**42**	51
	312	338

There are no significant leases for which contingent rent is payable, nor any that have purchase options, escalation clauses or restrictions. Certain of the operating leases have renewal clauses which are at fair market value.

20. Related party transactions

Transactions between the group and its related parties are made on terms equivalent to those that prevail in arm's length transactions.

(a) Subsidiaries

Transactions between the company and its subsidiaries are eliminated on consolidation and therefore are not disclosed. Details of the principal group companies are given in note 21.

(b) Associates and joint ventures

Sales and purchases to and from associates and joint ventures are principally in respect of premium drinks products but also include the provision of management services.

Transactions and balances with associates and joint ventures are set out in the table below:

	2018 £ million	2017 restated(i) £ million	2016 restated(i) £ million
Income statement items			
Sales	10	10	31
Purchases	29	32	36
Balance sheet items			
Group payables	3	4	5
Group receivables	2	1	2
Loans payable	6	6	6
Loans receivable	59	31	21
Cash flow items			
Loans and equity contributions, net	37	14	–

(i) Comparatives for loans receivable from associates and joint ventures were restated to include advances to associates that are convertible to equity.

Other disclosures in respect of associates and joint ventures are included in note 6.

(c) Key management personnel

The key management of the group comprises the Executive and Non-Executive Directors, the members of the Executive Committee and the Company Secretary. They are listed under 'Board of Directors and Company Secretary' and 'Executive Committee'.

	2018 £ million	2017 £ million	2016 £ million
Salaries and short term employee benefits	10	10	11
Annual incentive plan	10	9	9
Non-Executive Directors' fees	1	1	1
Share-based payments(i)	15	9	7
Post employment benefits	2	2	2
Termination benefits	–	2	2
	38	33	32

(i) Time-apportioned fair value of unvested options and share awards.

Non-Executive Directors do not receive share-based payments or post employment benefits. Details of the individual Directors' remuneration are given in 'Single total figure of remuneration for Executive Directors' and 'Non-Executive Directors' remuneration' in the Directors' remuneration report.

(d) Pension plans

The Diageo pension plans are recharged with the cost of administration services provided by the group to the pension plans and with professional fees paid by the group on behalf of the pension plans. The total amount recharged for the year was £14 million (2017 – £15 million; 2016 – £16 million).

(e) Directors' remuneration

	2018 £ million	2017 £ million	2016 £ million
Salaries and short term employee benefits	2	2	2
Annual incentive plan	3	3	2
Non-Executive Directors' fees	1	1	1
Share option exercises(i)	–	2	–
Shares vesting(i)	1	4	5
Post employment benefits(ii)	1	1	1
	8	13	11

(i) Gains on options realised in the year and the benefit from share awards, calculated by using the share price applicable on the date of exercise of the share options and release of the awards.
(ii) Includes a cash allowance in lieu of pension contributions.

Details of the individual Directors' remuneration are given in 'Single total figure of remuneration for Executive Directors' and 'Non-Executive Directors' remuneration' in the Directors' remuneration report.

21. Principal group companies

The companies listed below include those which principally affect the profits and assets of the group. The operating companies listed below may carry on the business described in the countries listed in conjunction with their subsidiaries and other group companies.

	Country of incorporation	Country of operation	Percentage of equity owned(i)	Business description
Subsidiaries				
Diageo Ireland	Republic of Ireland	Worldwide	100%	Production, marketing and distribution of premium drinks
Diageo Great Britain Limited	England	Great Britain	100%	Marketing and distribution of premium drinks
Diageo Scotland Limited	Scotland	Worldwide	100%	Production, marketing and distribution of premium drinks
Diageo Brands B.V.	Netherlands	Worldwide	100%	Marketing and distribution of premium drinks
Diageo North America, Inc.	United States	Worldwide	100%	Production, importing, marketing and distribution of premium drinks
United Spirits Limited(ii)	India	India	54.78%	Production, importing, marketing and distribution of premium drinks
Diageo Capital plc(iii)	Scotland	United Kingdom	100%	Financing company for the group
Diageo Finance plc(iii)	England	United Kingdom	100%	Financing company for the group
Diageo Investment Corporation	United States	United States	100%	Financing company for the US group
Mey İçki Sanayi ve Ticaret A.Ş.	Turkey	Turkey	100%	Production, marketing and distribution of premium drinks
Associates				
Moët Hennessy, SAS(iv)	France	France	34%	Production, marketing and distribution of premium drinks

(i) All percentages, unless otherwise stated, are in respect of holdings of ordinary share capital and are equivalent to the percentages of voting rights held by the group.
(ii) Percentage ownership excludes 2.38% owned by the USL Benefit Trust.
(iii) Directly owned by Diageo plc.
(iv) French limited liability company.

(1) Diageo Finance B.V. (Netherlands) is a wholly owned finance subsidiary of the group. As at 30 June 2018, there were no outstanding securities issued by Diageo Finance B.V.

22. Post balance sheet events

Offer for shares in Sichuan Shuijingfang Company Limited (SJF)

On 10 July 2018 Diageo launched a partial tender offer to increase its aggregate equity stake in SJF from 39.71% to up to a maximum of 60%. The price per share offered is RMB62.00 per share (adjusted for any dividend distribution by SJF during the tender offer period) and gives all non Diageo shareholders the opportunity to elect to sell their shares in SJF to Diageo up to 11 August 2018. The maximum possible consideration to reach 60% of the equity in SJF is RMB6,146 million (£703 million), of which RMB1,229 million (£141 million) was deposited in escrow with the Chinese regulatory authorities on 3 July 2018. $900 million (£682 million) of the $3.5 billion (£2,652 million) available undrawn committed bank facilities have been ring-fenced, as a backstop to Diageo's normal funding sources, for the cost of acquiring the shares in SJF until settlement is completed.

Share buyback

On 25 July 2018 the Board resolved to delegate to a committee of the Board a decision in respect of a potential share buyback programme of up to £2 billion in the year ending 30 June 2019. It is anticipated that the committee will make a decision on the matter at a meeting to be held on 26 July 2018.

Company balance sheet of Diageo plc

	Notes	30 June 2018 £ million	30 June 2018 £ million	30 June 2017 £ million	30 June 2017 £ million
Non-current assets					
Investment in subsidiary undertakings	3	27,043		27,041	
Other financial assets	4	253		308	
Deferred tax assets	5	–		24	
Post employment benefit assets	6	858		214	
			28,154		27,587
Current assets					
Amounts owed by group undertakings		66		1,334	
Trade and other receivables		3		8	
Other financial assets	4	1		24	
Cash and cash equivalents		25		8	
			95		1,374
Total assets			28,249		28,961
Current liabilities					
Amounts owed to group undertakings		(591)		(609)	
Borrowings		–		(31)	
Other financial liabilities	4	(1)		(24)	
Trade and other payables		(42)		(50)	
Provisions	7	(13)		(17)	
			(647)		(731)
Non-current liabilities					
Amounts owed to group undertakings		(7,738)		(8,246)	
Other financial liabilities	4	(253)		(308)	
Provisions	7	(192)		(191)	
Deferred tax liabilities	5	(90)		–	
Post employment benefit liabilities	6	(101)		(108)	
			(8,374)		(8,853)
Total liabilities			(9,021)		(9,584)
Net assets			19,228		19,377
Equity					
Share capital (2018 – 2,695 million shares (2017 – 2,754 million shares of $28^{101}/_{108}$ pence each)	9	780		797	
Share premium		1,349		1,348	
Merger reserve	9	9,161		9,161	
Other reserves		3,163		3,146	
			14,453		14,452
Retained earnings:					
At beginning of year		4,925		4,723	
Profit for the year		2,346		1,482	
Other changes in retained earnings		(2,496)		(1,280)	
			4,775		4,925
Total equity			19,228		19,377

The accompanying notes are an integral part of these parent company financial statements.

These financial statements were approved by a duly appointed and authorised committee of The Board of Directors on 25 July 2018 and were signed on its behalf by Ivan Menezes and Kathryn Mikells, Directors.

Company registration number No. 23307

Statement of changes in equity for Diageo plc

	Share capital £ million	Share premium £ million	Merger reserve £ million	Capital redemption reserve £ million	Retained earnings: Own shares £ million	Retained earnings: Other reserve £ million	Retained earnings: Total £ million	Total equity £ million
At 30 June 2016	797	1,347	9,161	3,146	(2,189)	6,912	4,723	19,174
Profit for the year	–	–	–	–	–	1,482	1,482	1,482
Other comprehensive income for the year	–	–	–	–	–	210	210	210
Employee share schemes	–	–	–	–	13	(23)	(10)	(10)
Share-based incentive plans	–	–	–	–	–	34	34	34
Tax on share-based incentive plans	–	–	–	–	–	1	1	1
Shares issued	–	1	–	–	–	–	–	1
Dividends paid	–	–	–	–	–	(1,515)	(1,515)	(1,515)
At 30 June 2017	797	1,348	9,161	3,146	(2,176)	7,101	4,925	19,377
Profit for the year	–	–	–	–	–	2,346	2,346	2,346
Other comprehensive income for the year	–	–	–	–	–	528	528	528
Employee share schemes	–	–	–	–	32	(7)	25	25
Share-based incentive plans	–	–	–	–	–	39	39	39
Shares issued	–	1	–	–	–	–	–	1
Share buyback programme	(17)	–	–	17	–	(1,507)	(1,507)	(1,507)
Dividends paid	–	–	–	–	–	(1,581)	(1,581)	(1,581)
At 30 June 2018	780	1,349	9,161	3,163	(2,144)	6,919	4,775	19,228

The accompanying notes are an integral part of these parent company financial statements.

Notes to the company financial statements of Diageo plc

1. Accounting policies of the company

Basis of preparation

The financial statements of Diageo plc (the company) are prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

In preparing these financial statements, the company applies the recognition, measurement, and disclosure requirements of International Financial Reporting Standards as adopted by the EU (IFRS), but makes amendments where necessary in order to comply with the Companies Act 2006 and has excluded certain information as permitted by FRS 101.

The financial statements are prepared on a going concern basis under the historical cost convention, except for certain financial instruments and post employment benefits which are stated at their fair value.

By virtue of section 408 of the Companies Act 2006 the company is exempt from presenting an income statement and disclosing employee numbers and staff costs. The company has taken advantage of the exemption under FRS 101 from preparing a cash flow statement and related notes, disclosures in respect of transactions and the capital management of wholly owned subsidiaries, the effects of new but not yet effective IFRSs and disclosures in respect of the compensation of Key Management Personnel. As the consolidated financial statements of Diageo plc include equivalent disclosures, the company has also utilised exemptions available under FRS 101 from disclosing IFRS 2 Share-based Payment in respect of group settled share-based payments, disclosures required by IFRS 7 Financial Instruments Disclosures and by IFRS 13 Fair Value Measurement.

New accounting policies

The following standards issued by the IASB and endorsed by the EU have been early adopted by the company from 1 July 2017:

IFRS 9 – Financial instruments replaces IAS 39 (Financial instruments – Recognition and measurement) and addresses the classification and measurement of financial instruments, introduces new principles for hedge accounting and a new forward-looking impairment model for financial assets. The adoption of IFRS 9 principles did not result in any changes in the measurement and classification of financial instruments and had no impact on the balance sheet of the company for the year ended 30 June 2018.

All classes of financial assets and financial liabilities had as at 1 July 2017 the same carrying values under IFRS 9 as they had under IAS 39.

Investment in subsidiaries

Investments in subsidiaries are stated at historical cost less impairment provisions for any permanent decrease in value. The carrying amounts of the company's investments are reviewed at each reporting date to determine whether there is an indication of impairment. If such an indication exists, then the asset's recoverable amount is estimated. Losses are recognised in the income statement and reflected in an allowance against the carrying value. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the income statement.

Dividends paid and received

Dividends are included in the financial statements in the financial year in which they are approved. Dividends received are included in the financial statements in the year in which they are receivable.

Share-based payments – employee benefits

The company's accounting policy for share-based payments is the same as set out in note 17 to the consolidated financial statements. Where the company grants options over its own shares to the employees of its subsidiaries, it generally recharges the cost to the relevant group company. Where the amount is not recharged the value of the options is recognised as a capital contribution to the subsidiaries and increases the cost of investment.

Pensions and other post employment benefits

The company's accounting policy for post employment benefits is the same as set out in note 13 to the consolidated financial statements.

The company acts as sponsor of all UK post employment plans for the benefit of employees and former employees throughout the group. There is no contractual agreement or stated policy for charging the net defined benefit costs for the plan measured in accordance with FRS 101, to other group companies whose employees participate in these group wide plans. However, recharges to other group companies are made on a funding basis and are credited against post employment service costs to the extent they are in respect of current service. The fair value of the plans' assets less the present value of the plans' liabilities are disclosed as a net asset or net liability on the company's balance sheet as it is deemed to be the legal sponsor of these plans. The net income charge/credit reflects the increase in the defined benefit obligation resulting from service in the current year, benefit changes, curtailments and settlements. Past service costs are recognised in income. The net interest cost is calculated by applying the discount rate to the net balance of the defined benefit obligation and the fair value of the plan assets and is included in the income statement. Any differences due to changes in assumptions or experience are recognised in other comprehensive income.

Provisions

Provisions are liabilities of uncertain timing or amount. A provision is recognised if, as a result of a past event, the group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are calculated on a discounted basis. The carrying amounts of provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

Taxation

Current tax is based on taxable profit for the year. Taxable profit is different from accounting profit due to temporary differences between accounting and tax treatments, and due to items that are never taxable or tax deductible. Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, tax benefits are reviewed each year to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. Tax provisions are included in current liabilities. Penalties and interest on tax liabilities for the year ended 30 June 2018 are included in profit before taxation. In prior years penalties and interest on tax liabilities were provided for in the tax charge.

Full provision for deferred tax is made for temporary differences between the carrying value of assets and liabilities for financial reporting purposes and their value for tax purposes. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of recovery or settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the assets will not be realised in the future.

Financial instruments

Financial assets and liabilities are initially recorded at fair value including, where permitted by IFRS 9, any directly attributable transaction costs. For those financial assets that are not subsequently held at fair value, the company assesses whether there is evidence of impairment at each balance sheet date.

The company classifies its financial assets and liabilities into the following categories: financial assets and liabilities at amortised cost, financial assets and liabilities at fair value through profit and loss. Where financial assets or liabilities are eligible to be carried at either amortised cost or fair value the company does not apply the fair value option. Non-interest bearing receivables and payables are stated at their nominal value which is equal to amortised cost as they are due on demand.

For a number of loans owed to other group companies, the company has a contractual right to defer payment by one year and one day and therefore these amounts are disclosed as non-current liabilities.

Allowances for expected credit losses are made based on the risk of non-payment taking into account ageing, previous experience, economic conditions and forward looking data. Such allowances are measured as either 12-months expected credit losses or lifetime expected credit losses depending on changes in the credit quality of-the counterparty.

Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values. These liabilities are subsequently measured at the higher of the amount determined under IAS 37 and the amount initially recognised (fair value) less where appropriate, cumulative amortisation of the initial amount recognised.

Critical accounting judgements

The company's critical accounting policies, which the Directors consider are of greater complexity and/or particularly subject to the exercise of judgements are the same as those disclosed in note 1 to the consolidated financial statements in respect of taxation, post-employment benefits, contingent liabilities and legal proceedings. A critical accounting judgement, specific to the company, is the assessment that the recoverable amount of the company's investment in subsidiaries is greater than the carrying amount.

2. Income statement

Note 3 to the consolidated financial statements provides details of the remuneration of the company's auditor for the group.

Information on directors' emoluments, share and other interests, transactions and pension entitlements is included in the Directors' remuneration report in this Annual Report.

3. Investment in subsidiary undertakings

	£ million
Cost less provisions	
At 30 June 2017	27,041
Additions (a)	2
At 30 June 2018	27,043

Investments in subsidiary undertakings are stated at historical cost of £27,329 million (2017 – £27,327 million) less impairment provisions of £286 million (2017 – £286 million).

(a) Investment in subsidiary undertakings include £129 million (2017 – £127 million) of costs in respect of share-based payments, granted to subsidiary undertakings which were not recharged to the subsidiaries. The additions of £2 million comprise the amount not recharged and capitalised as a cost of investment during the year ended 30 June 2018.

A list of group companies as at 30 June 2018 is provided in note 11.

4. Financial instruments

Other financial assets and liabilities are recorded at fair value through profit and loss and comprise the fair value of interest rate swaps and cross currency interest rate swaps with subsidiary undertakings, where the company acts as an intermediary between group companies, therefore it is not expected that there will be any net impact on future cash flows.

Amounts owed by and to group undertakings, trade and other receivables and trade and other payables are measured at amortised cost.

5. Deferred tax assets and liabilities

The amounts of deferred tax accounted for in the balance sheet comprises the following net deferred tax assets/(liabilities):

	Post employment plans £ million	Other temporary differences £ million	Total £ million
At 30 June 2016	28	43	71
Recognised in income statement	(6)	–	(6)
Recognised in other comprehensive income and equity	(40)	(1)	(41)
At 30 June 2017	(18)	42	24
Recognised in income statement	(3)	(2)	(5)
Recognised in other comprehensive income and equity	(108)	(1)	(109)
At 30 June 2018	(129)	39	(90)

Deferred tax on other temporary differences includes assets in respect of the UK Thalidomide Trust liability of £35 million (2017 – £36 million) and share-based payment liabilities of £4 million (2017 – £6 million).

6. Post employment benefits

The movement in the net surplus for the two years ended 30 June 2018, for all UK post employment plans for which the company is the sponsor, is as follows:

	Plan assets £ million	Plan liabilities £ million	Net (deficit)/ surplus £ million
At 30 June 2016	6,047	(6,193)	(146)
Charge before taxation	166	(233)	(67)
Other comprehensive income/(loss)	817	(597)	220
Contributions by group companies	99	–	99
Employee contributions	1	(1)	–
Benefits paid	(341)	341	–
At 30 June 2017	**6,789**	**(6,683)**	**106**
Charge before taxation	**166**	**(215)**	**(49)**
Other comprehensive income	**247**	**359**	**606**
Contributions by group companies	**94**	**–**	**94**
Employee contributions	**1**	**(1)**	**–**
Benefits paid	**(505)**	**505**	**–**
At 30 June 2018	**6,792**	**(6,035)**	**757**

The net surplus for the UK post employment plans of £757 million (2017 – £106 million) for which the company is a sponsor comprises funded plans of £858 million (2017 – £214 million) disclosed as part of non-current assets and unfunded liabilities of £101 million (2017 – £108 million) disclosed as part of non-current liabilities.

Additional information on the UK post employment plans and the principal risks and assumptions applicable is disclosed in note 13 to the consolidated financial statements.

7. Provisions

	Thalidomide £ million	Other £ million	Total £ million
At 30 June 2017	**208**	**–**	**208**
Provisions charged during the year	**–**	**2**	**2**
Provisions utilised during the year	**(11)**	**–**	**(11)**
Unwinding of discounts	**6**	**–**	**6**
At 30 June 2018	**203**	**2**	**205**

The company's commitment to the UK Thalidomide Trust is discounted and will be utilised over the period of the commitment up to 2037.

At 30 June 2018 £13 million (2017 – £17 million) of provision is current and £192 million (2017 – £191 million) is non-current.

8. Financial guarantees

The company has guaranteed certain borrowings of subsidiaries which at 30 June 2018 amounted to £9,177 million (2017 – £8,099 million).

The company has also provided irrevocable guarantees relating to the liabilities of certain of its Irish and Dutch subsidiaries. In addition, the company has provided a guarantee to the Guinness Ireland Group Pension Scheme.

The Directors do not expect the company to be liable for any legal obligation in respect of these financial guarantee agreements, and they have been recognised at nil fair value.

9. Shareholders' funds

(a) Merger reserve

On the acquisition of a business, or of an interest in an associate, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets acquired. Where merger relief is applicable under the UK Companies Acts, the difference between the fair value of the business acquired and the nominal value of shares issued as purchase consideration is treated as a merger reserve.

(b) Own shares

At 30 June 2018 own shares comprised 4 million ordinary shares held by employee share trusts (2017 – 5 million; 2016 – 7 million); 222 million ordinary shares repurchased and held as treasury shares (2017 – 222 million; 2016 – 223 million); and 12 million ordinary shares held as treasury shares for hedging share scheme grants (2017 – 14 million; 2016 – 14 million).

In the year ended 30 June 2018 the company purchased 58.9 million ordinary shares for a cost of £1,507 million (including £9 million of transaction costs) through a share buyback programme. The shares purchased under the share buyback programme were cancelled.

As at 30 June 2017 the Guinness Ireland Group Pension Scheme held 22,807 ordinary shares in Diageo plc.

Information on movements in own shares is provided in note 17(c) to the consolidated financial statements.

(c) Retained earnings

£4,185 million (2017 – £4,644) of retained earnings is available for the payment of dividends, or purchases of own shares.

10. Post balance sheet event

On 25 July 2018 the Board resolved to delegate to a committee of the Board a decision in respect of a potential share buyback programme of up to £2 billion in the year ending 30 June 2019. It is anticipated that the committee will make a decision on the matter at a meeting to be held on 26 July 2018.

11. Group companies

In accordance with Section 409 of the Companies Act 2006 a full list of subsidiaries, partnerships, associates, joint ventures and joint arrangements, the country of incorporation and the effective percentage of equity owned, as at 30 June 2018 are disclosed below. Unless otherwise stated the share capital disclosed comprises ordinary shares which are indirectly held by Diageo plc.

FULLY OWNED SUBSIDIARIES

Angola

Rua Fernao de Sousa, Condominio Bengo, Letter A, 11.s floor, Fraction A37, neighbourhood Vila Alice, Municipality of Luanda, Province of Luanda.
Diageo Angola Limitada

Argentina

Italia 415- 3rd Floor, B1638BMC Vicente Lopez, Buenos Aires
Diageo de Argentina S.A.

Australia

162 Blues Point Road, Level 1, NSW, 2060, McMahons Point
Bundaberg Distilling Investments Pty Ltd
Crescendo Australia Pty Ltd(iii)
Diageo Australia Limited(iii)
D.C.L (Holdings) Australia Proprietary Limited(ii),(iii)
Whitted Street, QLD, 4670, Bundaberg
Bundaberg Distilling Company Pty. Limited(v)

Austria

Teinfaltstrasse 8, 1010, Wien
Diageo Austria GmbH

Belgium

Z.3 Doornveld 150, 1731, Zellik
Diageo Belgium N.V.

Bermuda

Canon's Court 22, Victoria Street, Hamilton, HM12
Atalantaf Limited

Brazil

Av. Washington Soares, 1280, Ceará, 60.810-350, Fortaleza
Ypioca industrial de Bebidas S.A.
Fazenda Santa Eliza, s/n, Ceará, 62.685-000, Paraipaba
Ypioca Agricola LTDA
Rua Olimpiadas, 205, 14o and 15o floor, Sao Paulo, 04551-000, Sao Paulo
Diageo Brasil Ltda

Bulgaria

7 Iskarsko Shose Blvd., Trade Center Europe, building 12, floor 2, 1528, Sofia
Diageo Bulgaria Ltd

Cameroon

Bassa industrial trade zone, Ndog HemII, PO BOX 1213 Douala
Guinness Cameroun S A

Canada

Avenue Lafleur, 225, Quebec, H8R 3H2, LaSalle
United Distillers Canada Inc.
Boul Henri-Bourassa E., 9225, Local A, Quebec, H1E 1P6 , Montreal
Diageo Americas Supply Quebec Distribution Inc.
Boul Henri-Bourassa E., 9225, Local B, Quebec, H1E 1P6, Montreal
Diageo Ireland Quebec Distribution Inc.
Peter, 134, 1501, 15, Ontario, M5V 2H2, Toronto
Diageo Canada Holdings Inc.
Diageo Canada Inc.
Gilbey Canada Investments Limited
Joseph E. Seagram & Sons Limited(ii),(iii)

Cayman Islands

Second Floor, Century Yard, P O Box 448GT, Cricket Square, Grand Cayman
Grand Metropolitan (Cayman Islands) Limited(ii)

Chile

Cerro El Plomo 5630, Piso 13, Las Condes
Diageo Chile Limitada

China

Office 781,7/F, Office Tower 2, Sun Dong An Plaza No. 138 Wangfujing Avenue Dongcheng District , 100006, Beijing
Johnnie Walker House Beijing Co. Ltd.
No. 9 Quanxing Road, Jinniu District, 610036, Chengdu City
Sichuan Chengdu Shuijingfang Group Co., Ltd
No.209 Gonghe Road, Tower 2, Enterprise Centre, 2101, 21, Jing'an District, 200070, Shanghai
Diageo China Limited
No.28 Jiafeng Road, 2502, 5, Pudong District, 200137, Shanghai
Diageo (Shanghai) Limited

Colombia

100 street No.13 21 Office 502. Bogota
Diageo Colombia S.A.

Costa Rica

1 km Este Periodico La Nacion, Llorente de Tibas, Edificio Vinum Store, San Jose
Diageo Costa Rica S.A.

Croatia

Hektoroviceva ulica 2, 10000, Zagreb
Diageo Croatia d.o.o.za usluge

Cyprus

3 Themistokli Dervi Ave, Julia House, 1066, Nicosia
Horizon Developments Limited(ii)

Czech Republic

Na Pankráci 1724/129, 140 00, Prague
Diageo Czech Marketing Services LLC

Denmark

Sundkrogsgade 21, 2100, Copenhagen
Diageo Denmark AS

Dominican Republic

A J Aybar 204 SD, Santo Domingo
Diageo Dominicana S.R.L

Ethiopia

Region Oromia, Subcity Finfine around Oromia, Woreda/Kebele Sebeta Hawas, City Sebeta Town
Meta Abo Brewery Share Company

France

178, Rue Achard 33300 Bordeaux
Vignobles Internationaux S.A.S.
73, Rue de Provence, 75009, Paris
Diageo France Holdings S.A.S.
Diageo France Investments S.A.S.
Diageo France S.A.S.
Guinness France Holdings S.A.S
United Distillers France SAS

Gabon

c/o Sobraga, P O Box 487, Libreville
Phenix Gabon SARL

Germany

Potsdamer Str. 91, 10785 Berlin
Belsazar GmbH
Reeperbahn 1, 20359, Hamburg
Diageo Germany GmbH

Greece

27, Agiou Thoma street, Marousi, 151 24, Athens
Diageo Hellas S.A.

Guernsey

Heritage Hall, Le Marchant Street, St Peter Port, GY1 4HY
Diageo Group Insurance Company Limited

Hong Kong

11 Hoi Shing Road, 11 Hoi Shing Road, Room 7, 18, Tsuen Wan, New Territories, 999077
Diageo RTD Hong Kong Limited
3/F, 21 Li Yuen Street West Central
Vast Fund Limited

Hungary

1132 Budapest, Vaci ut 20-26
DIAGEO Business Services Limited
Diageo Employee Ownership Program Organization
DIAGEO HUNGARY FINANCE Limited Liability Company
DIAGEO Hungary Marketing Services Limited Liability Company

India

GK marg, Piramal towers, 4, maharashtra, 400013, Mumbai
Diageo India Private Limited
Kempapura Main Road, Opp Nagawara Lake, Karle SEZ Tower, 2nd floor, Karnataka, 560045, Bengaluru
Diageo Business Services India Private Limited
Southern park, saket palace, 1, Delhi, 110017, Delhi
Diageo Distilleries Private Limited(vii)

Indonesia

Jl Jend Sudirman Kav. 76 – 78, Sudirman Plaza, Plaza Marein, 15th, Jakarta Selatan, 12910, Jakarta
PT Gitaswara Indonesia(ix)
Jalan Jend. Sudirman Kav. 29-31, Gedung World Trade Center I, 16th Floor, Setiabudi, South Jakarta, 12920, Jakarta
PT Langgeng Kreasi Jayaprima(ix)

Italy

Strada Statale 63, 12069, Santa Vittoria d'Alba (CN)
Diageo Operations Italy S.p.A.
Via Lugaro 15, 10126, Torino
Diageo Italia S.p.A.

Jamaica

214 Spanish Town Road. P.O. Box 190. Kingston 11.
Diageo Jamaica Limited
7th Floor, Scotiabank Centre, Duke Street, Kingston
Trelawny Estates Limited
Lot14, Gilbert Drive, Lakeside Park, Discovery Bay, St. Ann
Myers Rum Company (Jamaica) Limited(ii)

Japan

Nakano-ku 4-10-2, Nakano Central Park South, 17, Tokyo, 164-0001
Diageo Japan K.K

Kazakhstan

Timiryazev street 28 V, office 704, Bostandik district, 50040, Almaty
Diageo Kazakhstan LLP.

Kenya

L R NO 1870/1/569, 2nd Floor, Apollo Centre, Ring Road Parklands, Westlands, PO BOX 764 00606 Nairobi
Diageo Kenya Limited

La Reunion

14, rue Jules Thirel A30 97460 Saint Paul, Reunion Island
Diageo Reunion 2 SAS(ii)
Diageo Reunion SA

Lebanon

Verdun Street, Ibiza Building, Beirut, PO Box 113-5631
Diageo Lebanon Holding SAL
Diageo LENA Offshore SAL

Mexico

Av. Ejercito Nacional, 843-B, Torre Paseo Acceso B, 2, Mexico City , 11520
Diageo Mexico Comercializadora S.A. de C.V.
Diageo Mexico II SA de CV Sociedad Financiera de Objeto Multiple
Diageo Mexico SA de CV
Porfirio Díaz, 17, Jalisco , 47750, Atotonilco el Alto
Don Julio Agavera S.A. de C.V.
Don Julio Agricultura y Servicios S.A. de C.V.
Servicios Agavera, S.A.de C.V.
Tequila Don Julio Servicios, S.A.de C.V.

Mozambique

Avenida Marginal parcela 141 2do Andar – Predio da Global Alliance Caixa Postal 96 Maputo
Diageo Mozambique Lda.
Estrada Nacional numero 1, Micanhine, Marracuene
Diageo Supply Marracuene Lda.

New Zealand

123 Carlton Gore Road, Level 2, Newmarket, 1023, Auckland
Diageo New Zealand Limited(iii)
80 Queen Street, 1010, Auckland
Gilbeys New Zealand Limited

Nigeria

Oba Akran Avenue Ikeja, 24, Lagos, PMB 21071, 100001
Diageo Brands Nigeria Ltd

Norway

Karenslyst Allee 11, 278, Oslo
Diageo Norway AS

Panama

Costa del Este, Ave La Rotonda, Business Park, Torre V. , 15
Diageo Panama S.A.
West Boulevard, PH ARIFA, 9th and 10th, Santa Maria Business
Diageo Taiwan Inc.

Paraguay

Avda Aviadores del Chaco 2050. Edificio World trade center. Torre 3 piso 11
Diageo Paraguay S.R.L.

Peru

Calle Las Begonias 415 Piso 03 Of. 301, San Isidro, Lima
Diageo Peru S.A.
Ciudadela Zofratacna Mz. D Lt. 8,9,10,15,16 y 17 Carretera Panamericana Sur Km 13, Tacna
Diageo Del Peru S.A.

Philippines

15th Floor, W-fifth Building, 5th Avenue, Bonifacio Global City, Taguig City
Diageo Export SR Inc.(ii)
Diageo Philippines Free Port Inc(ii)
Diageo Philippines, Inc
North Island United Enterprise Holdings Inc(ii)
United Distillers & Vintners Philippines Inc(ii)
Lower G/F, Unit A Eight West Campus Le Grand Avenue, Mckinley West Fort Bonifacio, Taguig City , NCR Fourth District, 1630
Diageo Asia Pacific Shared Services Centre Limited, Inc.

Poland

Warsaw, Przyokopowa Str. 31, PL 01 – 208 Warsaw
Diageo Polska Sp. z o.o.

Portugal

Avenida D. Joao II, No 49, Edificio Arts Torre A, 10, 1990-085, LISBOA
Diageo Portugal – Distribuidora de Bebidas, Unipessoal, Lda

Puerto Rico

270 Munoz Rivera Ave. San Juan, PR 00918
Diageo Puerto Rico, Inc

Republic of Ireland

Nangor House, Western Estate, Nangor Road, Dublin, 12
Gilbeys of Ireland (R&D) Unlimited Company
Gilbeys of Ireland Unlimited Company
Nicholas Doyle (New Ross) Unlimited Company(ii)
R & A Bailey & Co
UDV Ireland Group (Trustees) Designated Activity Company
UDV Operations Ireland Unlimited Company(ii)
United Beverages Pension Trustees Company Limited by Guarantee
United Beverages Sales Unlimited Company(ii)
St. James's Gate, Dublin 8
1759 Property Limited
AGS Employee Shares Nominees (Ireland) Designated Activity Company
Arthur Guinness Son & Company (Dublin)(ii)
Deasy & Co. Unlimited Company(ii)
Diageo Europe Holdings Limited
Diageo Ireland
Diageo Ireland Finance 1 Unlimited Company
Diageo Ireland Finance 2 Unlimited Company
Diageo Ireland Finance 3 Unlimited Company
Diageo Ireland Finance Unlimited Company
Diageo Ireland Holdings Unlimited Company
Diageo Ireland Pension Trustee Designated Activity Company
Diageo Turkey Holdings Limited
E. Smithwick & Sons Unlimited(ii)
Guinness Storehouse Ireland Pension Trustees Designated Activity Company
Guinness Storehouse Limited
Harp Ireland Unlimited(ii)
Irish Ale Breweries Holdings Unlimited Company(iii)
Irish Ale Breweries Unlimited Company
Macardle Moore & Company Unlimited Company(ii)
Powtom 11 Limited
Powtom 12 Limited
Powtom 13 Limited
Powtom 14 Limited
Powtom 16 Limited
Powtom 17 Limited
Powtom 18 Unlimited Company
R&A Bailey Pension Trustee Designated Activity Company
St. James's Gate Trading Unlimited Company(ii)
The Connacht Mineral Water Unlimited Company(ii)

Russia

7 Gasheka ulitsa, Moscow 123056
CJSC IDV Selviac
Kaspiyskaya Street, 22, main bld. 1, bld. 5, floor 3, apartment VII, room 31a, 115304, Moscow
D Distribution Joint-Stock Company
Diageo Brands Distributors LLC

Singapore

Singapore, 112 Robinson Road, 1, 5th Floor, 1, 68902
Diageo GTME Pte Ltd
Diageo Singapore Pte Ltd.
Diageo Singapore Supply Pte. Ltd.
Streetcar Investment Holding Pte. Ltd.

South Africa

Building 3, Maxwell Office Park, Magwa Crescent West, Waterfall City, Midrand, 2090
Brandhouse Beverages (Pty) Limited(ii)
Diageo South Africa (Pty) Limited
Diageo Southern Africa Markets (Pty) Ltd
United Distillers Southern Africa (Proprietary) Limited
Gallagher House, Gallagher Estate, Richards Drive, Midrand 1685
National Sorghum Breweries Properties Proprietary Limited(ii)
Newshelf 1167 Proprietary Limited(v)
Reldann Investments No. 12 Proprietary Limited(ii)
United National Breweries (SA) Proprietary Limited(ii)

South Korea

46, Dumujae-ro, Bubal-eup, Icheon-shi, Gyeonggi-do, 17317, Icheon
Diageo Korea Company Limited
737, GFC, 32FL, Yuksam dong, Kangnam-gu, 6236, Seoul
Guinness UDV Korea Limited(ii)

Spain

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Diageo Espana S.A.

Sweden

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Diageo Sweden AB

Switzerland

Rue du Grand-Pre 2b, 1007, Lausanne
Diageo Suisse S.A.

Tanzania

CRB Africa Legal Attorneys, Plot 60, Ursino Street P.O. Box 32840, Dar es Salaam
Sumagro Limited(ii)

The Netherlands

Molenwerf 12, 1014 BG, Amsterdam
Diageo Atlantic B.V.
Diageo Brands B.V.
Diageo Brands Holdings B.V.
Diageo Highlands Holding B.V.
Diageo Holdings Netherlands B.V.
Diageo Nederland B.V.
Diageo Overseas B.V.
Global Farming Initiative B.V.
Relay B.V.(v)
Selviac Nederland B.V.

Turkey

Büyükdere Caddesi, Bahar Sokak, River Plaza, N0:13, 25-29, Þiþli, 34394, Istanbul
Mey Alkollu Ickiler Sanayi ve Ticaret A.S
Mey Icki Sanayi ve Ticaret A.S.

Ukraine

1v Pavla Tychyny avenue, 2152, Kyiv
Diageo Ukraine LLC
Chervonoarmiyska Street, bld. 9/2, apt. 70, Kyiv
Seagram Ukraine Limited

United Kingdom

Lakeside Drive, Park Royal, NW10 7HQ, London
Anyslam Investments
Anyslam Limited(i),(viii)
Cellarers (Wines) Limited
DEF Investments Limited
Diageo (IH) Limited(ii)
Diageo Balkans Limited
Diageo CL1 Limited
Diageo DV Limited
Diageo Eire Finance & Co
Diageo Employee Shares Nominees Limited(i),(ii)
Diageo Finance Australia LLP
Diageo Finance plc(i)
Diageo Finance US Limited
Diageo Financing Turkey Limited
Diageo Great Britain Limited
Diageo Healthcare Limited(ii)
Diageo Holdings Limited(i)
Diageo Holland Investments Limited(ii)
Diageo Investment Holdings Limited
Diageo Overseas Holdings Limited(vi)
Diageo Scotland Investment Limited
Diageo Share Ownership Trustees Limited(i),(ii)
Diageo Treasury Australia LLP
Diageo UK Turkey Finance Limited
Diageo UK Turkey Holdings Limited(vi)
Diageo UK Turkey Limited
Diageo United Kingdom Limited(ii)
Diageo US Holdings
Diageo US Investments
Grand Metropolitan Capital Company Limited
Grand Metropolitan Estates Limited
Grand Metropolitan Holdings Limited(ii)
Grand Metropolitan International Holdings Limited
Grand Metropolitan Limited
Grandmet Foods (UK) Limited(ii)
Guinness Limited(i)
Guinness Overseas Holdings Limited(i)
Guinness Overseas Limited
James Buchanan & Company Limited(ii)
John Walker and Sons Limited(ii)
Otford Estates Limited
PSP (Sales and Distribution) Limited(ii)
Tanqueray Gordon and Company, Limited(i)
The Distillers Company (Biochemicals) Limited(ii)
The Pimm's Drinks Company Limited(ii)
UDV (SJ) Holdings Limited(i)
UDV (SJ) Limited
United Distillers & Vintners (SJ) B.V.(ii)
United Distillers France Limited(ii)
United Distillers Investments Limited(ii)
W. & A. Gilbey Limited(ii)
Winchester House Property Company Limited(ii)
3rd Floor Capital House, 3 Upper Queen Street, Belfast
Diageo Global Supply IBC Limited
Diageo Northern Ireland Limited(i)
S & B Production Limited
61 St. James's Street, LONDON, SW1A 1LZ
Justerini & Brooks, Limited
Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT
Arthur Bell & Sons Limited(ii)
Carillon U.K. Limited(ii)
Diageo Capital plc(i)
Diageo Distilling Limited(ii)
Diageo Scotland Limited
J & B Scotland Limited(ii)
John Haig & Company Limited
United Distillers UK plc(ii)
William Sanderson and Son Limited(ii)
Zepf Technologies UK Limited

United States

1131 King Street, Christiansted, St. Croix, U.S. Virgin Islands 00820-4971
Diageo USVI, Inc
1209 Orange Street, New Castle, Delaware 19801
Casamigos Spirits Company LLC
Casamigos Tequila LLC
DV Technology LLC
801 Main Avenue – Norwalk, CT 06851
Ballroom Acquisition, Inc.
Diageo Americas Supply, Inc.
Diageo Americas, Inc.
Diageo Beer Company USA
Diageo Inc.
Diageo Investment Corporation
Diageo Latin America & Caribbean LLC
Diageo North America Foundation, Inc.
Diageo North America, Inc.(v)
Diageo US Turkey LLC
Liquor Investment Llc.
The Bulleit Distillery, Inc.
The Pierre Smirnoff Company Limited(v)

Uruguay

Av. Luis A. de Herrera, 1.248, WTC- Torre II – office 1074, Montevideo
Diageo Uruguay SA

Venezuela

Av Intercomunal Alí Primera, Los Taques, Estado Falcón
DV Paraguana, C.A.
Av La Hormiga con Intersección de la Carretera via Payara, C.C. Tierra Buena. Acarigua. Estado Portuguesa.
Mull Trading, C.A.
Av. Circunvalacion Norte (Jose Asunsion Rodriguez) Edificio Distribuidora Metropol, Porlamar, Estado Nueva Esparta
Clyde Trading, C.A.(v)
Cupar Trading, C.A.(v)
Diageo Nueva Esparta, C.A.
DV Trading, C.A.(v)
Zeta Importers, C.A.(v)
Ave. San Felipe Urbanización La Castellana, Edificio Centro Coinasa, Piso 6. Caracas, 1060
Diageo Venezuela C.A
Industrias Pampero C.A.(ii)
Calle 1 con calle Calle 1 Este; Edificio y Galpon BTP, Zona Industrial La Caracarita; Municipio Los Guayos; estado Carabobo
Arran Tradings, C.A.
DV Release, C.A.
Islay Trading, C.A.
L4L Trading, C.A.
Lismore Trading, C.A.
Skye Trading, C.A.
Carretera Nacional Acarigua-Barquisimeto Casa Agropecuaria Las Marias I C.A.S-N Sector los Guayones La Miel, Lara.
Agropecuarias Las Marias I C.A.

Vietnam

No. 157, 21/8 Street, Phuoc My Ward, Phan Rang – Thap Cham City, Ninh Thuan Province
Diageo Vietnam

Zimbabwe

48 Midlothian Avenue, Eastlea, Harare
International Distillers – Zimbabwe (Private) Limited(ii)

SUBSIDIARIES WHERE THE EFFECTIVE INTEREST IS LESS THAN 100%

British Virgin Islands

Sea Meadow House, Blackburne Highway, P.O. Box 116, Road Town, Tortola
Palmer Investment Group Limited(xi) – 54.78%
USL Holdings Limited(ii),(xi) – 54.78%
Wickhams Cay, 1, OMC Chambers, Road Town, Tortola
Rum Creation & Products, Inc.(v) – 50.00%

Canada

Queen's Quay West, 207, 299, 2, Ontario, M5J 1A7, Toronto
Guinness Canada Limited – 51.00%

China

No. 9 Quanxing Road, Jinniu District, 610036, Chengdu City
Chengdu Jianghai Trade Development Co. Limited – 39.71%
Chengdu Jiayuan Jiuye Marketing Co. Limited(ii) – 39.71%
Chengdu Rongshangfang Marketing Co. Limited – 39.71%
Chengdu Ruijin Trade Co. Limited – 39.71%
Chengdu Shuijingfang Jiuye Co. Limited – 39.71%
Chengdu Shuijingfang Marketing Co. Limited – 39.71%
Chengdu Tengyuan Jiuye Marketing Co. Limited – 39.71%
Sichuan Shuijingfang Jiuye Co. Limited(ii) – 39.71%
Sichuan Swellfun Co., Ltd – 39.71%
Unit 215, Xinxing Building, No. 8, Jia Feng Road, Wai Gao Qiao Free Trade Zone, Shanghai
United Spirits (Shanghai) Trading Company Ltd(xi) – 54.78%

Ghana

Guinness Brewery, Plot 1 Block L, Industrial Area, Kaasi, P. O. Box 1536, Kumasi
Guinness Ghana Breweries Limited – 80.39%

Guatemala

0 calle 8-19 zona 9, Quetzaltenango
Anejos De Altura, Sociedad Anonima – 50.00%

India

Roxana Towers, Ground Floor, M.No.7-1-24/1/RT/G1&G2, Greenlands, Begumpet, Hyderabad 500 016
Pioneer Distilleries Limited(xi) – 41.01%
Sovereign Distilleries Limited(xi) – 54.78%
Tern Distilleries Private Limited(xi) – 54.78%
UB Tower, #24, Vittal Mallya Road, Bangalore-560001
Four Seasons Wines Limited(xi) – 54.78%
Royal Challengers Sports Private Limited(xi) – 54.78%
United Spirits Limited(xi) – 54.78%

Jersey

Ordnance House, 31 Pier Road, St Helier, JE4 8PW
UB Sports Management Overseas Ltd(xi) – 54.78%

Kenya

Tusker House, Ruaraka, PO Box 30161, 00100 Nairobi GPO
Allsopp (East Africa) Limited(ii) – 48.52%
EABL International Limited(ii) – 50.03%
East African Breweries Limited – 50.03%
East African Maltings Limited – 50.03%
Harp Distributors Limited(ii) – 76.85%
Kenya Breweries Limited – 50.03%
Kenya Distillers Limited(ii) – 76.85%
Kenya Liquor Distributors Limited(ii) – 76.85%
Masterplan (Kenya) Limited(ii) – 50.02%
Salopia Limited(ii) – 50.02%
Tembo Properties Limited(ii) – 50.03%
Tusker Football Club – 50.03%
UDV Kenya Limited – 76.85%

Lebanon

Beirut Symposium Bldg, 10th floor, Beirut, POBox 113-5250, Beirut
Diageo Lebanon SAL – 85.00%

Mauritius

IFS Court, Twenty Eight, Cybercity, Ebene
Asian Opportunities and Investment Limited(xi) – 54.78%

Nigeria

Oba Akran Avenue Ikeja, 24, Lagos, PMB 21071, 100001
Guinness Nigeria plc – 58.02%

North Cyprus

Sehit Mehmet Cetin Sokak, Kucuk Sanayi Bölgesi, 48, 99450, Gazi Magusa
Turk Alkollu Icki ve Sarap Endustri Ltd. – 66.00%

Panama

Edificio Vallarino, Penthouse Calle 52 y Elvira Mendez P. O. Box 0816-06805 R.P.
Montrose International SA(xi) – 54.78%

Philippines

15th Floor, W-fifth Building, 5th Avenue, Bonifacio Global City, Taguig City
ULM Holdings Inc.(ii) – 40.00%

Rwanda

Kimihurura, Gasabo, Umujyi was Kigali, 7130 Port Bell Luzira
East African Breweries Rwanda Limited – 50.03%

Seychelles

O'Brien House, 273 Le Rocher, Mahe
Seychelles Breweries Limited – 54.40%

Singapore

9 battery road, 15-01 straits trading building, 049910
United Spirit Singapore Pte. Ltd.(xi) – 54.78%

South Sudan

Southern Sudan African Park Hotel, Juba Town
East African Beverages (Southern Sudan) Limited – 49.53%

Tanzania

2nd Floor, East Wing TDFL Building, Ohio street. P.O. Box 32840 Dar es Salaam
EABL (Tanzania) Limited(ii) – 50.03%
Plot 117/2, Access Road, Nelson Mandela Expressway, Chang'Ombe Industrial Area, P.O. Box 41080, Dar es Salaam
Serengeti Breweries Limited – 25.52%

The Netherlands

Molenwerf 12, 1014 BG, Amsterdam
DC Brands B.V.(iii) – 50.00%
Ketel One Worldwide B.V.(iv) – 50.00%

Uganda

P O BOX 7130 KAMPALA
East African Maltings (Uganda) Limited – 50.03%
Plot 3-17 Port Bell Road, Luzira, Kampala, P.O. Box 7130
Uganda Breweries Limited – 49.03%
Plot No 1 Malt Road, Portbell Luzira P.O. Box 3221 Kampala
International Distillers Uganda Limited – 50.03%

United Kingdom

Lakeside Drive, Park Royal, NW10 7HQ, London
Diageo Pension Trust Limited(ix) – 55.00%
Lakeside MWS Limited Liability Partnership
Shaw Wallace Overseas Limited(xi) – 54.78%
United Spirits (Great Britain) Limited(xi) – 54.78%
United Spirits (UK) Limited(xi) – 54.78%
USL Holdings (UK) Limited(xi) – 54.78%
5 Appold Street, Boardwalk House C/p Ashurst LLP, EC2A 2HA, London
Drury Lane/Dryden Street Company No.1 Limited – 55.00%
Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT
Lochside MWS Limited Partnership
McDowell & Co. (Scotland) Ltd(xi) – 54.78%

United States

801 Main Avenue – Norwalk, CT 06851
California Simulcast Inc(ii) – 80.00%
D/CE Holdings LLC – 50.00%
Liquidity Inc.(ii),(xi) – 27.94%

Vietnam

621 Pham Van Chi Street, District 6, Ho Chi Minh City
Vietnam Spirits and Wine LTD – 55.00%

ASSOCIATES

Australia

14 Burra Road, Artarmon 2064, NSW
Mr Black Spirits Pty Ltd. – 20.00%
50 Bertie Street, Port Melbourne, Victoria 3207
New World Whisky Distillery PTY Limited – 30.00%

Curacao

Citco Curacao, Schottegatweg Oost 44, Willemstad
International Brand Developers N.V. – 25.00%

Denmark

Stauningvej 38, 6900 Skjern
Stauning Whisky Holding ApS – 40.00%

France

24/32 rue Jean Goujon – 75008 Paris
Moët Hennessy International, SAS – 34.00%
Moët Hennessy, SAS – 34.00%

Hungary

26 Soroksari ut, Budapest, 1095.
Zwack Unicum plc – 26.00%

Jamaica

2nd Floor, 2-6 Grenada Crescent; Kingston 5
Clarendon Distillers Limited – 27.00%

Spain

Calle General Vara del Rey 5, 1 Piso, 26003 Logroño, La Rioja
El Bandarra, S.L. – 25.00%
carrtera La Cuesta Taco Km 0.5. La Laguna, Santa Crus De Teneriffe
Compania Cervecera De Canarias, S.A. – 20.00%
Tomino (Ponteverda), 36750, Parroquia de Goian, Barrio de Centinela, 1
Valdomino Premium Spirits, S.L. – 20.00%

The Netherlands

Ceresstraat 1, 4811 CA Breda
Canbrew B.V.(iv) – 28.16%
Wichersstraat 26, 1051 ML Amsterdam
Pekoe B.V. – 20.00%

United Kingdom

12 Church Road, Teddington, London TW11 8PB
Tipplesworth Limited – 20.00%
17 Grosvenor Street, Mayfair, London W1K 4QG
Del Professore Limited – 20.00%
1st Floor, Colina House, Colina Mews, London, N15 3HS
Longflint Drinks Limited – 20.00%
28 Vale Road, Claygate, Esher, KT10 0NJ
London Botanical Drinks Limited – 20.00%
34 Statham Court, Tollington Way, London, N7 6FP
Ban Poitin Ltd – 20.00%
354 Castlehill, The Royal Mile, Edinburgh, EH1 2NE
The Scotch Whisky Heritage Centre Limited(vi) – 22.38%
64 New Cavendish Street, London W1G 8TB
Melius Drinks Ltd – 20.00%
71-75 Shelton street London, WC2H 9JQ
Seedlip Ltd – 20.00%
Ballindalloch Castle, Ballindalloch, Banffshire AB37 9AX
Ballindalloch Distillery LLP – 33.33%
Cambridge Distillery, 20 High Street, Grantchester, Cambridge CB3 9NF
Cambridge Distillery Limited – 33.33%
Forsyth House, Lomond Court Castle Business Park, Stirling, FK9 4TU
Copper Dog Whisky Limited – 30.00%

United States

222 Cliffwood Avenue, Los Angeles, CA 90049
Soh Spirits Llc – 20.00%
2459 E 8th Street; Los Angeles, California 90021
Modern Spirits, Llc – 20.00%

Vietnam

94 Lo Duc Street, Pham Dinh Ho Ward, Hai Ba Trung District, Ha Noi City
Hanoi Liquor Joint Stock Company (Halico) – 45.57%

JOINT VENTURES

United Kingdom

9 Wheatfield Road, EDINBURGH, EH11 2PX
Lothian Distillers Limited – 50.00%
North British Distillery Company Limited – 50.00%

JOINT OPERATIONS(x)

China

702A, Taiping Finance Tower, 488 Middle Yincheng Road,China (Shanghai) Pilot Free Trade Zone
Moet Hennessy Diageo (China) Co Ltd(xii) – 67.00%

Costa Rica

Barreal de Heredia, contiguo a MABE
Holcom Industrial, SA – 47.35%
Llorente de Tibás, 1Km este del Periódico La Nación
HA&COM Bebidas del Mundo, SA – 50.00%

Dominican Republic

Independencia Street, No. 129, Santiago
Gist Dominicana S.A. – 60.90%
Salvador Sturla Street, Ensanche Naco, Santo Domingo, DN
Seagram Dominicana S.A. – 60.90%
Segunda (2da) Street, Los Platanitos, Santiago
Industria de Licores Internationales S.A. – 59.71%

France

105 Boulevard de la Mission Marchand, Courbevoie, 92400
MHD Moët Hennessy Diageo SAS – 0.05%

Hong Kong

Level 54, Hopewell Centre, 183 Queen's Road East
Moet Hennessy Diageo Hong Kong Limited(xii) – 67.00%

Japan

Jinbocho Mitsui Bldg, Chiyodaku, Kandajinbocho, Tokyo
MHD Moet Hennessy Diageo K.K.(xii) – 67.00%
Nakano-ku 4-10-2, Nakano Central Park South, 17, Tokyo, 164-0001
Diageo Kirin Company Limited – 51.00%

Macau

Unit 43 & 45, Level 20, AIA Tower, Nos 251A – 301 Avenida Comercial de Macau
Moet Hennessy Diageo Macau Limited(xii) – 67.00%

Malaysia

Unit 30-01, Level 30, Tower A, Vertical Business Suite, Avenue 3, Bangsar South, No. 8, Jalan Kerinchi, 59200 Kuala Lumpur
Moet Hennessy Diageo Malaysia Sdn Bhd.(xii) – 67.00%

Singapore

83 Clemenceau Ave, #09-01 UE Square, 239920
Moet Hennessy Diageo Singapore Pte. Ltd(xii) – 67.00%

Thailand

South Sathorn, Empire Tower 1, 17-18Floor, Sathorn, 10120, Bangkok
Diageo Moet Hennessy (Thailand) Limited(xiii) – 63.02%

The Netherlands

Molenwerf 12, 1014 BG, Amsterdam
Diageo-Moet Hennessy B.V.(iv) – 67.00%

United Kingdom

Goldsworth House, The Goldsworth Park Centre, Woking, Surrey, GU21 3LF
Trafalgar Metropolitan Homes Limited – 50.00%

(i) Directly owned by Diageo plc.
(ii) Dormant company.
(iii) Ownership held in class of A shares.
(iv) Ownership held in class of B shares.
(v) Ownership held in class of A shares and B shares.
(vi) Ownership held in preference shares.
(vii) Ownership held in equity shares and preference shares.
(viii) 99.11% owned by Diageo plc.
(ix) Companies controlled by the group based on management's assessment.
(x) Diageo shares joint control over these entities under shareholders' agreements, and Diageo's rights to the profit, assets and liabilities of the companies are dependent on the performance of the group's brands rather the effective equity ownership of the companies.
(xi) Based on 54.78% equity investment in USL that excludes 2.38% owned by the USL Benefit Trust.
(xii) Operation is managed by Moët Hennessy.
(xiii) Operation is managed by Diageo.

Unaudited financial information

1. Five years financial information

The following tables present selected consolidated financial data for Diageo for the five years ended 30 June 2018 and as at the respective year ends. The data presented below has been derived from Diageo's audited consolidated financial statements.

	Year ended 30 June				
Income statement data	2018 £ million	2017 £ million	2016 £ million	2015 £ million	2014 £ million
Sales	**18,432**	18,114	15,641	15,966	13,980
Excise duties	**(6,269)**	(6,064)	(5,156)	(5,153)	(3,722)
Net sales	**12,163**	12,050	10,485	10,813	10,258
Cost of sales	**(4,634)**	(4,680)	(4,251)	(4,610)	(4,029)
Gross profit	**7,529**	7,370	6,234	6,203	6,229
Marketing	**(1,882)**	(1,798)	(1,562)	(1,629)	(1,620)
Other operating expenses	**(1,956)**	(2,013)	(1,831)	(1,777)	(1,902)
Operating profit	**3,691**	3,559	2,841	2,797	2,707
Non-operating items	**–**	20	123	373	140
Net interest and other finance charges	**(260)**	(329)	(327)	(412)	(388)
Share of after tax results of associates and joint ventures	**309**	309	221	175	252
Profit before taxation	**3,740**	3,559	2,858	2,933	2,711
Tax before exceptional items	**(799)**	(736)	(552)	(517)	(546)
Exceptional taxation	**203**	4	56	51	99
Profit from continuing operations	**3,144**	2,827	2,362	2,467	2,264
Discontinued operations	**–**	(55)	–	–	(83)
Profit for the year	**3,144**	2,772	2,362	2,467	2,181

Weighted average number of shares	**million**	million	million	million	million
Shares in issue excluding own shares	**2,484**	2,512	2,508	2,505	2,506
Dilutive potential ordinary shares	**11**	11	10	12	11
	2,495	2,523	2,518	2,517	2,517

Per share data	**pence**	pence	pence	pence	pence
Dividend per share	**65.3**	62.2	59.2	56.4	51.7
Earnings per share					
Basic					
Continuing operations – before exceptional items	**118.6**	108.5	89.4	88.8	95.5
Continuing operations – after exceptional items	**121.7**	108.2	89.5	95.0	93.0
Discontinued operations	**–**	(2.2)	–	–	(3.3)
Basic earnings per share	**121.7**	106.0	89.5	95.0	89.7
Diluted					
Continuing operations	**121.1**	107.7	89.1	94.6	92.6
Discontinued operations	**–**	(2.2)	–	–	(3.3)
Diluted earnings per share	**121.1**	105.5	89.1	94.6	89.3

1. Five years financial information (continued)

Balance sheet data	2018 £ million	2017 £ million	2016 £ million	2015 £ million	2014 £ million
					As at 30 June
Non-current assets	**21,024**	20,196	19,639	18,134	15,495
Current assets	**8,691**	8,652	8,852	7,670	7,469
Total assets	**29,715**	28,848	28,491	25,804	22,964
Current liabilities	**(6,360)**	(6,660)	(6,187)	(5,290)	(4,851)
Non-current liabilities	**(11,642)**	(10,160)	(12,124)	(11,258)	(10,523)
Total liabilities	**(18,002)**	(16,820)	(18,311)	(16,548)	(15,374)
Net assets	**11,713**	12,028	10,180	9,256	7,590
Share capital	**780**	797	797	797	797
Share premium	**1,349**	1,348	1,347	1,346	1,345
Other reserves	**2,133**	2,693	2,625	1,994	2,243
Retained earnings	**5,686**	5,475	3,761	3,634	2,438
Equity attributable to equity shareholders of the parent company	**9,948**	10,313	8,530	7,771	6,823
Non-controlling interests	**1,765**	1,715	1,650	1,485	767
Total equity	**11,713**	12,028	10,180	9,256	7,590
Net borrowings	**(9,091)**	(7,892)	(8,635)	(9,527)	(8,850)

2. Contractual obligations and other commitments

	Less than 1 year £ million	1-3 years £ million	3-5 years £ million	More than 5 years £ million	Total £ million
					Payments due by period
As at 30 June 2018					
Long term debt obligations	1,494	2,054	2,117	3,951	9,616
Interest obligations	341	472	382	1,385	2,580
Purchase obligations	1,072	599	276	46	1,993
Operating leases	100	118	52	42	312
Post employment benefits[(i)]	58	100	90	125	373
Provisions and other non-current payables	113	142	25	376	656
Finance leases	37	75	39	26	177
Credit support obligations	54	–	–	–	54
Capital commitments	159	2	–	–	161
Other financial liabilities	164	–	–	–	164
Total	**3,592**	**3,562**	**2,981**	**5,951**	**16,086**

(i) For further information see note 13(d) to the consolidated financial statements.

Long term debt obligations comprise the principal amount of borrowings (excluding foreign currency swaps) with an original maturity of greater than one year. Interest obligations comprise interest payable on these borrowings and are calculated based on the fixed amounts payable and where the interest rate is variable on an estimate of what the variable rates will be in the future. Credit support obligations represent liabilities to counterparty banks in respect of cash received as collateral under credit support agreements. Purchase obligations include various long term purchase contracts entered into for the supply of raw materials, principally bulk whisk(e)y, cereals, cans and glass bottles. Contracts are used to guarantee the supply of raw materials over the long term and to enable a more accurate prediction of costs of raw materials in the future. Provisions and other non-current payables exclude £4 million in respect of vacant properties. For certain provisions discounted numbers are disclosed.

Corporate tax payable of £243 million and deferred tax liabilities are not included in the table above, as the ultimate timing of settlement cannot be reasonably estimated.

On 10 July 2018 Diageo launched a partial tender offer to increase its aggregate equity stake in SJF from 39.71% to up to a maximum of 60%. The price per share offered is RMB62.00 per share and gives all non Diageo shareholders the opportunity to elect to sell their shares in SJF to Diageo up to 11 August 2018. The maximum possible consideration to reach 60% of the equity in SJF is RMB6,146 million (£703 million).

Management believe that it has sufficient funding for its working capital requirements.

Post employment benefits contractual obligations comprise committed deficit contributions but exclude future service cost contributions.

3. Off-balance sheet arrangements

Neither Diageo plc nor any member of the Diageo group has any off-balance sheet financing arrangements that currently have or are reasonably likely to have a material future effect on the group's financial condition, changes in financial condition, results of operations, liquidity, capital expenditure or capital resources.

Additional information for shareholders

Related party transactions

Transactions with other related parties are disclosed in note 20 to the consolidated financial statements.

Share capital

Major shareholders

At 30 June 2018, the following substantial interests (3% or more) in the company's ordinary share capital (voting securities) had been notified to the company.

Shareholder	Number of ordinary shares	Percentage of issued ordinary share capital (excluding treasury shares)	Date of notification of interest
BlackRock Investment Management (UK) Limited (indirect holding)	147,296,928	5.89%	3 December 2009
Capital Research and Management Company (indirect holding)	124,653,096	4.99%	28 April 2009

The company has not been notified of any other substantial interests in its securities. The company's substantial shareholders do not have different voting rights. Diageo, so far as is known by the company, is not directly or indirectly owned or controlled by another corporation or by any government. Diageo knows of no arrangements, the operation of which may at a subsequent date result in a change of control of the company.

Articles of association

The company is incorporated under the name Diageo plc, and is registered in England and Wales under registered number 23307.

The following description summarises certain provisions of Diageo's articles of association (as adopted by special resolution at the Annual General Meeting on 14 October 2009) and applicable English law concerning companies (the Companies Acts), in each case as at 13 July 2018. This summary is qualified in its entirety by reference to the Companies Acts and Diageo's articles of association.

Investors can obtain copies of Diageo's articles of association by contacting the Company Secretary at **the.cosec@diageo.com**.

Any amendment to the articles of association of the company may be made in accordance with the provisions of the Companies Act 2006, by way of special resolution.

Directors

Diageo's articles of association provide for a board of directors, consisting (unless otherwise determined by an ordinary resolution of shareholders) of not fewer than three directors and not more than 25 directors, in which all powers to manage the business and affairs of Diageo are vested. Directors may be elected by the members in a general meeting or appointed by Diageo's Board. At each annual general meeting, the following are required to retire and are then reconsidered for election/re-election, assuming they wish to stand for election/re-election: any director who has been appointed by Diageo's Board since the last annual general meeting; any director who has been in office during the two previous general meetings and did not retire at either of them; and any director who has been in office, other than in an executive position, for a continuous period of nine years or more at the date of the meeting. There is no age limit requirement in respect of directors. Directors may also be removed before the expiration of their term of office in accordance with the provisions of the Companies Acts.

Voting rights

Voting on any resolution at any general meeting of the company is by a show of hands unless a poll is duly demanded. On a show of hands, (a) every shareholder who is present in person at a general meeting, and every proxy appointed by any one shareholder and present at a general meeting, has/have one vote regardless of the number of shares held by the shareholder (or, subject to (b), represented by the proxy), and (b) every proxy present at a general meeting who has been appointed by more than one shareholder has one vote regardless of the number of shareholders who have appointed him or the number of shares held by those shareholders, unless he has been instructed to vote for a resolution by one or more shareholders and to vote against the resolution by one or more shareholders, in which case he has one vote for and one vote against the resolution.

On a poll, every shareholder who is present in person or by proxy has one vote for every share held by that shareholder, but a shareholder or proxy entitled to more than one vote need not cast all his votes or cast them all in the same way (the deadline for exercising voting rights by proxy is set out in the form of proxy).

A poll may be demanded by any of the following:

- the chairman of the general meeting;
- at least three shareholders entitled to vote on the relevant resolution and present in person or by proxy at the meeting;
- any shareholder or shareholders present in person or by proxy and representing in the aggregate not less than one-tenth of the total voting rights of all shareholders entitled to vote on the relevant resolution; or
- any shareholder or shareholders present in person or by proxy and holding shares conferring a right to vote on the relevant resolution on which there have been paid up sums in the aggregate equal to not less than one-tenth of the total sum paid up on all the shares conferring that right.

Diageo's articles of association and the Companies Acts provide for matters to be transacted at general meetings of Diageo by the proposing and passing of two kinds of resolutions:

- ordinary resolutions, which include resolutions for the election, re-election and removal of directors, the declaration of final dividends, the appointment and re-appointment of the external auditor, the remuneration report and remuneration policy, the increase of authorised share capital and the grant of authority to allot shares; and
- special resolutions, which include resolutions for the amendment of Diageo's articles of association, resolutions relating to the disapplication of pre-emption rights, and resolutions modifying the rights of any class of Diageo's shares at a meeting of the holders of such class.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast by those entitled to vote at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast by those entitled to vote at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of Diageo is a minimum of two shareholders present in person or by proxy and entitled to vote.

A shareholder is not entitled to vote at any general meeting or class meeting in respect of any share held by him if he has been served with a restriction notice (as defined in Diageo's articles of association) after failure to provide Diageo with information concerning interests in those shares required to be provided under the Companies Acts.

Pre-emption rights and new issues of shares

While holders of ordinary shares have no pre-emptive rights under Diageo's articles of association, the ability of the directors to cause Diageo to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Acts, the directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's articles of association or given by its shareholders in a general meeting, but which in either event cannot last for more than five years. Under the Companies Acts, Diageo may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Repurchase of shares

Subject to authorisation by special resolution, Diageo may purchase its own shares in accordance with the Companies Acts. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of Diageo's issued share capital.

Restrictions on transfers of shares

The Board may decline to register a transfer of a certificated Diageo share unless the instrument of transfer (a) is duly stamped or certified or otherwise shown to the satisfaction of the Board to be exempt from stamp duty, and is accompanied by the relevant share certificate and such other evidence of the right to transfer as the Board may reasonably require, (b) is in respect of only one class of share and (c) if to joint transferees, is in favour of not more than four such transferees.

Registration of a transfer of an uncertificated share may be refused in the circumstances set out in the uncertificated securities rules (as defined in Diageo's articles of association) and where, in the case of a transfer to joint holders, the number of joint holders to whom the uncertificated share is to be transferred exceeds four.

The Board may decline to register a transfer of any of Diageo's certificated shares by a person with a 0.25% interest (as defined in Diageo's articles of association) if such a person has been served with a restriction notice (as defined in Diageo's articles of association) after failure to provide Diageo with information concerning interests in those shares required to be provided under the Companies Acts, unless the transfer is shown to the Board to be pursuant to an arm's length sale (as defined in Diageo's articles of association).

Documents on display

The Annual Report on Form 20-F and any other documents filed by the company with the US Securities Exchange Commission ('SEC') may be inspected at the SEC's office of Investor Education and Advocacy located at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms and their copy charges. Filings with the SEC are also available to the public from commerical document retrieval services, and from the website maintained by the US Securities and Exchange Commission at **www.sec.gov**.

Warning to shareholders – share fraud

Please beware of the share fraud of 'boiler room' scams, where shareholders are called 'out of the blue' by fraudsters (sometimes claiming to represent Diageo) attempting to obtain money or property dishonestly. Further information is available in the investor section of the company's website (**www.diageo.com**) but in short, if in doubt, take proper professional advice before making any investment decision.

External limited assurance of selected Sustainability & Responsibility performance data

We engaged PwC LLP to perform an independent limited assurance engagement, reporting to the Board of Directors of Diageo plc, over selected Sustainability & Responsibility (S&R) performance data marked with the symbol Δ within the Strategic Report of the Annual Report 2018, and the S&R Performance Addendum to the Annual Report 2018. PwC LLP engagement was performed in accordance with International Standard on Assurance Engagements 3000 (Revised) 'Assurance Engagements other than Audits and Reviews of Historical Financial Information' and, in respect of the greenhouse gas emissions, in accordance with International Standard on Assurance Engagements 3410 'Assurance engagements on greenhouse gas statements', issued by the International Auditing and Assurance Standards Board.

PwC LLP's full assurance opinion is available in the S&R Performance Addendum to the Annual Report 2018, available at **www.diageo.com**.

A summary of the work they performed is included in their assurance opinion. It is important to read the selected S&R performance data contained within this report in the context of PwC LLP's full limited assurance opinion and our reporting methodologies. Our reporting methodologies are included in the S&R Performance Addendum to the Annual Report, available at **www.diageo.com**.

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, objectives and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of changes in interest or exchange rates, the availability or cost of financing to Diageo, anticipated cost savings or synergies, expected investments, the completion of any strategic transactions or restructuring programmes, anticipated tax rates, changes in the international tax environment, expected cash payments, outcomes of litigation, anticipated changes in the value of assets and liabilities related to pension schemes and general economic conditions. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo's control.

These factors include, but are not limited to:

- economic, political, social or other developments in countries and markets in which Diageo operates, which may contribute to a reduction in demand for Diageo's products, adverse impacts on Diageo's customer, supplier and/or financial counterparties, or the imposition of import, investment or currency restrictions (including the potential impact of any global, regional or local trade wars or any tariffs, duties or other restrictions or barriers imposed on the import or export of goods between territories, including but not limited to, imports into and exports from the United States, Canada, Mexico, the United Kingdom and/or the European Union);
- the negotiating process surrounding, as well as the final terms of, the United Kingdom's exit from the European Union, which could lead to a sustained period of economic and political uncertainty and complexity whilst detailed withdrawal terms and any successor trading arrangements with other countries are negotiated, finalised and implemented, potentially adversely impacting economic conditions in the United Kingdom and Europe more generally as well as Diageo's business operations and financial performance;
- changes in consumer preferences and tastes, including as a result of changes in demographics, evolving social trends (including any shifts in consumer tastes towards locally produced small-batch products), changes in travel, vacation or leisure activity patterns, weather conditions, and/or a downturn in economic conditions;
- any litigation or other similar proceedings (including with customs, competition, environmental, anti-corruption or other regulatory authorities), including litigation directed at the beverage alcohol industry generally or at Diageo in particular;
- changes in the domestic and international tax environment, including as a result of the OECD Base Erosion and Profit Shifting Initiative and EU anti-tax abuse measures, leading to uncertainty around the application of existing and new tax laws and unexpected tax exposures;
- the effects of climate change, or legal, regulatory or market measures intended to address climate change, on Diageo's business or operations, including on the cost and supply of water;
- changes in the cost of production, including as a result of increases in the cost of commodities, labour and/or energy or as a result of inflation;
- legal and regulatory developments, including changes in regulations relating to production, distribution, importation, marketing, advertising, sales, pricing, labelling, packaging, product liability, antitrust, labour, compliance and control systems, environmental issues and/or data privacy;
- the consequences of any failure by Diageo or its associates to comply with anti-corruption, sanctions, trade restrictions or similar laws and regulations, or any failure of Diageo's related internal policies and procedures to comply with applicable law or regulation;
- the consequences of any failure of internal controls, including those affecting compliance with new accounting and/or disclosure requirements;
- contamination, counterfeiting or other circumstances which could harm the level of customer support for Diageo's brands and adversely impact its sales;
- Diageo's ability to maintain its brand image and corporate reputation or to adapt to a changing media environment;
- increased competitive product and pricing pressures, including as a result of actions by increasingly consolidated competitors, that could negatively impact Diageo's market share, distribution network, costs and/or pricing;

- any disruption to production facilities, business service centres or information systems, including as a result of cyber-attacks;
- Diageo's ability to derive the expected benefits from its business strategies, including in relation to expansion in emerging markets, acquisitions and/or disposals, cost savings and productivity initiatives or inventory forecasting;
- increased costs for, or shortages of, talent, as well as labour strikes or disputes;
- fluctuations in exchange rates and/or interest rates, which may impact the value of transactions and assets denominated in other currencies, increase Diageo's cost of financing or otherwise adversely affect Diageo's financial results;
- movements in the value of the assets and liabilities related to Diageo's pension plans;
- Diageo's ability to renew supply, distribution, manufacturing or licence agreements (or related rights) and licences on favourable terms, or at all, when they expire; or
- any failure by Diageo to protect its intellectual property rights.

All oral and written forward-looking statements made on or after the date of this document and attributable to Diageo are expressly qualified in their entirety by the above factors and by the principal risks set out in the 'Strategic Report – How we protect our business: Risk management and principal risks'. Any forward-looking statements made by or on behalf of Diageo speak only as of the date they are made. Diageo does not undertake to update forward-looking statements to reflect any changes in Diageo's expectations with regard thereto or any changes in events, conditions or circumstances on which any such statement is based. The reader should, however, consult any additional disclosures that Diageo may make in any documents which it publishes and/or files with the US Securities and Exchange Commission (SEC). All readers, wherever located, should take note of these disclosures.

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

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

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

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Printed by CPI Colour on behalf of RR Donnelley. CPI Colour are ISO14001 certified, CarbonNeutral®, Alcohol Free and are FSC® Chain of Custody certified. The inks used are vegetable oil based.

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Registered in England
No. 23307

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