DIAGEO PLC
Form 20-F/A
February 04, 2004

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 20-F/A

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

| | |
|---|---|
| For the fiscal year ended: | **30 June 2003** |
| Commission file number: | **1-10691** |

# DIAGEO plc

*(Exact name of Registrant as specified in its charter)*

**England**
*(Jurisdiction of incorporation or organisation)*

**8 Henrietta Place, London W1G 0NB, England**
*(Address of principal executive offices)*

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| American Depositary Shares | New York Stock Exchange |
| Ordinary shares of 28 $^{101/108}$ pence each | New York Stock Exchange* |
| 9.42% Cumulative guaranteed preferred securities, series A** | New York Stock Exchange |

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

** Issued by Grand Metropolitan Delaware, LP, of which the Registrant is the sole general partner, and guaranteed as to certain payments by the Registrant.

Securities registered or to be registered pursuant to Section 12(g)of the Act: None
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None
Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the Annual Report: 3,099,593,537 ordinary shares of 28 $^{101/108}$ pence each.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

Indicate by check mark which financial statement item the Registrant has elected to follow.

Item 17 [ ] Item 18 [X]

This document comprises the annual report on Form 20-F and the annual report to shareholders for the year ended 30 June 2003 of Diageo plc (the 2003 Form 20-F). Reference is made to the cross reference to Form 20-F table on page 144 hereof (the Form 20-F Cross reference table). Only (i) the information in this document that is referenced in the Form 20-F Cross reference table, (ii) the cautionary statement concerning forward-looking statements on page 18 and (iii) the Exhibits, shall be deemed to be filed with the Securities and Exchange Commission for any purpose, including incorporation by reference into the Registration Statements on Form F-3 (File Nos. 333-10410, 333-14100 and 333-110804) and Registration Statements on Form S-8 (File Nos. 333-08090, 333-08092, 333-08094, 333-08096, 333-08098, 333-08100, 333-08102, 333-08104, 333-08106, 333-09770, 333-11460 and 333-11462), and any other documents, including documents filed by Diageo plc pursuant to the Securities Act of 1933, as amended, which purport to incorporate by reference the 2003 Form 20-F. Any information herein which is not referenced in the Form 20-F Cross reference table, or the Exhibits themselves, shall not be deemed to be so incorporated by reference.

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This is the annual report on Form 20-F of Diageo plc for the year ended 30 June 2003.

The market data contained in this document is taken from independent industry sources in the markets in which Diageo operates.

The reporting format has been revised to separate goodwill amortisation from exceptional items. Goodwill amortisation is now included in the before exceptional items column of the profit and loss account.

This document contains forward-looking statements that involve risk and uncertainty. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors beyond Diageo s control. For more details, please refer to the cautionary statement concerning forward-looking statements on page 18.

This report includes names of Diageo s products, which constitute trademarks or trade names which Diageo owns or which others own and licence 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. A glossary of terms used in this report is included at the end of the document.

Diageo s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United Kingdom (UK GAAP), which is the group s primary reporting framework. Unless otherwise indicated all other financial information contained in this document has been prepared in accordance with UK GAAP. The principal differences between UK and US GAAP are discussed in the operating and financial review and set out in the consolidated financial statements.

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**Explanatory Note**

The purpose of this amendment is to amend Diageo s US GAAP treatment for deferred tax associated with minimum pension liabilities as of and for the year ended 30 June 2003. The amendment results in a deferred tax charge of £53 million being reclassified from other comprehensive deficit to net income and a reversal of deferred tax of £118 million previously charged to other comprehensive deficit. The overall effect is therefore a reduction of £53 million in net income, a reduction in the comprehensive deficit of £118 million and an increase in shareholders equity of £118 million. The amendment does not affect operating income or cash flow under US GAAP nor does it affect Diageo s principal financial information prepared under UK GAAP.

Diageo is including certain certifications of the chief executive officer and the chief financial officer.

This amendment amends Item 3 Key Information , Item 5 Operating and Financial Review and Prospects , Item 18 Financial Statements a Item 19 Exhibits .

Other than as expressly set forth above, this Form 20-F/A does not, and does not purport to, amend, update or restate the information in any other Item of the Form 20-F filed on 26 November 2003 or reflect any events that have occurred after the Form 20-F was filed.

Diageo intends to announce its results for the six months ended 31 December 2003 on 19 February 2004.

# Five year information

The following table presents selected consolidated financial data for Diageo for the five years ended 30 June 2003 and as at the respective year ends. The UK GAAP data for the five years ended 30 June 2003 and the US GAAP data for the three years ended 30 June 2003 have been derived from Diageo s consolidated financial statements, which have been audited by Diageo s independent auditor. The US GAAP data for the two years ended 30 June 2000 has been extracted from Diageo s US GAAP audited consolidated financial statements.

| | | | | | Year ended 30 June |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| **Profit and loss account data**[1] | **£ million** | £ million | £ million | £ million | £ million |
| **UK GAAP** | | | | | |
| Turnover: | | | | | |
| Premium drinks | **8,961** | 8,704 | 7,580 | 7,117 | 7,163 |
| Discontinued operations[2] | **479** | 2,578 | 5,241 | 4,753 | 4,632 |
| **Total turnover** | **9,440** | 11,282 | 12,821 | 11,870 | 11,795 |
| Operating profit before exceptional items:[3][4] | | | | | |
| Premium drinks | **1,976** | 1,766 | 1,430 | 1,285 | 1,240 |
| Discontinued operations[2] | **53** | 340 | 671 | 678 | 659 |
| **Total operating profit before exceptional items** | **2,029** | 2,106 | 2,101 | 1,963 | 1,899 |
| Exceptional items charged to operating profit[4] | **(168)** | (453) | (228) | (181) | (382) |
| **Operating profit** | **1,861** | 1,653 | 1,873 | 1,782 | 1,517 |
| Other exceptional items[4] | **(1,334)** | 758 | (4) | (166) | 86 |
| **Profit for the year** | **76** | 1,617 | 1,207 | 990 | 937 |
| **US GAAP**[2] | | | | | |
| Sales | **9,153** | 10,760 | 11,868 | 11,015 | 11,579 |
| Gains/(losses) on disposals of businesses | **16** | 1,843 | (8) | 75 | (35) |
| Net income (2003 restated[11]) | **434** | 2,554 | 758 | 798 | 392 |
| | | | | | |
| **Per share data** | **pence** | pence | pence | pence | pence |
| **UK GAAP** | | | | | |
| Dividend per share[6] | **25.6** | 23.8 | 22.3 | 21.0 | 19.5 |
| Earnings per share: | | | | | |
| Basic | **2.4** | 48.8 | 35.7 | 29.2 | 26.5 |
| Diluted | **2.4** | 48.7 | 35.7 | 29.1 | 26.4 |
| Earnings before exceptional items per ordinary share: | | | | | |
| Basic | **49.0** | 43.2 | 41.6 | 37.3 | 33.5 |
| Diluted | **49.0** | 43.1 | 41.6 | 37.3 | 33.3 |
| **US GAAP (2003 restated[11])** | | | | | |
| Basic earnings per ordinary share | **13.9** | 77.0 | 22.4 | 23.5 | 11.1 |
| Diluted earnings per ordinary share | **13.9** | 77.0 | 22.4 | 23.5 | 11.0 |
| Basic earnings per ADS | **55.6** | 308.0 | 89.6 | 94.0 | 44.4 |
| Diluted earnings per ADS | **55.6** | 308.0 | 89.6 | 94.0 | 44.0 |

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| | | | | | As at 30 June |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| **Balance sheet data[1]** | **£ million** | £ million | £ million | £ million | £ million |
| **UK GAAP** | | | | | |
| Net current (liabilities)/assets[7] | **(392)** | (32) | 226 | (115) | (941) |
| Total assets | **16,197** | 18,493 | 17,644 | 16,089 | 16,216 |
| Net borrowings[7] | **4,870** | 5,496 | 5,479 | 5,545 | 6,056 |
| Shareholders equity | **4,954** | 6,001 | 5,123 | 4,664 | 3,964 |
| Called up share capital[8] | **897** | 930 | 987 | 990 | 992 |
| **US GAAP** | | | | | |
| Total assets[9] | **24,071** | 26,153 | 25,955 | 24,868 | 25,586 |
| Long term obligations[7] | **3,149** | 3,892 | 4,029 | 3,753 | 3,431 |
| Shareholders equity (2003 restated[11]) | **9,344** | 11,316 | 11,880 | 11,802 | 11,690 |
| | **million** | million | million | million | million |
| Number of ordinary shares[8] | **3,100** | 3,215 | 3,411 | 3,422 | 3,428 |

**Notes to the selected consolidated financial data**

**1 Seagram** The results and balance sheets for the two years ended 30 June 2003 have been affected by the acquisition of the Seagram spirits and wine businesses on 21 December 2001. See Operating and financial review Operating results .

**2 Discontinued operations** Included within UK GAAP discontinued operations are the quick service restaurants business (Burger King sold 13 December 2002) and the packaged food businesses (Pillsbury sold 31 October 2001). The quick service restaurants and packaged food businesses have been included in continuing operations under US GAAP. There are no discontinued operations under US GAAP.

**3 Brands and goodwill amortisation** An analysis of goodwill amortisation charged to UK GAAP operating profit is as follows:

| | | | | | Year ended 30 June |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| | **£ million** | £ million | £ million | £ million | £ million |
| Continuing operations premium drinks | **(2)** | (2) | (2) | (1) | |
| Discontinued operations | **(2)** | (10) | (24) | (16) | (4) |
| | **(4)** | (12) | (26) | (17) | (4) |

An analysis of brands and goodwill amortisation charged to US GAAP operating income is as follows:

| | | | | | Year ended 30 June |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| | **£ million** | £ million | £ million | £ million | £ million |
| Premium drinks | | | (220) | (222) | (230) |
| Quick service restaurants | | | (70) | (40) | (39) |
| Packaged food | | | (145) | (130) | (123) |
| | | | (435) | (392) | (392) |

The group adopted the requirements of SFAS No. 141 and SFAS No. 142 for the first time on 1 July 2001. Accordingly amortisation of intangible assets with indefinite useful lives ceased from that date. In addition, in the year ended 30 June 2002 an impairment in the carrying value of goodwill attributable to the group s quick service restaurants business of £135 million was recognised.

**4 Exceptional items** An analysis of exceptional items before taxation under UK GAAP is as follows:

| | | | | Year ended 30 June | |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| | **£ million** | £ million | £ million | £ million | £ million |
| **Exceptional items charged to operating profit** | | | | | |
| Continuing operations premium drinks: | | | | | |
| Seagram integration costs | **(177)** | (164) | | | |
| Guinness/UDV integration costs | **(48)** | (48) | (74) | | |
| GrandMet/Guinness merger integration costs | | | | (83) | (262) |
| Other integration and restructuring costs | | | (79) | | |
| Bass distribution rights | **57** | | | | |
| José Cuervo settlement | | (220) | | | |
| Share option funding costs | | | | | (43) |
| | **(168)** | (432) | (153) | (83) | (305) |
| Discontinued operations: | | | | | |
| Restructuring, reorganisation and other net costs | | (21) | (75) | (98) | (77) |
| | **(168)** | (453) | (228) | (181) | (382) |
| **Other exceptional items** | | | | | |
| Charged to associates | **(21)** | (41) | | (3) | (8) |
| (Losses)/gains on disposal of fixed assets | **(43)** | (22) | 19 | 5 | (10) |
| (Losses)/gains on disposal and termination of businesses | **(1,270)** | 821 | (23) | (168) | 104 |
| | **(1,334)** | 758 | (4) | (166) | 86 |

Exceptional items under UK GAAP do not represent extraordinary items under US GAAP.

**5 Unusual items** An analysis of unusual (charges)/income, excluding gains/(losses) on disposal of businesses and (losses)/gains on disposal of fixed assets, included in, and affecting the comparability of, US GAAP operating income, is as follows:

| | | | | Year ended 30 June | |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| | **£ million** | £ million | £ million | £ million | £ million |
| Seagram integration costs | **(154)** | (82) | | | |
| Other integration and restructuring costs | **(48)** | (48) | (169) | (115) | (272) |
| Bass distribution rights | **57** | | | | |
| José Cuervo settlement | | (194) | | | |
| Derivative instruments in respect of General Mills shares | **(4)** | 166 | | | |
| Burger King impairment charges and transaction costs | **(750)** | (135) | | | |
| Other impairment charges | | | | | (74) |
| | **(899)** | (293) | (169) | (115) | (346) |

**6 Dividends** The Diageo plc board expects that Diageo will pay an interim dividend in April and a final dividend in October of each year. Approximately 40% of the total dividend in respect of any financial year is expected to be paid as an interim dividend and approximately 60% as a final dividend. The payment of any future dividends, subject to shareholder approval, will depend upon Diageo s earnings, financial condition and such other factors as the Diageo plc board deems relevant.

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

| | | | | | | Year ended 30 June |
|---|---|---|---|---|---|---|
| | | **2003** | 2002 | 2001 | 2000 | 1999 |
| | | **pence** | pence | pence | pence | pence |
| Per ordinary share | Interim | **9.9** | 9.3 | 8.9 | 8.4 | 7.8 |
| | Final | **15.7** | 14.5 | 13.4 | 12.6 | 11.7 |
| | Total | **25.6** | 23.8 | 22.3 | 21.0 | 19.5 |
| | | **$** | $ | $ | $ | $ |
| Per ADS | Interim | **0.61** | 0.54 | 0.51 | 0.53 | 0.50 |
| | Final | **1.06** | 0.90 | 0.78 | 0.72 | 0.76 |
| | Total | **1.67** | 1.44 | 1.29 | 1.25 | 1.26 |

**7 Definitions** Net current (liabilities)/assets is defined as current assets less current liabilities. Net borrowings is defined as total borrowings (i.e. short term borrowings and long term borrowings plus finance lease obligations) less cash at bank and liquid resources, interest rate and foreign currency swaps and current asset investments. Long term obligations is defined as long term borrowings and capital lease obligations which fall due after more than one year.

**8 Share capital** The called up share capital represents the number of ordinary shares in issue. During the year ended 30 June 2003 the group repurchased for cancellation 116 million ordinary shares at a cost of £852 million (2002 198 million ordinary shares, cost of £1,658 million; 2001 18 million ordinary shares, cost of £108 million; 2000 10 million ordinary shares, cost of £54 million; 1999 175 million shares, cost of £1,211 million (including £15 million for B shares)).

**9 Burger King** Under UK GAAP, the sale of Burger King has been accounted for as a disposal and the results prior to disposal are presented within discontinued operations. Under US GAAP, the transaction is not accounted for as a disposal due to the size of the investment made by the buyer and Diageo s continuing involvement through the guarantee provided by Diageo in respect of the acquisition finance. Under US GAAP, the results of Burger King prior to 13 December 2002 (the completion date) are presented as continuing operations in the income statement and, on the completion of the transaction, a charge for impairment has been recognised rather than a loss on disposal. Following the completion date, Diageo does not recognise profits of Burger King in its income statement but will, generally, reflect losses as an impairment charge against the assets retained on the balance sheet. In the US GAAP balance sheet, the total assets and total liabilities of Burger King at 30 June 2003 (including consideration deferred under US GAAP) classified within other long term assets and other long term liabilities were each £1.3 billion. The transaction will be accounted for as a disposal when the uncertainties related to the guarantee provided in respect of the acquisition finance have been substantially resolved and/or the buyer s cumulative investment meets or exceeds minimum levels.

**10 Exchange rates** A substantial portion of the group s assets, liabilities, revenues and expenses is denominated in currencies other than pound sterling, principally US dollars. For a discussion of the impact of exchange rate fluctuations on the company s financial condition and results of operations, see Operating and financial review Risk management .

The following table shows, for the periods indicated, information regarding the US dollar/pound sterling exchange rate, based on the noon buying rate, expressed in US dollars per £1.

| | | | | | Year ended 30 June |
|---|---|---|---|---|---|
| | **2003** | 2002 | 2001 | 2000 | 1999 |
| Period end | **1.65** | 1.52 | 1.41 | 1.51 | 1.58 |
| Average rate (a) | **1.59** | 1.45 | 1.45 | 1.59 | 1.64 |

(a) The average of the noon buying rates on the last business day of each month during the year. These rates have been provided for your convenience. They are not necessarily the rates that have been used in this document for currency translations or in the preparation of the financial statements. See note 2 (i)(c) to the consolidated financial statements for the actual rates used.

The following table shows period end and average US dollar/pound sterling noon buying exchange rates by month, for the period to 31 October 2003, expressed in US dollars per £1.

| | | | | | | | **2003** |
|---|---|---|---|---|---|---|---|
| | **October** | **September** | **August** | **July** | **June** | **May** | **April** |
| Period end | **1.70** | **1.66** | **1.58** | **1.61** | **1.65** | **1.64** | **1.60** |
| Average rate | **1.68** | **1.62** | **1.59** | **1.62** | **1.66** | **1.62** | **1.57** |

The average rate for the period 1 to 14 November 2003 was £1=$1.68 and the noon buying rate on 14 November 2003 was £1=$1.68.

**11 Restatement** The US GAAP selected consolidated financial information for the year ended 30 June 2003 has been restated to reflect an adjustment to deferred tax associated with minimum pension liabilities. The restatement results in a reduction in net income of £53 million, a reduction in basic and diluted earnings per share of 1.7p for the year ended 30 June 2003 and an increase in shareholders equity at 30 June 2003 of £118 million. The adjustment does not affect Diageo s financial information prepared under UK GAAP or any other reported period. See note 32 of the consolidated financial statements.

**Discontinued operations**

***Quick service restaurants*** Diageo completed the disposal of Burger King on 13 December 2002. See Operating and financial review Off-balance sheet arrangements . Burger King is a leading company in the worldwide quick service restaurant industry. In the year ended 30 June 2003, Burger King contributed turnover of £479 million and operating profit of £53 million to Diageo.

***Packaged food*** Diageo completed the disposal of Pillsbury to General Mills on 31 October 2001. Pillsbury contributed turnover of £1,455 million and operating profit before exceptional items of £184 million in the year ended 30 June 2002. As a division of Diageo, Pillsbury produced and distributed leading food brands including Pillsbury s refrigerated dough and other dough based goods, Old El Paso Mexican foods, Progresso soups, Green Giant vegetables and Häagen-Dazs ice cream, and, in addition, operated a foodservice business.

In connection with the disposal of Pillsbury Diageo has guaranteed the debt of a third party up to an amount of $200 million (£121 million).

**Risk factors**

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

**Diageo may not be able to derive the expected benefits from its strategy to focus on premium drinks or its change and cost-saving programmes designed to enhance earnings** On 17 July 2000, Diageo announced the integration of its spirits, wine and beer businesses to create a premium drinks business as part of an integrated strategy to be a focused premium drinks company. In line with this strategy, Diageo acquired on 21 December 2001 certain of the Seagram spirits and wine businesses. There can be no assurance that Diageo s strategic focus on premium drinks will result in better opportunities for growth and improved margins.

Following the acquisition of the Seagram spirits and wine businesses, Diageo has been consolidating the Diageo and former Seagram brands into a single distributor in each US state. This consolidation has given rise and could continue to give rise to legal actions. See Business description Premium drinks Marketing and distribution North America .

It is possible that the pursuit of this strategic focus on premium drinks could give rise to further acquisitions. There can be no guarantee that any such acquisition would deliver the benefits intended.

Certain change programmes have been initiated (especially in the United States, Ireland and Great Britain) designed to improve the effectiveness and efficiency of end-to-end operating, administrative and financial systems and processes. This includes moving transaction processing from a number of markets to shared service centres. There can be no certainty that these programmes will deliver the expected benefits. There is likely to be disruption caused to production processes and possibly to administrative and financial systems as these changes are effected. They could also lead to adverse customer or consumer reaction. Any failure of information systems could adversely impact Diageo s ability to operate.

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

In addition, beverage alcohol products are the subject of national import and excise duties in many countries around the world. An increase in import or excise duties could have a significant adverse effect on Diageo s sales revenue or margin, both through

reducing overall consumption and by encouraging consumers to switch to lower-taxed categories of beverage alcohol.

Companies in the beverage alcohol industry may also be exposed to class action or other litigation relating to alcohol abuse problems or health consequences from the misuse of alcohol. If the industry were to be involved in such litigation, Diageo s business could be materially adversely affected.

US regulatory authorities are considering possible changes to the regulation of flavored malt beverages. Discussions are taking place in respect of possible rule changes related to the alcohol content in flavored malt beverages. Revised rules could result in changes in the methods by which Diageo currently produces flavored malt beverages and therefore increase the costs of production and/or distribution of these products. In addition, possible regulatory changes could impose adverse federal tax consequences on the import and sale of flavored malt beverages. Flavored malt beverages form a component of Diageo s growth strategy within the United States and it is possible that the implementation of any regulatory changes by the US authorities could have an adverse effect on Diageo s future profitability.

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

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

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

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

Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for Diageo s products and erosion of its competitive and financial position.

**If the social acceptability of Diageo s products declines, or if litigation is directed at the beverage alcohol industry, Diageo s sales volume could decrease and the business could be materially adversely affected** In recent years, there has been increased social and political attention directed to the beverage alcohol industry. Diageo believes that this attention is the result of public concern over problems related to alcohol abuse, including drink driving, underage drinking and health consequences from the misuse of alcohol. If the social acceptability of beverage alcohol were to decline significantly, sales of Diageo s products could materially decrease. Similarly, recent litigation against the tobacco industry has directed increased attention to other industries, including the beverage alcohol industry. If the drinks industry were to become involved in litigation of the type brought against other industries, such as tobacco, Diageo s business could be materially adversely affected.

Diageo learned on 20 November 2003 that a purported class action lawsuit, Hakki v. Adolph Coors Company et al., was commenced against a number of alcohol beverage companies on 14 November 2003, including Diageo, in the Superior Court of Washington, D.C. Diageo has not been served with a lawsuit. The complaint asserts claims under the District of Columbia Consumer Protection Procedures Act (DCCPPA) and the common law of the District of Columbia that the defendants specifically targeted the US advertising and marketing of certain of their products to individuals below the 21 year-old legal purchase age. The complaint alleges that at least 15-20% of all alcoholic beverages sold in the United States are consumed by underage drinkers . The complaint further alleges that profits earned by the defendants from the alleged illegal sales to underaged drinkers greatly exceed $1 billion per year .

The lawsuit seeks certification as a class action on behalf of (a) parents and guardians whose funds were used by their children under 21 from 1982 to the present without their knowledge to purchase alcohol beverages marketed by the defendants, on whose behalf monetary recovery is sought and (b) the parents and guardians of all children under 21, on whose behalf the complaint requests that the Court enter an injunction prohibiting the defendants from marketing alcohol beverages to underage persons.

The prayer for relief in the complaint seeks, among other matters, (i) that defendants each disgorge to the purported class all amounts by which they have been allegedly unjustly enriched, plus costs and interest; (ii) rescission of the alleged transactions whereby defendants allegedly obtained revenues from the illegal sale of alcoholic beverages to underage consumers and ordered to pay such monies to the purported class; and (iii) to assess all defendants jointly and severally for all alleged actual damages sustained by the purported plaintiff class plus treble damages or $1,500 per violation, whichever is greater, punitive damages, attorneys fees, costs of suit, and interest.

Diageo intends to strenuously defend this purported action.

See Additional information for shareholders Legal proceedings for further detail.

**Diageo s operating results may be adversely affected by increased costs or shortages of raw materials or labour or disruption to production facilities** The raw materials which Diageo uses for the production of its food and beverage products are largely commodities that are subject to price volatility caused by changes in global supply and demand, weather conditions, agricultural uncertainty or governmental controls. If commodity price changes result in unexpected increases in raw materials cost

or the cost of packaging materials, Diageo may not be able to increase its prices to offset these increased costs without suffering reduced volume, revenue and operating income. Diageo may be adversely affected by shortages of such raw materials or packaging materials.

Similarly, Diageo s operating results could be adversely affected by labour or skill shortages or increased labour costs due to increased competition for employees, higher employee turnover or increased employee benefit costs. Diageo s success is dependent on the capability of its employees. There is no guarantee that Diageo will continue to be able to recruit, retain and develop the capabilities that it requires to deliver its strategy, for example in relation to sales and marketing capability within markets or in its senior management.

Diageo would be affected if there were a catastrophic failure of its major production facilities. See Business description Premium drinks Production for a listing of Diageo s principal production sites. In addition, the maintenance and development of information systems may result in systems failures which may adversely affect business operations.

Diageo has a substantial inventory of aged product categories, principally Scotch whisky and Canadian whisky, which mature over periods of up to 30 years. As at 30 June 2003, the historical cost of Diageo s maturing inventory amounted to £1,409 million. The maturing inventory is stored primarily in Scotland, and the loss through contamination, fire or other natural disaster of all or a portion of the stock of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, Diageo would not be able to meet consumer demand for these products as it arises. In addition, there can be no assurance that insurance proceeds would cover the replacement value of Diageo s maturing inventory or other assets were such assets to be lost due to contamination, fire or natural disasters or destruction resulting from negligence or the acts of third parties.

**Diageo s business may be adversely impacted by unfavourable economic conditions or political or other developments and risks in the countries in which it operates** Diageo s business is dependent on general economic conditions in the United States, Great Britain and other important markets. A significant deterioration in these conditions, including a reduction in consumer spending levels, could have a material adverse effect on Diageo s business and results of operations. In addition, Diageo may be adversely affected by political and economic developments in any of the countries where Diageo has distribution networks, production facilities or marketing companies. Diageo s operations are also subject to a variety of other risks and uncertainties related to trading in numerous foreign countries, including political or economic upheaval and the imposition of any import, investment or currency restrictions, including tariffs and import quotas or any restrictions on the repatriation of earnings and capital. Current examples of such potential upheaval are currency restrictions and potential further disruption to movement of goods into and out of Venezuela, affecting both imports of goods (principally Scotch whisky into Venezuela) and export of rum (Cacique, especially to Spain), unrest in the Middle East, and the impact on tourism and travel of both terrorist threats and ongoing fears of global pandemics, such as SARS. These disruptions can affect Diageo s ability to import or export products and ability to repatriate funds as well as the levels of consumer demand (for example in duty free outlets at airports or in on trade premises in affected regions) and therefore on Diageo s levels of sales or profitability.

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

Diageo may be adversely affected by fluctuations in exchange rates. The results of operations of Diageo are accounted for in pounds sterling. Approximately 35% of sales in the year ended 30 June 2003 were in US dollars, approximately 21% were in sterling and approximately 22% were in euros. Movements in exchange rates used to translate foreign currencies into pounds sterling may have a significant impact on Diageo s reported results of operations from year to year.

Diageo may also be adversely impacted by fluctuations in interest rates, mainly through an increased interest expense. To partly delay any adverse impact from interest rate movements, Diageo maintains approximately 50% of its debt at fixed interest rates. See Operating and financial review Risk management .

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

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

**Diageo remains exposed to factors affecting the US food industry** While Diageo s strategy is to focus on premium drinks, it remains exposed to factors affecting the US food industry through its equity interest in General Mills and its residual exposure to Burger King. Following the disposal of Pillsbury to General Mills, Diageo now holds approximately 21% of General Mills outstanding share capital. The market value of this interest may be affected adversely by a variety of factors, including the performance of General Mills and the extent to which that performance meets investors expectations, economic conditions in the United States, including the US financial markets, and the dilution of our holding as a result of future issues of shares by General Mills. On 15 October 2003, General Mills announced that it had received a formal request from the US Securities and Exchange Commission (the SEC) concerning its sales practices and related accounting. General Mills stated that the SEC had advised the company that it had not reached any conclusions related to the information request.

In connection with the disposal of Burger King, Diageo has retained $212 million (£129 million) of subordinated debt, with a 10 year maturity, from the entity owning Burger King. In addition, Diageo has guaranteed up to $850 million (£515 million) of borrowings of the Burger King company. These loans have a term of five years although Diageo and Burger King have structured their arrangements to encourage refinancing by Burger King on a non-guaranteed basis prior to the end of the five years. There are no assurances, however, that such refinancing will occur or that no liability will arise with respect to the financing of the Burger King disposal. Both General Mills and Burger King may also be subject to factors affecting the food industry generally, including increased competition, changes in consumer preferences and concerns over obesity and the potential for related litigation or regulation. These factors could also affect Diageo s ability over time to reduce its equity interest in, or affect the price it receives for, General Mills shares. They could also result in Diageo not fully recovering the book value of its subordinated debt due from Burger King and/or having to make payments under the guarantee of Burger King s debt.

**It may be difficult to effect service of US process and enforce US legal process against the directors of Diageo** Diageo is a public limited company incorporated under the laws of England and Wales. The majority of Diageo s directors and officers, and some of the experts named in this document, reside outside of the United States, principally in the United Kingdom. A substantial portion of Diageo s assets, and the assets of such persons are located outside of the United States. Therefore, it may not be possible to effect service of process within the United States upon Diageo or these persons in order to enforce judgements of US courts against Diageo or these persons based on the civil liability provisions of the US Federal Securities laws. There is doubt as to the enforceability in England and Wales, in original actions or in actions for enforcement of judgements of US courts, of civil liabilities solely based on the US Federal Securities laws.

**Cautionary statement concerning forward-looking statements**

This document contains statements with respect to the financial condition, results of operations and business of Diageo and certain of the plans and objectives of Diageo with respect to these items. These forward-looking statements are made pursuant to the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to Diageo and parties or consortia who have purchased Diageo s assets, actions of parties or consortia who have purchased Diageo s assets, anticipated cost savings or synergy and the completion of Diageo s strategic transactions, are forward-looking statements. 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:

- increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo s market share, increase expenses and hinder growth potential;
- the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergy and/or costs savings;
- Diageo s ability to complete future acquisitions and disposals;
- legal and regulatory developments, including changes in regulations regarding consumption of, or advertising for, beverage alcohol, changes in accounting standards, taxation requirements, such as the impact of excise tax increases with respect to the premium drinks business and environmental laws;
- changes in the food industry in the United States, including increased competition and changes in consumer preferences;
- changes in consumer preferences and tastes, demographic trends or perceptions about health related issues;
- changes in the cost of raw materials and labour costs;
- changes in economic conditions in countries in which Diageo operates, including changes in levels of consumer spending;
- levels of marketing and promotional expenditure by Diageo and its competitors;
- renewal of distribution rights on favourable terms when they expire;
- termination of existing distribution rights in respect of agency brands;
- technological, developments that may affect the distribution of products or impede Diageo s ability to protect its intellectual property rights; and
- changes in financial and equity markets, including significant interest rate and foreign currency rate fluctuations, which may affect Diageo s access to or increase the cost of financing.

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 the Risk factors contained in this document for the year ended 30 June 2003.

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

# Operating and financial review

## Introduction

**Information presented** Diageo s strategy is to focus on its branded drinks businesses with international potential. Diageo completed the disposal of its quick service restaurants business on 13 December 2002 and the combination of its packaged food business with General Mills on 31 October 2001.

The consolidated information for the year ended 30 June 2003 presented in this annual report includes the results of the quick service restaurants business for the five and a half months ended 13 December 2002. In accordance with UK GAAP, the results of the quick service restaurants and, in the comparative periods, the packaged food businesses have been included within discontinued operations.

The following discussion is based on Diageo s UK GAAP results for the year ended 30 June 2003 compared with the year ended 30 June 2002, and the year ended 30 June 2002 compared with the year ended 30 June 2001.

There are a number of accounting differences between UK and US GAAP. A reconciliation of net income from UK to US GAAP and an explanation of the differences between UK and US GAAP are set out in the US GAAP information in note 32 of the consolidated financial statements, with a further explanation of significant reconciling items between UK and US GAAP net income which is included in Discussion of US GAAP differences below.

The US GAAP financial information for the year ended 30 June 2003 has been restated to reflect an adjustment to deferred tax associated with minimum pension liabilities. The effects of this restatement are set out in Discussion of US GAAP differences below and in note 32 to the consolidated financial statements.

**Presentation of information in relation to the premium drinks business** In addition to describing the significant factors impacting on the profit and loss account compared to the prior year for both of the years ended 30 June 2003 and 30 June 2002, additional information is also presented on the operating performance of the premium drinks segment.

***Volume*** Volume has been measured on an equivalent units basis to nine litre cases of spirits. Equivalent units are calculated as follows: 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. An equivalent unit represents approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer.

Reference is made to information regarding the premium distilled spirits market segments from Impact and other independent industry sources in the markets in which Diageo operates. Impact collects information on the premium distilled spirits market from a variety of sources, including brand owners, import and export enterprises, trade associations and government agencies such as the US Commerce Department. Impact is aware of, and has consented to, being named in this document. Market data information is taken from industry sources in the markets in which Diageo operates. Diageo believes that all of the information in this document that is based on statements from Impact and other industry sources is reliable.

***Non-GAAP measures*** Organic movement in volume, net sales (after deducting excise duties) and operating profit before exceptional items are measures not specifically used in the consolidated financial statements themselves (non-GAAP measures). The performance of the premium drinks segment is discussed using these measures.

Since overall performance is the result of a number of factors, breaking these down into broad categories and discussing each of these categories assists management and the reader in understanding the overall picture. Once factors such as the effect of currency movements, excise duties and acquisitions and disposals have been discussed, the above measures enable the reader to focus on the performance of the premium drinks brand portfolio which is common to both periods. Organic movement measures also most closely reflect the way in which the business is managed, for the same reasons of achieving comparability between periods. Diageo s strategic planning and budgeting process is based on organic movement in volume, net sales (after deducting excise duties) and operating profit before exceptional items, and these measures closely reflect the way in which operating targets are defined and performance is monitored by the group s management. These measures are chosen for planning, budgeting and reporting purposes since, as explained further below, they represent those measures which local managers are most directly able to influence and they enable consideration of the underlying business performance without the distortion caused by fluctuating exchange rates, excise duties, acquisitions and disposals. In addition, management bonus targets are set based on the performance of the business as measured by organic operating profit growth before exceptional items.

The group s management believe these measures provide valuable additional information for users of the financial statements in understanding the group s performance since they provide information on those elements of performance which local managers are most directly able to influence and focus on that element of the core brand portfolio which is common to both periods. However, whilst these measures are important in the management of the business, they should not be viewed as replacements for, but rather as complementary to, the comparable GAAP measures such as turnover and reported (rather than organic) movements in individual profit and loss account captions. These GAAP measures reflect all of the factors which impact the business and the discussion in relation to premium drinks should be read in the context of the discussion of the overall group performance.

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

Also in the discussion of the performance of the premium drinks segment, certain information is presented using sterling amounts on a constant currency basis. This strips out the translation effect of foreign exchange and enables an understanding of the underlying performance of the market that is most closely influenced by the actions of the group s management. The risk from foreign exchange translation is managed centrally and is not a factor over which local managers have any control.

During the last two years the group has undergone a major restructuring which has resulted in the disposal of its food businesses (Pillsbury and Burger King) and its Malibu rum brand and the acquisition of the Seagram spirits and wine businesses. As a consequence results are not comparable from period to period and require additional explanation. For this reason it is necessary to separate the effects of acquisitions and disposals on the sales and profit of brands acquired or disposed of in order to provide information on the underlying performance of individual markets.

Adjusting for these items enables group management to monitor performance over factors which local managers are most directly able to influence in relation to the core ongoing brand portfolio. The underlying performance on a constant currency basis and excluding the impact of acquisitions and disposals is referred to as organic performance, and further information on the calculation of organic measures as used in the discussion of the premium drinks segment is included below.

In order to assist the reader of the financial statements, the comparisons of both 2003 with 2002 and 2002 with 2001 include tables which present the exchange, disposal, acquisition and organic components of the year on year movement for each of turnover, net sales (after deducting excise duties) and operating profit before exceptional items.

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

For acquisitions, a similar adjustment is made in the organic movement calculations. For acquisitions in the current period, the post acquisition results are excluded from the organic movement calculations. For acquisitions in the prior period, post acquisition results are included in the prior period but are only included from the anniversary of the acquisition date in the current period.

A further adjustment in organic movement is made to exclude the effect of exchange rate movements by recalculating the prior period s results as if they had been generated at the current period s exchange rates.

Organic movement percentages are calculated as the organic movement amount in £ million, expressed as the percentage of the prior period results at current year exchange rates and after adjusting for disposals. The basis of calculation means that the results used to measure organic growth for a given year will be adjusted when used to measure organic growth in the subsequent year.

## Operating results 2003 compared with 2002

### Summary consolidated profit and loss account

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Before exceptional items £ million | Exceptional items £ million | Total £ million | Before exceptional items £ million | Exceptional items £ million | Total £ million |
| **Turnover** | **9,440** | | **9,440** | 11,282 | | 11,282 |
| Operating costs | **(7,411)** | **(168)** | **(7,579)** | (9,176) | (453) | (9,629) |
| **Operating profit** | **2,029** | **(168)** | **1,861** | 2,106 | (453) | 1,653 |
| Share of profits of associates | **478** | **(21)** | **457** | 324 | (41) | 283 |
| Disposal of fixed assets and businesses | | **(1,313)** | **(1,313)** | | 799 | 799 |
| Interest payable (net) | **(351)** | | **(351)** | (399) | | (399) |
| **Profit/(loss) before taxation** | **2,156** | **(1,502)** | **654** | 2,031 | 305 | 2,336 |
| Taxation | **(539)** | **52** | **(487)** | (511) | (121) | (632) |
| **Profit/(loss) after taxation** | **1,617** | **(1,450)** | **167** | 1,520 | 184 | 1,704 |
| Minority interests | **(91)** | | **(91)** | (87) | | (87) |
| **Profit/(loss) for the year** | **1,526** | **(1,450)** | **76** | 1,433 | 184 | 1,617 |

Note: Exceptional items under UK GAAP represent items which, in management s judgement, are material items that arise from events or transactions that fall within the ordinary activities of the group and, by virtue of their size or incidence, should be separately disclosed if the financial statements are to properly reflect the results for the period. Exceptional items under UK GAAP do not represent extraordinary items under US GAAP.

**Turnover**

**Overall** Turnover decreased by £1,842 million (16%) from £11,282 million in the prior year to £9,440 million in the year ended 30 June 2003, following the disposals of Pillsbury in October 2001 and Burger King in December 2002, both of which are accounted for as discontinued operations and which contributed £479 million to turnover in the year ended 30 June 2003 compared with £2,578 million in the prior year.

**Continuing operations premium drinks** For continuing operations, which now represents Diageo s premium drinks business, turnover increased by £257 million (3%) from £8,704 million in the year ended 30 June 2002 to £8,961 million in the year ended 30 June 2003. The Seagram spirits and wine businesses, which were acquired on 21 December 2001, contributed £1,214 million to turnover during the year, compared with £573 million in the six month period ended 30 June 2002. This increase attributable to the acquired Seagram business was partly offset by the impact of brands which were disposed of during the two year period ended 30 June 2003 of £327 million, principally due to Malibu (impact of £107 million), North American wine brands (£42 million) which were sold in May and April 2002 respectively, and the loss of the distribution rights of Jack Daniels and Southern Comfort in Great Britain effective August 2002 (£108 million). Turnover was also adversely impacted by the effect of exchange rate movements, primarily the US dollar, which reduced turnover by an estimated £329 million. The remaining £272 million increase in turnover reflects the underlying performance of the ongoing brand portfolio which saw volume increase by 1%.

**Discontinued operations** Burger King contributed £479 million to turnover in the year ended 30 June 2003 compared with £1,123 million, in the year ended 30 June 2002 following the disposal of Burger King in December 2002. Turnover in the year ended 30 June 2002 also included £1,455 million from Pillsbury which was sold on 31 October 2001.

## Operating costs

**Overall** Operating costs decreased by £2,050 million (21% on a reported basis) from £9,629 million in the year ended 30 June 2002 to £7,579 million in the year ended 30 June 2003. This decrease was caused by the disposals of Pillsbury in October 2001, which had £1,271 million operating costs in the prior year, and Burger King in December 2002, whose operating costs fell by £562 million reflecting the reduction in the period of ownership by the group. Operating costs of premium drinks decreased by £217 million.

**Continuing operations premium drinks** For continuing operations, which now represents Diageo s premium drinks business, operating costs decreased by £217 million (3% on a reported basis) from £7,370 million in the year ended 30 June 2002 to £7,153 million in the year ended 30 June 2003. Operating exceptional costs for continuing operations decreased by £264 million from £432 million in the prior year to £168 million (these are discussed under exceptional operating costs below).

Excluding the exceptional operating costs, continuing operating costs increased by £47 million (1%) from £6,938 million in the year ended 30 June 2002 to £6,985 million in the year ended 30 June 2003. There were increases in operating costs compared with the prior period arising from the acquisition of the Seagram spirits and wine businesses in December 2001 and from organic increases in marketing and other costs. These were almost fully offset by reductions in costs from the movements in exchange rates (£291 million), principally the US dollar, and from disposals (£254 million), principally the loss of the distribution rights for Jack Daniels and Southern Comfort in Great Britain (£99 million) and Malibu (£67 million).

Marketing investment for premium drinks increased by £58 million (5% ) to £1,185 million. Marketing investment on the global priority brands grew 5%, to £803 million. The major drivers of the increase were higher spend on the Johnnie Walker, Baileys and Smirnoff brands and behind the launch of Smirnoff Ice in key and venture markets. Marketing spend on J B declined and spend on Guinness was down as a result of a reduction in spend in Great Britain and in Ireland.

## Operating profit before exceptional items

**Overall** Operating profit before exceptional items decreased by £77 million from £2,106 million to £2,029 million. The decrease reflects an increase attributable to premium drinks of £210 million, offset by a reduced contribution of £287 million from discontinued operations.

**Continuing operations premium drinks** Operating profit before exceptional items for premium drinks increased by £210 million (12%) from £1,766 million to £1,976 million. The Seagram businesses, in the six months ended 31 December 2002, contributed £211 million, but this was offset by a £73 million impact of businesses disposed, primarily Malibu (impact of £40 million) and North American wine brands (£5 million) which were sold in May and April 2002 respectively, and the loss of the distribution rights of Jack Daniels and Southern Comfort in Great Britain effective August 2002 (£9 million). £110 million of the increase in operating profit before exceptional items is attributable to the organic performance of the brand portfolio, discussed in more detail below. Exchange rate movements, net of the effect of currency hedging, had an adverse impact on operating profit before exceptional items of £38 million.

**Discontinued operations** The results for the year included an operating profit contribution of £53 million from discontinued operations (Burger King only), compared with £340 million in the year ended 30 June 2002 (Burger King and Pillsbury).

## Exceptional operating costs

**Overall** The operating profit for the year ended 30 June 2003 is after exceptional operating charges of £168 million compared to £453 million (including £21 million in respect of discontinued operations) for the year ended 30 June 2002. This comprised integration and restructuring costs of £225 million, offset by £57 million received on the termination of Bass distribution rights in the United States.

**Continuing operations premium drinks** In the year ended 30 June 2003, £177 million was incurred in respect of the integration of the Seagram spirits and wine businesses, acquired in December 2001 (year ended 30 June 2002 £164 million). Approximately £43 million of these costs were employee related, £7 million were in respect of write downs of tangible fixed assets, £57 million were incurred in putting in place new distributor and broker agreements as part of the Next Generation Growth programme in the United States, and the balance included consultancy and systems costs. The majority of these costs were incurred in North America and the United Kingdom. It is expected that the total programme cost of restructuring and integrating the business will be approximately $700 million (£460 million) of which $590 million (£390 million) is expected to be cash. The majority of the balance of the cost will be incurred in the year ending 30 June 2004 as an operating exceptional item. As a result of the amount charged to the profit and loss account in the two years ended 30 June 2003, it is anticipated that approximately 2,200 jobs will be lost of which

some 1,800 had been terminated by 30 June 2003. On completion of the programme it is anticipated that some 2,500 jobs will be lost and that integration synergy will reduce Diageo s annual cost base by approximately £115 million in the year ending 30 June 2005. The above merger synergy represents the latest management estimate and, as a forward-looking statement, involves risk and uncertainty. The expected level of synergy is based on a number of assumptions, including certain expectations concerning: the integration of back offices and sales forces in subsidiary regional offices resulting in headcount reductions and rationalisation of facilities; headcount reductions in central and regional offices; and procurement savings through improvement of supplier terms.

£48 million (2002 £48 million; 2001 £74 million) was incurred in respect of the restructuring of the UDV (spirits and wine) and the Guinness (beer) businesses. Approximately £28 million of the costs were employee related and the balance included legal and professional costs. Total costs of this integration totalled £170 million charged to the profit and loss account over the three years ended 30 June 2003, and no further costs are expected. As a result of the restructuring charge in the three years ended 30 June 2003, it is anticipated that approximately 750 jobs will be lost, of which approximately 600 had been terminated at 30 June 2003.

Effective 30 June 2003, Diageo relinquished its distribution rights for Bass Ale in the United States. Under the distribution agreement, Diageo had the right to continue selling and marketing the brand in the United States until July 2016. Consideration of £57 million received has been accounted for as an exceptional operating item.

In the year ended 30 June 2002, exceptional operating costs in relation to the premium drinks business included £164 million in respect of the integration of the Seagram spirits and wine businesses, £48 million in respect of the restructuring of the UDV and Guinness businesses and £220 million in respect of a settlement with José Cuervo following the termination of litigation and the formalisation of new arrangements for the distribution by Diageo of José Cuervo brands in the United States.

**Discontinued operations** There were no exceptional operating costs in relation to discontinued operations in the year ended 30 June 2003. In the prior year, exceptional operating costs for discontinued operations comprised £21 million in relation to the restructuring of franchisee loan financing arrangements in anticipation of the disposal of the Burger King business.

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**Associates**
The group s share of profits of associates before exceptional items was £478 million for the year compared with £324 million for last year. The 21% equity interest in General Mills contributed £287 million (£143 million in the eight months ended 30 June 2002). Exceptional items for associates comprise £18 million for Diageo s share of General Mills exceptional costs incurred on its restructuring of the acquired Pillsbury business, and £3 million in respect of restructuring within Moët Hennessy.

**Interest**
The net interest charge decreased by 12% from £399 million in the prior year to £351 million in the year ended 30 June 2003. The net benefits of £76 million in respect of the disposal of businesses, of £27 million from exchange rate related movements, and of £44 million from the reduction in interest rates were offset by other factors. These factors included an increase of £14 million in the amount relating to the share of General Mills interest charge, the effect of business acquisitions, principally the Seagram spirits and wine businesses, of £60 million and the funding of the share repurchases which increased the interest charge by £43 million.

**Non operating exceptional items**
Non operating exceptional items before taxation comprise losses of £43 million on disposal of fixed assets and losses of £1,270 million on disposal of businesses in the year ended 30 June 2003 compared with losses of £22 million and gains of £821 million respectively in the prior year.

Burger King was sold on 13 December 2002 for $1.5 billion (£0.9 billion).The sale resulted in a pre tax charge of £1,457 million, after writing back goodwill previously written off to reserves of £673 million. Diageo retained $212 million (£129 million) of subordinated debt, with a ten year maturity (2013), from the Burger King Company. In addition, Diageo has guaranteed up to $850 million (£515 million) of borrowings of the Burger King Company. These loans have a term of five years from December 2002, although Diageo and Burger King have structured their arrangements to encourage refinancing by Burger King on a non-guaranteed basis prior to December 2007. The loss on disposal of Burger King was partially offset by the receipt of £171 million additional consideration on the disposal of Pillsbury. Gains on disposals of businesses in the year ended 30 June 2002 principally related to the disposal of Malibu (£532 million) and Pillsbury (£322 million).

**Taxation**
The effective rate of taxation on profit before exceptional items for the year ended 30 June 2003 was 25.0% compared with 25.2% for the year ended 30 June 2002. After exceptional items the effective rate of taxation was 74.5% for the year ended 30 June 2003 compared with 27.1% for the year ended 30 June 2002. The effective rate of taxation for the year ended 30 June 2003 reflected the fact that the pre tax loss on the disposal of Burger King was £1,457 million reduced by tax relief of £80 million.

**Premium drinks** The following discussion provides additional commentary on the trading performance of the premium drinks business with the equivalent period in the prior year.

In the discussion movements are segregated between reported or organic performance. Reported means that the measure reflects movement in the number disclosed in the financial statements. Organic represents the movement excluding the impact of exchange, acquisitions and disposals. In the discussion under organic brand performance for each market, movements given for volume, turnover, net sales (after deducting excise duties) and marketing expenditure are organic movements. A further description of organic movement, how it is calculated and why it is considered useful for the reader is set out on pages 19 and 20.

The organic movement calculations for turnover, net sales (after deducting excise duties) and operating profit before exceptional items for the year ended 30 June 2003 were as follows:

| | 2002 Reported £ million | Exchange £ million | Disposals £ million | **Acquisitions £ million** | **Organic movement £ million** | **2003 Reported £ million** | **Organic movement %** |
|---|---|---|---|---|---|---|---|
| **Turnover** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 2,669 | (238) | (105) | **444** | **25** | **2,795** | **1** |
| Great Britain | 1,467 | | (135) | **17** | **80** | **1,429** | **6** |
| Ireland | 937 | 40 | (15) | **1** | **(10)** | **953** | **(1)** |
| Spain | 380 | 15 | (11) | **35** | **5** | **424** | **1** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | 5,453 | (183) | (266) | **497** | **100** | **5,601** | **2** |
| Key markets | 2,078 | (113) | (30) | **141** | **53** | **2,129** | **3** |
| Venture markets | 1,173 | (33) | (31) | **12** | **110** | **1,231** | **10** |
| **Total premium drinks** | 8,704 | (329) | (327) | **650** | **263** | **8,961** | **3** |

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| | 2002 Reported £ million | Exchange £ million | Disposals £ million | Acquisitions £ million | Organic movement £ million | 2003 Reported £ million | Organic movement % |
|---|---|---|---|---|---|---|---|
| **Net sales(after deducting excise duties)** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 2,230 | (197) | (95) | 373 | 24 | 2,335 | 1 |
| Great Britain | 896 | | (84) | 9 | 18 | 839 | 2 |
| Ireland | 625 | 27 | (13) | 1 | (2) | 638 | |
| Spain | 298 | 12 | (10) | 26 | (4) | 322 | (1) |
| | 4,049 | (158) | (202) | 409 | 36 | 4,134 | 1 |
| Key markets | 1,631 | (93) | (27) | 100 | 75 | 1,686 | 5 |
| Venture markets | 905 | (33) | (26) | 9 | 120 | 975 | 14 |
| **Total premium drinks** | 6,585 | (284) | (255) | 518 | 231 | 6,795 | 4 |
| Excise duties | 2,119 | | | | | 2,166 | |
| **Turnover** | 8,704 | | | | | 8,961 | |
| **Operating profit before exceptional items** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 550 | (2) | (30) | 154 | 57 | 729 | 11 |
| Great Britain | 204 | | (17) | 4 | 28 | 219 | 15 |
| Ireland | 151 | 6 | (2) | | (14) | 141 | (9) |
| Spain | 94 | 1 | (2) | 11 | (5) | 99 | (5) |
| | 999 | 5 | (51) | 169 | 66 | 1,188 | 7 |
| Key markets | 524 | (41) | (12) | 39 | 12 | 522 | 3 |
| Venture markets | 243 | (2) | (10) | 3 | 32 | 266 | 14 |
| **Total premium drinks** | 1,766 | (38) | (73) | 211 | 110 | 1,976 | 7 |

**Notes**

(1) The exchange adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items are principally in respect of the US dollar.

(2) Disposal adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in relation to the disposal of Malibu rum (£107 million, £93 million, £40 million); the termination of the distribution rights for Jack Daniels and Southern Comfort (£113 million, £70 million, £10 million) in the United Kingdom; the sale of Glen Ellen/MG Vallejo wines (£42 million, £38 million, £5 million); the transfer of distribution rights of Cuervo 1800 (£27 million, £22 million, £10 million); the sale of Croft Inns (£10 million, £10 million, nil); the sale of Gilbey s Green and White Label whiskies in India (£9 million, £8 million, £1 million); the termination of distribution rights for Drambuie (£7 million, £4 million, £1 million); the sale of Croft and Delaforce port and sherry brands (£5 million, £4 million, £2 million); and other disposals (£7 million, £6 million, £4 million).

(3) Acquisition adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in respect of the purchase of the Seagram spirits and wine businesses (£650 million, £518 million, £211 million).

(4) In the calculation of operating profit before exceptional items the overheads included in disposals and acquisitions were directly attributable to those businesses and do not result from subjective judgements of management.

(5) The organic movement percentage is the amount in the column headed organic movement in the table above expressed as a percentage of the aggregate of the first three columns. The basis of the calculation of the organic movement is explained on page 20.

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**Organic brand performance**

| | Equivalent units million | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|---|
| Smirnoff | **23.0** | **6** | **8** |
| Johnnie Walker | **10.8** | **2** | **2** |
| Guinness | **11.4** | **2** | **6** |
| Baileys | **6.2** | **10** | **13** |
| J B | **6.0** | **(5)** | **(6)** |
| Captain Morgan* | **2.5** | **(1)** | **(12)** |
| José Cuervo | **4.2** | **7** | **7** |
| Tanqueray | **1.9** | **3** | **7** |
| **Total global priority brands** | **66.0** | **3** | **5** |
| **Local priority brands** | **17.1** | **(1)** | **4** |
| **Category brands** | **26.8** | **(3)** | **1** |
| | **109.9** | **1** | **4** |
| **Acquisitions** | **9.4** | | |
| **Total in year ended 30 June 2003** | **119.3** | | |

*Captain Morgan included for second half only with first half volume included in acquisitions.

**Analysis by individual market**

**North America**

***Key measures:***

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | **15** | **1** |
| Turnover | **2,795** | 2,669 | **5** | **1** |
| Net sales (after deducting excise duties) | **2,335** | 2,230 | **5** | **1** |
| Marketing | **405** | 408 | **(1)** | **(3)** |
| Operating profit before exceptional items | **729** | 550 | **33** | **11** |

***Reported performance*** Turnover in North America increased 5% from £2,669 million in the year ended 30 June 2002 to £2,795 million in the year ended 30 June 2003. Operating profit before exceptional items increased 33% from £550 million in the year ended 30 June 2002 to £729 million in the year ended 30 June 2003.

***Organic performance*** The increase in turnover was primarily due to the turnover derived from the Seagram brands, acquired in the joint acquisition of the Seagram spirits and wine businesses in December 2001, which contributed £444 million in the six months ended 31 December 2002. The effect of brand disposals and of exchange rate movements in the US dollar reduced turnover in the year ended 30 June 2003 by £105 million and £238 million, respectively. The disposal impact is primarily attributable to the disposal of Malibu in May 2002 (£37 million), the Glen Ellen wine business in May 2002 (£37 million) and Cuervo 1800 in September 2002 (£24 million).

The acquired Seagram brands were the main factor in growing operating profit before exceptional items in North America from £550 million last year to £729 million in the year ended 30 June 2003 contributing £154 million in the six months ended 31 December 2002.

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*Organic brand performance:*

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| Smirnoff | 4 | (2) |
| Johnnie Walker | 2 | 7 |
| José Cuervo | 10 | 9 |
| Baileys | 14 | 17 |
| Tanqueray | 2 | 7 |
| Guinness | 1 | 1 |
| Captain Morgan | (6) | (17) |
| J B | (6) | (6) |
| **Total global priority brands** | 4 | 2 |
| **Local priority brands** | 1 | 4 |
| **Category brands** | (7) | (3) |
| **Total** | 1 | 1 |

Smirnoff volume excluding ready to drink was up 9% and net sales (after deducting excise duties) were up 11%

Excluding Captain Morgan Gold, volume of Captain Morgan was up 8% and net sales (after deducting excise duties) were up 10%

Excluding ready to drink, total volume was up 3% and net sales (after deducting excise duties) were up 5%

Volume growth in North America was driven by the strong performance of the priority spirits brands. Global priority brand volume excluding ready to drink grew 7%. Ready to drink volume, which includes flavored malt beverages and ready to drink in the United States and ready to drink in Canada, was down 17%, representing a decline in Smirnoff ready to drink of 11% and the withdrawal of Captain Morgan Gold.

Smirnoff had another strong year despite weakness in Smirnoff ready to drink. Excluding ready to drink, volume was up 9%, driven by strong growth in Smirnoff Red and the continued success of the Smirnoff Twist flavoured vodka range. Smirnoff Red increased its share to 23.1%. The brand s volume growth was driven by the success of the What s your mix advertising campaign. In addition, Smirnoff Red continues to benefit from spend behind Smirnoff ready to drink and Smirnoff Twist.

Smirnoff ready to drink volume was down 11%. The launch of Smirnoff Ice Triple Black in January 2003 partially offset softness in Smirnoff Ice.

Volume of Johnnie Walker Red Label improved in the second half of the year. Johnnie Walker Black Label also gained share although volume growth slowed from the first half. Net sales (after deducting excise duties) for the total brand were up 7% due to volume growth of 2% and favourable price/mix variances of 5%, driven by a 3% price increase in certain markets.

Baileys continued its impressive growth driven by national advertising around a very successful holiday programme, and the continued success of initiatives to broaden the appeal of the brand to new occasions. The launch of Baileys Minis in May also contributed incremental volume and revenue, as well as generating momentum for the brand.

The strategy for J B in North America is to maximise value and in the year operating profit from the brand increased as marketing expenditure was reduced.

José Cuervo continues to be the leader in US tequila sales. The key drivers of its growth were high consumer visibility, the success of national advertising and an increased trial programme.

The success of the Distinctive Since campaign was a key driver of the growth in Tanqueray. Both Tanqueray and Tanqueray No. TEN increased their share of the category.

Excluding Captain Morgan Gold ready to drink, Captain Morgan volume was up 8% and net sales (after deducting excise duties)

were up 10% driven by increased advertising and media spending for Captain Morgan Original Spiced Rum.

Guinness volume grew slightly in the year driven by strong performance by bottled Guinness Extra Stout and Guinness Draught in Bottles.

Local priority brand volume was up 1% for the year, with net sales (after deducting excise duties) up 4%. Crown Royal showed strong gains, as did Sterling Vineyards, however these were partially offset by volume decline in Gordon s Gin, Beaulieu Vineyard, and other smaller brands. Volume of category brands was down 7% for the year, with net sales (after deducting excise duties) down 3%. The decrease in volume was due to declines in Gordon s vodka and other smaller category brands. Bass volume was down versus the prior year; distribution of the brand was returned to Interbrew as of 30 June 2003. There has been a mix improvement due to inclusion of the former Seagram brands and the launch of Cîroc.

*Other business performance drivers:*

Almost 80% of Diageo s volume now distributed through dedicated sales teams

Ready to drink segment under pressure

Efficiencies generated savings of over 10% in media planning and buying

Share of US spirits brands increased by 0.3 percentage points to 27.3%

Diageo North America continued to progress its strategic initiatives. In particular its Next Generation Growth programme has made excellent further progress. In the second half of the year, new distribution and brokerage agreements were reached in nine more states and additional distributors established dedicated sales forces. Distributors and brokers in 34 states and Washington DC, representing nearly 80% of Diageo s volume, are now supporting Diageo s brands with just under 2,000 sales personnel working in teams solely dedicated to Diageo and S&S brands.

Following two years of rapid growth, flavored malt beverages in the United States have slowed considerably and volume in the segment was broadly level for the year. Of the new launches this year, Smirnoff Ice Triple Black was the most successful and it is now the second best selling flavored malt beverage in the United States behind Smirnoff Ice. Flavored malt beverages currently represent 2% of the beer category, of which Smirnoff ready to drink is estimated to constitute about a third.

Diageo s share of US spirits increased in the year to 27.3% as a result of share gains in most priority brands.

Diageo has now consolidated to one media planning and buying agency resulting in a 10% reduction in media spend against prior year cost levels. In addition a 15% reduction versus prior year was achieved in media production costs. Marketing spend at £405 million was 3% below prior year while share of voice in the combined beer and spirits category increased.

**Great Britain**

*Key measures:*

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | (2) | 5 |
| Turnover | 1,429 | 1,467 | (3) | 6 |
| Net sales (after deducting excise duties) | 839 | 896 | (6) | 2 |
| Marketing | 188 | 188 | | 2 |
| Operating profit before exceptional items | 219 | 204 | 7 | 15 |

***Reported performance*** Turnover in Great Britain was down 3% on a reported basis from £1,467 million last year to £1,429 million in the year ended 30 June 2003. Operating profit before exceptional items was up £15 million from £204 million in the year ended 30 June 2002 to £219 million in the year ended 30 June 2003.

***Organic performance*** The principal reason for the decrease in turnover was the termination of the distribution rights for Jack Daniels and Southern Comfort in Great Britain in August 2002 which reduced turnover by £108 million. The acquired Seagram brands contributed £17 million to turnover in the six months ended 31 December 2002. The organic increase in the year was £80 million (6%).

Increase in operating profit before exceptional items was due to organic growth of £28 million, partly offset by a net negative impact resulting from acquisitions and disposals of £13 million.

*Organic brand performance:*

| Net sales (after deducting |
|---|

| | Volume movement % | excise duties) movement % |
|---|---|---|
| Smirnoff | 7 | (1) |
| Guinness | (1) | (1) |
| Baileys | 29 | 30 |
| **Total global priority brands** | 6 | 2 |
| **Local priority brands** | (3) | (11) |
| **Category brands** | 14 | 14 |
| **Total** | 5 | 2 |

Smirnoff volume excluding ready to drink was up 11% and net sales (after deducting excise duties) up 16%

Excluding ready to drink total volume was up 6% and net sales (after deducting excise duties) up 7%

Great Britain has achieved solid volume growth in the year and again increased share driven by growth of the global priority spirits brands. Growth in the spirits brands offset the decline in volume in ready to drink and beer.

Smirnoff Red retained its leadership position in terms of share. Excluding ready to drink, volume grew 11%. In addition, a 6% price increase was achieved in September 2002 against strong competition from the value end of the category.

Smirnoff ready to drink volume fell 3% in the year and net sales (after deducting excise duties) declined by 11%. However, the brand grew share by 2 percentage points. The ready to drink segment has been significantly impacted by the duty increase in April 2002, with volume declining by 4% in the year ended 30 June 2003. Diageo absorbed the duty increase and as a result

net sales (after deducting excise duties) value per equivalent unit reduced by 9%. In addition, the duty impact has been exacerbated by a move towards value offerings and by shifts in consumer drinking habits away from the on trade and city centre venues, which are the primary outlets for ready to drink occasions.

Baileys continued its very strong growth. Share increased to 41% in the face of the introduction of two competing products into the category. The launch of Baileys Minis and continued media awareness contributed to this growth as did brand building activity focused on broadening consumer enjoyment of the brand into new occasions.

Guinness performed well in a difficult beer market, with net sales (after deducting excise duties) down only 1%, compared with a 3% net sales (after deducting excise duties) decline in the beer category.

Local priority brand volume declined 3%. Despite volume growth, net sales (after deducting excise duties) of Gordon s, excluding ready to drink, declined by 2%, due to increased competitive pressure in the off trade.

The blended whisky segment continues to be driven by aggressive pricing but Bell s has maintained its lead in the segment.

Archers had a disappointing year with both its schnapps and ready to drink products showing volume decline. Archers volume declined by 6%. Archers Aqua volume fell by 27% driven by the ready to drink segment downturn which was more pronounced in the fruit flavoured ready to drink segment.

Diageo s category brands performance has been driven by excellent growth from Pimm s, Piat d Or and Blossom Hill.

***Other business performance drivers:***

Increased resources behind sales execution
A comprehensive restructuring of the customer sales force drove growth in Great Britain. The new structure both increased frequency of contact with customers and generated more effective sales promotions.

**Ireland**

***Key measures:***

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | (6) | (5) |
| Turnover | 953 | 937 | 2 | (1) |
| Net sales (after deducting excise duties) | 638 | 625 | 2 | |
| Marketing | 67 | 65 | 3 | |
| Operating profit before exceptional items | 141 | 151 | (7) | (9) |

***Reported performance*** In Ireland, turnover increased £16 million from £937 million in the prior year to £953 million in the year ended 30 June 2003. Operating profit before exceptional items was £10 million lower than the previous year at £141 million.

***Organic performance*** Exchange rate movements increased turnover by £40 million, partially offset by an organic decline in turnover of £10 million. Operating profit before exceptional items was £10 million lower than the previous year at £141 million. Favourable exchange rate movements on the euro of £6 million were more than offset by the weaker performance of the brands compared to last year.

***Organic brand performance:***

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| Guinness | (4) | |

| | | |
|---|---|---|
| Smirnoff | **(5)** | **(7)** |
| Baileys | **(2)** | **(1)** |
| **Total global priority brands** | **(4)** | **(1)** |
| **Local priority brands** | **(5)** | **(1)** |
| **Category brands** | **(7)** | **1** |
| **Total** | **(5)** | |

In a weakening market in Ireland, Diageo volume declined by 5% and Diageo Ireland lost some share. The loss of share is mainly driven by the shift to at home consumption where Guinness and spirits are under represented. In addition, over 50% of Diageo s off trade volume is in premium beer which has been impacted by aggressive price discounting by competitors. There has also been a shift in consumption towards wine and away from spirits and ready to drink since the duty increase.

Guinness held share in the year for the first time in 10 years despite volume decline of 4%. Net sales (after deducting excise duties) were level, benefiting from a price increase.

The decline in spirits and ready to drink volume in the second part of the year reflects the impact of the duty increase of over 40% in spirits and nearly 100% in ready to drink implemented in December 2002. Smirnoff Red and Baileys both gained share. Smirnoff ready to drink volume declined 6%, however Diageo s share of ready to drink was maintained.

Volume in each of the local priority brands, Budweiser, Smithwicks and Carlsberg, all declined. The duty increase also impacted volume growth of the category brands, 45% of the volume of which is spirits. Volume of Diageo s wine brands declined by 7%.

***Other business performance drivers:***

- Continued decline in beverage alcohol market driven by a weakening economic environment

- Implementing a reorganisation to reduce costs and improve effectiveness

As previously described the beverage alcohol market in Ireland deteriorated further as a result of declining consumer confidence, the continuing slowdown in economic growth and the excise duty increase on spirits and ready to drink which led to retail price increases of around 20%. The social aspects of drinking are a significant issue in Ireland. As part of its ongoing social responsibility programme, Diageo has participated fully in the establishment of MEAS a new independent association established as part of the social responsibility programme undertaken by the industry.

In response to the changes in the beverage alcohol market in Ireland, Diageo is in the process of implementing a reorganisation which is expected to result in a less complex and lower cost operating model. The cost of achieving this is not expected to give rise to a charge to exceptional items.

**Spain**

***Key measures:***

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | 5 | (1) |
| Turnover | 424 | 380 | 12 | 1 |
| Net sales (after deducting excise duties) | 322 | 298 | 8 | (1) |
| Marketing | 70 | 71 | (1) | (9) |
| Operating profit before exceptional items | 99 | 94 | 5 | (5) |

***Reported performance*** Turnover in the Spanish market increased £44 million to £424 million in the year ended 30 June 2003 compared with the prior year. Operating profit before exceptional items was up £5 million to £99 million in the year ended 30 June 2003.

***Organic performance*** The reasons for the increase in turnover are the favourable impact of exchange rate movements in the year (£15 million) and the benefit of the acquired Seagram brands, principally Cacique, which contributed £35 million to turnover in the six months ended 31 December 2002.

Operating profit before exceptional items benefited from a £11 million contribution from the acquired Seagram brands, partially offset by an organic decline of £5 million.

***Organic brand performance:***

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| J B | (3) | (7) |
| Baileys | (2) | 1 |
| Johnnie Walker | (4) | (14) |
| Smirnoff | (8) | (2) |
| **Total global priority brands** | (4) | (7) |
| **Local priority brands** | 25 | 16 |
| **Category brands** | 3 | 13 |
| **Total** | (1) | (1) |

Organic operating profit was down 5% as the volume increase in dark rum was partially offset by declines in Scotch. Marketing investment declined by 9% mainly due to the decision to reschedule the J B advertising campaign originally planned for April to September 2003.

The performance in the six months ended 30 June 2003 is in contrast to that of the first half of the year with volume up 14% having been 11% down in the first half. This was primarily driven by 9% growth in the volume of J B in the second half and the inclusion of Cacique for the first time in organic growth in the second half.

The decline in global priority brands in the first half was mainly driven by the poor economic environment and by the tough prior year comparison driven by the duty increase in January 2002. Volume declined by 4% in the full year against a 13% decline in the first half. Net sales (after deducting excise duties) decreased by 7% for the full year against a 11% decline in the first half.

J B volume was down 3% for the full year following a decline of 11% in the first half as volume in the second half grew 9%. Johnnie Walker volume was down 4% for the full year having been down 13% in the first half, an increase of 10% in the second half.

The other major global priority brands in Spain, Smirnoff Red and Baileys, saw volume decline in the difficult environment of the first six months. Volume and net sales (after deducting excise duties) increased in the second half.

Cacique continued to make share gains partially through increased distribution and, benefiting from its leading position in a growing category, volume was up 40%. In addition a price increase was implemented in May 2003. Cardhu volume grew 2%.

***Other business performance drivers:***

Market share gains on J B, Baileys, Johnnie Walker Red Label and Cacique
In the Scotch segment Diageo s brands gained share slightly with gains by J B and Johnnie Walker Red Label partially offset by share decline in VAT69.

**Key markets**

***Key measures:***

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | | (2) |
| Turnover | 2,129 | 2,078 | 2 | 3 |
| Net sales (after deducting excise duties) | 1,686 | 1,631 | 3 | 5 |
| Marketing | 269 | 239 | 13 | 12 |
| Operating profit before exceptional items | 522 | 524 | | 3 |

***Reported performance*** In key markets, turnover increased £51 million from £2,078 million in the year ended 30 June 2002 to £2,129 million in the year ended 30 June 2003. Operating profit before exceptional items was down £2 million at £522 million for the year ended 30 June 2003.

***Organic performance*** Turnover was boosted by the acquired Seagram brands which contributed £141 million in the six months ended 31 December 2002, and by an organic increase of £53 million. However, unfavourable exchange variances of £113 million (principally in respect of the Venezuelan Bolivar), and the impact of disposals of £30 million (principally Malibu £24 million) reduced turnover.

Operating profit before exceptional items was down £2 million at £522 million for the year ended 30 June 2003. Exchange losses on the Venezuelan Bolivar of £30 million were more than offset by the impact of acquired Seagram brands which contributed £39 million to operating profit before exceptional items in the six months ended 31 December 2002.

***Organic brand performance:***

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| Johnnie Walker | (1) | (3) |
| Guinness | 9 | 29 |
| J B | (10) | (9) |
| Smirnoff | 2 | 11 |
| Baileys | (2) | 2 |
| **Total global priority brands** | 1 | 5 |
| **Local priority brands** | (3) | 15 |
| **Category brands** | (5) | (1) |
| **Total** | (2) | 5 |

The volume growth in overall global priority brands was led by a continued strong performance of Guinness in Africa. Johnnie Walker volume declined as growth in Johnnie Walker Red Label, up 2%,was offset by a 6% decline in Johnnie Walker Black Label. Johnnie Walker Black Label was impacted by the tough trading environment in Latin America. Excluding Latin America, Johnnie Walker Black Label volume was up 4%. Ready to drink volume was up 26% driven by further strong performance of Diageo s ready to drink brands in Australia and by the Smirnoff Ice launches in Taiwan, France, Japan and Global Duty Free.

Local priority brand volume fell as strong performance on Bundaberg Rum, up 16%, and Guinness Malta, up 17%, only partially

compensated for the decline in Buchanans in Venezuela and for the impact which the change of distributor arrangements for Dimple in South Korea had on sales of that brand in the first half. Volume of category brands fell by 5% driven by the decline in VAT69 in Venezuela and by the decline in Spey Royal in Thailand in the first half. This was partially offset by growth in category brand volume in Africa.

While overall volume declined, net sales (after deducting excise duties) grew reflecting the benefit of strong price increases gained on the Guinness brand in Africa. Marketing investment grew by 12% driven by increased spend behind new brand launches and the relaunches of Johnnie Walker and Dimple in South Korea.

***Other business performance drivers:***

Strong performance in Africa

Strong volume growth in Australia

Continued impact of difficult economic situation in Latin America

Impact of SARS in Asia and Global Duty Free

Competitor pricing in Portugal

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As previously noted, several of Diageo s key markets are in geographies which have faced the most difficult challenges of the last year. The overall profitability of the key markets in Latin America declined. This was partially offset by growth in Africa and in South Korea while other key markets broadly maintained operating profit year on year.

Africa, which is Diageo s second largest market by volume, and its third largest market by operating profit, gained further momentum in the second half. Volume was up 6% and net sales (after deducting excise duties) up 18% for the full year. Guinness volume was up 10% driven by the continued success of the Michael Power campaign. Guinness Malta volume increased by 17% as distribution improved in Nigeria and Cameroon. Additional packaging and brewing capacity resulting from recent investment in Nigeria and Cameroon was also a major contributory factor behind the growth of both Guinness and Guinness Malta. Further capacity expansion projects are planned for the year to come. There was growth across all global priority spirits brands, with the exception of Smirnoff which was impacted by weak economic conditions in South Africa.

In Latin America overall volume and operating profit declined by 16% and 30% respectively. This reflects a dramatic decline in the Venezuelan business and a 7% volume decline in other Latin American markets. Despite a tough environment all markets remain profitable and there have been successes for a number of brands. For example, Smirnoff Red volume in Brazil grew by 12% as the brand benefited from increased marketing investment. Mexico s performance was also strong with volume up by 22%, driven by J B and Baileys which were moved to in-house distribution during the year.

In South Korea, Windsor, the leading Scotch whisky brand, gained share in the year and volume grew by 1% in the six months ended 30 June 2003. The structure of the acquisition of the Windsor brands has delivered an operating profit margin improvement. The in-house distribution arrangements for Dimple, the third largest Scotch whisky brand, are now fully operational. Dimple distribution was rebuilt from 53% to over 80% of target accounts. The performance of the Scotch whisky category slowed in the second half, impacted by the weaker economic environment.

Global Duty Free volume was level despite the impact of the Iraqi conflict and the SARS outbreak on world travel. This reflects extremely strong customer and consumer activities and continued investment in priority brands in this high profile market. Smirnoff Ice was launched in the year in a number of duty free markets and Tanqueray No. TEN was launched with very strong impact.

In Australia Diageo s leadership position was reinforced as overall share of spirits grew by over 7 percentage points in the year as all the priority brands gained share. Diageo s spirits business in Australia has benefited from focus on programmes to improve quality of serve in the on trade and to improve merchandising in both the on and off trade. Overall volume increased 16% and net sales (after deducting excise duties) were up 14%. Net sales (after deducting excise duties) per equivalent unit were slightly down due to the decision to reposition the prices of ready to drink brands to an appropriate price premium to beer. The strong volume growth was driven by Johnnie Walker up 35%, Baileys up 7% and Bundaberg up 16%. Diageo s ready to drink business grew by 30%. Dark spirits ready to drink performed exceptionally well with both Johnnie Walker and Bundaberg Premix increasing their share of the total ready to drink category. Despite the strong volume performance, operating profit growth was constrained by higher marketing investment and higher pension costs.

Despite a reduction in general consumer confidence the beverage alcohol market in Greece was stable and Diageo volume grew 3%. Volume growth was principally driven by Johnnie Walker Red Label up 5% and Johnnie Walker Black Label up 10%, as both gained share. Ready to drink volume grew 4% as growth in Smirnoff Ice up 8%, and Gordon s Space up 5%, offset weakness in Archers Aqua and Smirnoff Mule. Marketing expenditure was up 5% to support the launch of new campaigns on a number of brands.

In Taiwan the key driver of volume growth of 9% was again Johnnie Walker which increased 9%. Pricing remained flat in the year but net sales (after deducting excise duties) grew 16% due to mix improvements.

In Japan overall volume declined 1%, with Johnnie Walker down 17% and Old Parr down 15%. The Scotch category is in decline and Diageo s brands have also lost some share. This was offset by volume growth in Guinness, up 17%. Smirnoff Ice has sold 51,000 equivalent units since its launch in May.

In Portugal Diageo s strategy has been to maintain price and not follow the aggressive discounting policy of competitors. In addition a new route to market was introduced in the year which led to a reduction in stock held by distributors. Consequently volume was down 36% and net sales (after deducting excise duties) were down 39%. The change in market dynamics is considered to be long term and, as Diageo s strategy is to maximise value not volume, Portugal has been managed as a venture market since 1 July 2003.

**Venture markets**

***Key measures:***

| | 2003 £ million | 2002 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | **2** | **6** |
| Turnover | **1,231** | 1,173 | **5** | **10** |
| Net sales (after deducting excise duties) | **975** | 905 | **8** | **14** |
| Marketing | **186** | 156 | **19** | **25** |
| Operating profit before exceptional items | **266** | 243 | **9** | **14** |

***Reported performance*** Turnover in venture markets increased by £58 million from £1,173 million in the year ended 30 June 2002 to £1,231 million in the year ended 30 June 2003. Operating profit before exceptional items, at £266 million for the year ended 30 June 2003, was £23 million higher than in the previous year.

***Organic performance*** The main factor for the improvement in turnover was the strong organic growth which added £110 million to turnover compared with the previous year. However, this was offset by unfavourable exchange movements of £33 million and the disposal of brands of £31 million (principally Malibu £17 million and Gilbey s Green and White Label whiskies £9 million).

The principal element of the increase in operating profit before exceptional items was organic growth of £32 million.

***Organic brand performance:***

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| Johnnie Walker | 7 | 10 |
| Smirnoff | 25 | 82 |
| Guinness | 1 | 3 |
| Baileys | 11 | 10 |
| J B | 4 | 4 |
| **Total global priority brands** | 11 | 22 |
| **Local priority brands** | (3) | 10 |
| **Category brands** | (2) | (1) |
| **Total** | 6 | 14 |

Smirnoff volume excluding ready to drink was up 4% and net sales (after deducting excise duties) was up 8%

Excluding ready to drink, volume was up 2% and net sales (after deducting excise duties) up 4%

Volume growth reflected strong growth in global priority brands. In addition ready to drink was an important contributor to venture markets growth with further rollouts of Smirnoff Red and Black Ice as well as the full year benefit of last year s launches.

Johnnie Walker volume grew 7%, however growth slowed in the second half of the year due in part to the impact of the Iraqi conflict and the SARS outbreak on travel. Johnnie Walker Black Label volume was up 12% and Johnnie Walker Red Label grew 4% driven by strong performance across most of the venture markets with the exception of Germany where volume was constrained by competition from lower priced products.

Smirnoff Red volume increased 4% as the brand continued to benefit from the improvement in brand equity which has resulted from the launch of Smirnoff Ice across venture markets. In addition, marketing investment behind Smirnoff Red rose by 7%. Net sales (after deducting excise duties) of Smirnoff benefited from the favourable mix impact of ready to drink.

Guinness volume improved in the second half driven by strong performance in Malaysia. Volume of Red Stripe in Jamaica, venture markets only local priority brand, was impacted in the second half by the worsening economic conditions in Jamaica and excise duty increases, but net sales (after deducting excise duties) benefited from price increases in the second half.

Baileys volume grew by 11%, as the brand benefited from an extremely strong holiday programme and continued marketing investment was increased by 15% versus the prior year.

***Other business performance drivers:***

Marketing investment up 25% mainly behind ready to drink launches and longer term growth projects

Operating profit growth led by the Caribbean, Middle East, Nordics and Germany

Marketing investment grew by 25% due to investment to support ready to drink launches as well as investment to support longer term growth behind Baileys in Germany, Italy, the Caribbean and venture markets in Latin America and Johnnie Walker in Asia and the Caribbean.

The Caribbean and the Middle East markets performed strongly as a result of good performance across the global priority brands with volume up on these brands 20% and 10%, respectively.

In Norway, Diageo s business was successfully maintained by a third party distributor during the six month suspension of Diageo s trading licence and volume grew. Diageo is now fully operational again in Norway following the reinstatement of the trading licence in February and Smirnoff, Bell s and Gordon s have all gained share in the off trade, a segment which is showing strong growth following a reduction in excise duty. Smirnoff Ice continues to perform well in the Nordics and full year volume was 100,000 equivalent units.

In Germany ready to drink is currently the fastest growing segment in the spirits market and since its launch in February 2002, Smirnoff Ice has sold nearly 500,000 equivalent units. Germany has been managed as a key market since 1 July 2003. In the

Netherlands the second half performance was adversely impacted by an 18% duty increase in January and volume was down 2%.

In the venture markets across Asia, overall volume grew by 1% despite the impact of the SARS outbreak. In India the sale of the Gilbey s Green and White Label whiskies in December 2002 has resulted in increased focus on the global priority brands. However strong volume growth in India was offset by weakness in the Philippines where the decline in travel as a result of the SARS outbreak impacted the duty free channel.

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## Operating results 2002 compared with 2001

### Summary consolidated profit and loss account

| | 2002 | | | 2001 | | |
|---|---|---|---|---|---|---|
| | **Before exceptional items £ million** | **Exceptional items £ million** | **Total £ million** | Before exceptional items £ million | Exceptional items £ million | Total £ million |
| **Turnover** | **11,282** | | **11,282** | 12,821 | | 12,821 |
| Operating costs | **(9,176)** | **(453)** | **(9,629)** | (10,720) | (228) | (10,948) |
| **Operating profit** | **2,106** | **(453)** | **1,653** | 2,101 | (228) | 1,873 |
| Share of profits of associates | **324** | **(41)** | **283** | 203 | | 203 |
| Disposal of fixed assets and businesses | | **799** | **799** | | (4) | (4) |
| Interest payable (net) | **(399)** | | **(399)** | (350) | | (350) |
| **Profit/(loss) before taxation** | **2,031** | **305** | **2,336** | 1,954 | (232) | 1,722 |
| Taxation | **(511)** | **(121)** | **(632)** | (468) | 33 | (435) |
| **Profit/(loss) after taxation** | **1,520** | **184** | **1,704** | 1,486 | (199) | 1,287 |
| Minority interests | **(87)** | | **(87)** | (80) | | (80) |
| **Profit/(loss) for the year** | **1,433** | **184** | **1,617** | 1,406 | (199) | 1,207 |

Note: Exceptional items under UK GAAP represent items which, in management s judgement, are material items that arise from events or transactions that fall within the ordinary activities of the group and, by virtue of their size or incidence, should be separately disclosed if the financial statements are to properly reflect the results for the period. Exceptional items under UK GAAP do not represent extraordinary items under US GAAP.

### Turnover

**Overall** Turnover decreased by £1,539 million (12%) from £12,821 million in the year ended 30 June 2001 to £11,282 million in the year ended 30 June 2002. Increased turnover of £1,124 million in the premium drinks business and £81 million at Burger King were more than offset by a decrease of £2,744 million attributable to Pillsbury.

**Continuing operations premium drinks** Premium drinks generated turnover of £8,704 million in the year ended 30 June 2002, an increase of £1,124 million (15%) from the £7,580 million reported in the year ended 30 June 2001. The acquisition of the Seagram brands, which include Captain Morgan, Crown Royal, Seagram s 7, Seagram s VO, Cacique, Windsor Premier, Myers s Rum and Sterling Vineyards, completed on 21 December 2001. The results for the year ended 30 June 2002 include the trading performance of that business for the six months ended 30 June 2002, and the acquired Seagram brands generated sales of £573 million in the year ended 30 June 2002 with no contribution in the prior period. Other minor acquisitions contributed £120 million of the increase in turnover, but this was more than offset by the impact of a number of disposals of non-core brands or the termination of distribution rights which reduced turnover by £196 million, principally attributable to the loss of the distribution rights of Stolichnaya in December 2000 (£94 million). Exchange rate movements had a small (£13 million beneficial impact on turnover. The remaining £614 million increase in turnover is attributable primarily to brands owned throughout the two year period ended 30 June 2002 and reflects strong volume performance of the global priority brands (which grew by 8%) and 2% volume growth in local priority brands, offset by a 4% volume decline in category brands (all brands other than global priority brands and local priority brands).

**Discontinued operations** The decrease in turnover at Pillsbury was primarily attributable to the disposal of the business, which was sold in October 2001, and for which turnover is only included for the four months up to the date of disposal in the year ended 30 June 2002 compared with a full year in the prior period. Pillsbury contributed £1,455 million in the year ended 30 June 2002 compared with £4,199 million in the prior year. Burger King contributed turnover of £1,123 million in the year ended 30 June 2002, compared with £1,042 million in the prior period, an increase of £81 million (8%) driven primarily by revenue generated by the increase in the number of Burger King owned restaurants. Both Pillsbury and Burger King, following its disposal in December 2002, are accounted for as discontinued operations under UK GAAP in the financial statements for the year ended 30 June 2003.

### Operating costs

**Overall** Operating costs decreased by £1,319 million (12% on a reported basis) from £10,948 million in the year ended 30 June 2001 to £9,629 million in the year ended 30 June 2002. This decrease was caused by a fall of £2,439 million in costs in

respect of Pillsbury, which was sold on 31 October 2001. Operating costs of premium drinks increased by £1,067 million. Operating costs in respect of Burger King increased £53 million to £988 million in the year ended 30 June 2002 due partly to a £44 million (15%) increase in staff costs.

**Continuing operations premium drinks** Operating costs of premium drinks increased by £1,067 million (17% on a reported basis) from £6,303 million to £7,370 million in the year ended 30 June 2002. Operating exceptional costs for continuing operations increased by £279 million from £153 million in the prior year to £432 million in the year ended 30 June 2002 (this is discussed under exceptional operating costs below).

Excluding the exceptional operating costs, continuing operating costs increased by £788 million (13% on a reported basis) from £6,150 million in the year ended 30 June 2001 to £6,938 million in the year ended 30 June 2002. The main reason for the increase was the effect of acquisitions, which contributed an additional £545 million to operating costs (principally Seagram £443 million). This was partially offset by reductions in costs from the movements in exchange rates of £44 million and from disposals of £138 million. Marketing investment increased by £147 million (15% on a reported basis) to £1,127 million. Marketing spend on

the global priority brands grew by 10% to £764 million, particularly behind Smirnoff Ice in North America, the Keep Walking campaign for Johnnie Walker, and continued investment behind the successful Let Your Senses Guide You campaign for Baileys.

**Operating profit before exceptional items**

**Overall** Operating profit before exceptional items increased £5 million from £2,101 million to £2,106 million. Premium drinks operating profit before exceptional items increased by £336 million, offset by decreases in respect of Pillsbury and Burger King of £315 million and £16 million, respectively.

**Continuing operations premium drinks** Premium drinks accounted for £1,766 million of the operating profit before exceptional items, compared with £1,430 million in the prior period, an increase of £336 million.

Acquisitions represent £148 million of this increase, of which the Seagram spirits and wine businesses acquired on 21 December 2001 account for £130 million, whilst disposals adversely impacted profit by £58 million. Sales of Captain Morgan Gold did not meet original expectations and the product was subsequently withdrawn from the market, and therefore the total Seagram operating profit of £130 million before exceptional items earned in the period is after a provision of £24 million for the potential diminution in the value of product stock. Captain Morgan Gold was launched in May 2002 and in the period volume was 245,000 equivalent units, net sales (after deducting excise duties) were £27 million and marketing costs were £16 million.

The balance of the increase in the premium drinks contribution to operating profit before exceptional items of £246 million was driven primarily by volume increases, an improvement in the operating margin before exceptional items which increased from 18.9% to 20.3%, and the beneficial impact of exchange rate movements of £57 million, comprising £26 million on translation of overseas profits and £31 million on transactions.

**Discontinued operations** Pillsbury contributed £184 million in operating profit before exceptional items for the four months prior to its disposal compared with £499 million in the year ended 30 June 2001. The decline in operating profit before exceptional items primarily reflecting the reduced period of ownership in the year ended 30 June 2002 (four months) compared to the prior year (12 months).

Burger King contributed £156 million to operating profit before exceptional items compared with £172 million in the prior year. Worldwide comparable restaurant sales were flat for the year against a 4% decline in the prior year. Net restaurant numbers increased by 83 against an increase of 211 in the prior year.

**Exceptional operating costs**

**Overall** Operating profit was impacted in the year by exceptional charges which amounted to £453 million in the year ended 30 June 2002 compared with £228 million in the year ended 30 June 2001. These exceptional charges primarily relate to integration and restructuring costs, a settlement in relation to José Cuervo, and costs of the quick service restaurants business. This increase in exceptional charges of £225 million accounts for the majority of the decrease in operating profit of £220 million.

**Continuing operations premium drinks** The restructuring cost for the year ended 30 June 2002 included £48 million (2001 £74 million) in respect of the integration of the UDV (spirits and wine) and the Guinness (beer) businesses to create premium drinks. Approximately £18 million (2001 £32 million) of the costs were employee related, principally redundancy,£9 million (2001 £9 million) were legal and professional costs, £nil (2001 £7 million) were asset write downs, and the balance included consultancy and systems costs. The £48 million (2001 £74 million) integration cost comprised £15 million (2001 £32 million) in respect of global corporate functions, £5 million (2001 £15 million) on the integration of UDV and Guinness businesses in Great Britain, £12 million (2001 £12 million) on business services and £16 million (2001 £15 million) in other countries around the world. Incremental synergy achieved in the year, as a result of the integration of UDV and Guinness businesses amounted to £43 million. As a result of the amount charged to the profit and loss account in the two years ended 30 June 2002, it is expected that 680 jobs will be lost, of which 340 had been terminated by 30 June 2002. The total costs of this integration were £170 million with the remaining charge incurred in 2003 as an operating exceptional item.

The restructuring cost for the year ended 30 June 2002 included £164 million in respect of the integration of the Seagram spirits and wine businesses. Approximately £72 million of the costs were employee related, principally redundancies, £10 million were legal and professional costs, £36 million were asset write downs, and the balance included consultancy and systems costs. Of the £164 million integration cost, £20 million was in respect of global corporate functions, £114 million on the integration of the Seagram businesses in North America, and £30 million in other countries around the world. As a result of the amount charged to the profit and loss account in the year ended 30 June 2002, it is expected that approximately 1,200 jobs will be lost of which some 1,050 had been terminated by 30 June 2002.

On 5 February 2002, it was announced that Diageo and José Cuervo SA (José Cuervo) had agreed to terminate their litigation in respect of a change of control issue which José Cuervo claimed arose as a result of the merger of GrandMet and Guinness, and new arrangements were formalised for the distribution rights for the José Cuervo brands in the United States which now extend to 2013. The settlement in favour of José Cuervo involved the return of the group s 45% interest in José Cuervo and a net cash payment of £85 million. The exceptional charge of £220 million (before tax) comprises the write off of the group s investment in José Cuervo of £115 million, related goodwill previously written off to reserves of £20 million and the net cash payment to José Cuervo.

In the year ended 30 June 2001, £79 million costs were incurred in the reorganisation of beer production facilities in England and Ireland and the restructuring of ownership and management within premium drinks. Included in the costs were £35 million of employee related costs, principally redundancy, and £26 million of tangible fixed asset write downs. The reorganisation included the closure of the Dundalk packaging plant in Ireland, the restructuring of the Dundalk brewery and Belfast packaging plant both in Ireland and the restructuring of the packaging plant in Runcorn in England. Jobs lost were approximately 550 of which 480 had been terminated by 30 June 2002.

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**Discontinued operations** During 2002, in anticipation of the disposal of the Burger King business, its franchisee loan financing arrangements were restructured. This resulted in an exceptional charge for credit enhancement, performance and service fees of £21 million. In 2001, the exceptional items in respect of Burger King comprised provisions of £49 million made against certain fixed assets, costs associated with litigation of £21 million, less £5 million of successor franchise fee income.

During the year ended 30 June 2001, packaged food incurred restructuring costs of £10 million in respect of production facilities in Pillsbury s Bakeries and Foodservice division that have been classified as exceptional operating costs.

**Associates**

The group s share of profits of associates after exceptional items but before interest was £283 million for the year ended 30 June 2002 compared with £203 million for the year ended 30 June 2001. The group s 22% equity interest in General Mills contributed £112 million in the eight months ended 30 June 2002. Share of the associates profits for the year ended 30 June 2002 was adversely impacted by exceptional charges of £41 million, including £31 million in respect of General Mills restructuring of the acquired Pillsbury business and of its cereal manufacturing operations and £10 million in respect of Moët Hennessy.

**Interest**

The interest charge in the year increased to £399 million from £350 million in the prior year. The net benefits of £45 million in respect of the disposal and acquisition of businesses and of £34 million from the reduction in interest rates were offset by other factors. These factors included the effect of exchange rate related movements of £35 million, the share of General Mills interest charge of £59 million (for the eight months ended 30 June 2002) and the funding of the share repurchases made during the year, which increased the interest charge by £20 million.

**Non operating exceptional items**

Non operating exceptional items include losses on disposals of fixed assets of £22 million compared with gains of £19 million in the prior year and net gains on the disposal of brands and businesses of £821 million in the year ended 30 June 2002 compared with net losses of £23 million in the year ended 30 June 2001.

Exceptional items in respect of the disposal of fixed assets in the year ended 30 June 2002, included losses of £23 million relating to the disposal of tangible fixed assets in quick service restaurants.

The disposal of the Malibu brand, which was a condition of the acquisition of the Seagram spirits and wine businesses, resulted in a gain before taxes of £532 million. Pillsbury was sold on 31 October 2001 and generated a gain before taxes of £322 million, after writing back goodwill previously written off to reserves of £1,671 million. Other disposals in the year ended 30 June 2002 included Glen Ellen wines in North America which resulted in a loss before tax of £52 million, Guinness World Records Ltd which resulted in a gain before tax of £35 million and others which resulted in a loss before tax of £16 million.

In the year ended 30 June 2001, the disposals of premium drinks brands in Latin America resulted in a profit of £28 million. Professional fees, retention bonuses and other costs totalling £51 million were incurred in the year relating to the Pillsbury/General Mills transaction.

**Taxation**

The group complied with FRS 19 Deferred tax for the first time during the year ended 30 June 2002. The effective rate of taxation on profit before exceptional items for the year ended 30 June 2002 was 25.2%, compared with 24.0% for the year ended 30 June 2001. The 2001 tax charge benefited from a two percentage point reduction, reflecting a low effective rate of taxation in respect of associated companies, which did not recur in 2002.

The effective rate of taxation on profit after exceptional items for the year ended 30 June 2002 was 27.1% compared with 25.3% for the year ended 30 June 2001.

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## Premium drinks

The following discussion provides additional commentary on the trading performance of the premium drinks business with the equivalent period in the prior year.

In the discussion movements are segregated between reported or organic performance. Reported means that the measure reflects movement in the number disclosed in the financial statements. Organic represents the movement excluding the impact of exchange, acquisitions and disposals. In the discussion under organic brand performance for each market, movements given for volume, turnover, net sales (after deducting excise duties) and marketing expenditure are organic movements. A further description of organic movement, how it is calculated and why it is considered useful for the reader is set out on pages 19 and 20.

The organic movement calculations for turnover, net sales (after deducting excise duties) and operating profit before exceptional items for the year ended 30 June 2002 were as follows:

| | 2001 Reported £ million | Exchange £ million | Disposals £ million | **Acquisitions £ million** | **Organic movement £ million** | **2002 Reported £ million** | **Organic movement %** |
|---|---|---|---|---|---|---|---|
| **Turnover** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 2,092 | 38 | (134) | **431** | **242** | **2,669** | **12** |
| Great Britain | 1,304 | | (22) | **8** | **177** | **1,467** | **14** |
| Ireland | 942 | 8 | (1) | **1** | **(13)** | **937** | **(1)** |
| Spain | 335 | 3 | (1) | **18** | **25** | **380** | **7** |
| | 4,673 | 49 | (158) | **458** | **431** | **5,453** | **9** |
| Key markets | 1,807 | (37) | (30) | **227** | **111** | **2,078** | **6** |
| Venture markets | 1,100 | 1 | (8) | **8** | **72** | **1,173** | **7** |
| **Total premium drinks** | 7,580 | 13 | (196) | **693** | **614** | **8,704** | **8** |
| **Net sales (after deducting excise duties)** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 1,741 | 35 | (119) | **362** | **211** | **2,230** | **13** |
| Great Britain | 797 | | (18) | **5** | **112** | **896** | **14** |
| Ireland | 627 | 5 | (1) | **1** | **(7)** | **625** | **(1)** |
| Spain | 262 | 2 | (1) | **13** | **22** | **298** | **8** |
| | 3,427 | 42 | (139) | **381** | **338** | **4,049** | **10** |
| Key markets | 1,450 | (27) | (22) | **136** | **94** | **1,631** | **7** |
| Venture markets | 845 | | (7) | **6** | **61** | **905** | **7** |
| **Total premium drinks** | 5,722 | 15 | (168) | **523** | **493** | **6,585** | **9** |
| Excise duties | 1,858 | | | | | **2,119** | |
| **Turnover** | 7,580 | | | | | **8,704** | |
| **Operating profit before exceptional items** | | | | | | | |
| Major markets: | | | | | | | |
| North America | 363 | 65 | (39) | **95** | **66** | **550** | **17** |
| Great Britain | 162 | | (7) | **3** | **46** | **204** | **30** |
| Ireland | 155 | (8) | | | **4** | **151** | **3** |
| Spain | 85 | (2) | | **7** | **4** | **94** | **5** |
| | 765 | 55 | (46) | **105** | **120** | **999** | **16** |
| Key markets | 447 | 2 | (10) | **41** | **44** | **524** | **10** |
| Venture markets | 218 | | (2) | **2** | **25** | **243** | **12** |
| **Total premium drinks** | 1,430 | 57 | (58) | **148** | **189** | **1,766** | **13** |

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Notes

(1) The exchange adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items are principally in respect of the US dollar.

(2) Disposal adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in relation to the termination of the distribution rights for Stolichnaya vodka in the United States (£94 million, £81 million, £32 million); the sale of Croft and Delaforce port and sherry brands (£18 million, £14 million, £7 million); the disposal of Malibu rum (£12 million, £11 million, £6 million); the sale of Glen Ellen wines (£15 million, £14 million, £2 million); the disposal of Guinness World Records (£22 million, £22 million, £4 million); the sale of Dreher brands in Brazil (£24 million, £16 million, £6 million); and other disposals (£11 million, £10 million, £1 million).

(3) Acquisition adjustments for turnover, net sales (after deducting excise duties) and operating profit before exceptional items respectively were in relation to the purchase of the Seagram spirits and wine businesses (£573 million, £451 million, £130 million); and the acquisition of further equity interests in former associated companies which are now subsidiaries (£120 million, £72 million, £18 million).

(4) In the calculation of operating profit before exceptional items the overheads included in disposals and acquisitions were directly attributable to those businesses and do not result from subjective judgements of management.

(5) The organic movement percentage is the amount in the column headed organic movement in the table above expressed as a percentage of the aggregate of the first three columns. The basis of the calculation of the organic movement is explained on page 20.

***Organic brand performance:***

| | Equivalent units millions | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|---|
| Smirnoff | 21.8 | 21 | 42 |
| Johnnie Walker | 10.6 | 1 | 4 |
| Guinness | 11.1 | | 5 |
| Baileys | 5.7 | 10 | 9 |
| J B | 6.3 | 2 | 3 |
| José Cuervo | 4.2 | (2) | 2 |
| Tanqueray | 1.9 | | 1 |
| Malibu (sold 22 May 2002) | 2.2 | 7 | 6 |
| **Total global priority brands** | 63.8 | 8 | 13 |
| **Local priority brands** | 13.8 | 2 | 10 |
| **Category brands** | 26.6 | (4) | (1) |
| | 104.2 | 4 | 9 |
| **Acquisitions** | | | |
| Seagram brands | 7.5 | | |
| Other | 2.0 | | |
| **Total** | 113.7 | | |

**Analysis by individual markets**

**North America**

***Key measures:***

| | 2002 £ million | 2001 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | 18 | 7 |
| Turnover | 2,669 | 2,092 | 28 | 12 |
| Net sales (after deducting excise duties) | 2,230 | 1,741 | 28 | 13 |
| Marketing | 408 | 302 | 35 | 15 |
| Operating profit before exceptional items | 550 | 363 | 52 | 17 |

***Reported performance*** Turnover in North America increased 28% on a reported basis from £2,092 million in the year ended 30 June 2001 to £2,669 million in the year ended 30 June 2002. Net sales (after deducting excise duties), a non-GAAP measure, increased from £1,741 million to £2,230 million, an increase of 28%. Operating profit before exceptional items increased from £363 million to £550 million, an increase of £187 million.

***Organic performance*** These increases were primarily due to acquisitions, which contributed an additional £431 million to turnover, £362 million to net sales (after deducting excise duties) and £95 million to operating profit before exceptional items compared with the prior year. The increases, were principally generated by the brands acquired with Seagram. These were partly offset by the effect of disposals, which in the year ended 30 June 2001 contributed an incremental £134 million, £119 million and £39 million to turnover, net sales (after deducting excise duties) and operating profit before exceptional items, respectively. This disposal impact is primarily attributable to the termination of the distribution rights for Stolichnaya in the year ended 30 June 2001 (£94 million, £81 million and £32 million impact on turnover, net sales (after deducting excise duties) and operating profit before exceptional items, respectively) and to the disposal of the GlenEllen wine business which completed in May 2002 (£15 million, £14 million and £2 million impact on turnover, net sales (after deducting excise duties) and operating profit before exceptional items, respectively).

The US dollar was relatively stable against sterling, with the average rate moving from £1 = $1.45 to £1 = $1.44. After taking account of the effect of the group s hedges (see Liquidity and capital resources Currency risk ) exchange had a limited beneficial impact on reported turnover and net sales (after deducting excise duties) (£38 million and £35 million respectively). However, the beneficial impact on operating profit before exceptional items, affected by the losses arising from currency translation hedging arrangements in the year ended 30 June 2001, was more significant (£65 million).

***Organic brand performance:***

| | Volume movement % | Net sales (after deducting excise duties) movement % |
|---|---|---|
| Smirnoff | **34** | **68** |
| Johnnie Walker | **1** | **6** |
| José Cuervo | | **3** |
| Baileys | **7** | **4** |
| Tanqueray | **(2)** | **(1)** |
| Guinness | **(1)** | **9** |
| J B | **(10)** | **(7)** |
| **Total global priority brands** | **14** | **22** |
| **Local priority brands** | | **(3)** |
| **Category brands** | **(5)** | **(7)** |
| **Total** | **7** | **13** |

Volume of global priority brands up 14%

Growth of new products and improvements in product mix

Global priority brands posted strong growth, with volume up 14% over the prior year. The growth principally comprised strong performances by Smirnoff, Baileys and Johnnie Walker Black Label. Volume of J B, Tanqueray, Johnnie Walker Red Label and Guinness declined.

Marketing spend increased over the prior year, by 15%, driven by investment in Smirnoff Ice as well as increases in Johnnie Walker Black Label, Malibu and Tanqueray.

Smirnoff continued to lead the global priority brand growth with strong performance in the core brand, where volume was up 9%, and strong growth in Smirnoff Flavours and Smirnoff Ice. Total net sales (after deducting excise duties) growth was therefore 68%. Smirnoff Ice has continued to show strong growth since its launch in January 2001 and volume grew from 1.1 million equivalent units in the year ended 30 June 2001 to 2.8 million equivalent units.

Guinness net sales (after deducting excise duties) grew 9% despite a 1% volume decline, due to price increases and a favourable product mix. In its first nine months in the market, Guinness Draught in Bottles represented more than 10% of total Guinness volume in the North American market.

Johnnie Walker total volume grew 1%, whilst net sales (after deducting excise duties) grew 6% during the year due to a favourable mix between Johnnie Walker Black Label, which grew net sales (after deducting excise duties) 11%, and Johnnie Walker Red Label, where net sales (after deducting excise duties) declined 1%.

Baileys volume grew by 7% during the year however net sales (after deducting excise duties) growth was impacted by the introduction of trial packaging formats and grew 4%.

Volume of J B declined 10% in the year and net sales (after deducting excise duties) were down 7% as a result of price increases. Contribution after marketing improved, mainly as a result of reduction in marketing spend.

Tanqueray volume declined by 2% while net sales (after deducting excise duties) declined only 1% as a result of a change in product mix to more profitable product sizes and growing on-premise sales.

José Cuervo volume was level for the year with net sales (after deducting excise duties) up 3% following the prior year s price increases to cover the rising agave prices. Towards the end of the year, volume performance improved following selective price reductions.

Volume of Captain Morgan, a former Seagram brand, was level in the year ended 30 June 2002 versus the year ended 30 June 2001, as a result of substantial de-stocking of the brand. On a depletion basis, against the six months ended 30 June 2001, volume was up 9%. Captain Morgan gained 0.4 market share percentage points in the growing US rum category. The brand is responding well to renewed distributor focus.

Volume of Crown Royal, another former Seagram brand, declined 2% in the six months ended 30 June 2002, again as a result of de-stocking and depletions were up 1%.

Some of the local priority brands showed weak performance with volume declines in Gordon s gin and Goldschlager. Overall, volume was level and net sales (after deducting excise duties) declined 3% during the year. Category brands such as Popov and Gordon s vodka also declined during the year, with volume down 5% and net sales (after deducting excise duties) down 7%.

***Other business performance drivers*** Innovation continued to impact the North American performance positively. During the year, Smirnoff Ice volume showed strong selling growth, with the brand achieving a market share of approximately 1% of the US beer market and maintaining its position as the number one selling ready to drink brand. Smirnoff Ice now represents nearly one-third of the segment after just 18 months in the market. New product formats such as the 24-ounce format performed very well, as did the 16-ounce PET format that can be sold in sites where glass bottles are forbidden, such as sports arenas. The Smirnoff Ice six-pack is now number one in terms of dollar sales of premium beer in the grocery channel. Launched in September 2001, Guinness Draught in Bottles has exceeded initial targets for the brand with volume of over 100,000 equivalent units. Smirnoff Twist volume more than doubled to over 700,000 equivalent units.

The former Seagram wine business was transitioned into a new business, Diageo Chateau & Estates Wines, combining the Seagram and existing Diageo wine businesses in North America.

Diageo s North American business has achieved substantial progress on its strategic agenda over the year. Most notably, the Next Generation Growth (NGG) strategy was launched in the year. See Business description Premium drinks North America for further information.

**Great Britain**

***Key measures:***

| | 2002 £ million | 2001 £ million | Reported movement % | Organic movement % |
|---|---|---|---|---|
| Volume | | | **9** | **11** |
| Turnover | **1,467** | 1,304 | **13** | **14** |
| Net sales (after deducting excise duties) | **896** | 797 | **12** | **14** |
| Marketing | **188** | 169 | **11** | **13** |
| Operating profit before exceptional items | **204** | 162 | **26** | **30** |

***Reported performance*** Great Britain showed a very strong performance in the year ended 30 June 2002. Turnover was up 13% on a reported basis from £1,304 million to £1,467 million. Net sales (after deducting excise duties), a non-GAAP measure, were up £99 million (12%) to £896 million and operating profit before exceptional items increased 26% on a reported basis from £162 million in the year ended 30 June 2001 to £204 million in the year ended 30 June 2002.

***Organic performance*** The principal driver of this performance was organic growth, contributing £177 million to the turnover improvement, £112 million to the net sales (after deducting excise duties) growth and £46 million to the rise in operating profit before exceptional items.

The impact of the Seagram brands acquired was minimal, although disposals, principally the Malibu brand in May 2002 and Guinness World Records in July 2001, adversely affected turnover, net sales (after deducting excise duties) and operating profit before exceptional items by £22 million,£18 million and £7 million, respectively. There was no impact from exchange rate movements.

***Organic brand performance:***

| | Volume | Net sales (after deducting excise duties) |
|---|---|---|

| | movement<br>% | movement<br>% |
|---|---|---|
| Smirnoff | **15** | **15** |
| Guinness | | **1** |
| Baileys | **27** | **18** |
| **Total global priority brands** | **9** | **9** |
| **Local priority brands** | **14** | **28** |
| **Category brands** | **12** | **18** |
| **Total** | **11** | **14** |

Growth of global priority brands with volume up 9%

14% volume growth of the local priority brands

Favourable product mix

Key growth drivers were an increase in marketing spend, up 13% during the year and successful innovation. Three global priority brands, Smirnoff Red, Baileys and Johnnie Walker, continued to improve on the prior year s strong performance.

Smirnoff Red is the number one spirit in the GB market and volume was up 15% with net sales (after deducting excise duties) up 15%. Market share in the vodka category increased to 34%.

Baileys showed net sales (after deducting excise duties) growth of 18%, suggesting that the brand is beginning to benefit from marketing aimed at reducing the seasonality of the product.

Johnnie Walker, which sold over 50,000 equivalent units in Great Britain, had net sales (after deducting excise duties) growth of 16% during the year following an increase in marketing spend.

Other brands also performed well. While Guinness volume was level due to weakness in the overall beer category, market share increased in the on trade beer sector. Bell s volume grew 4% and Gordon s grew 7%. Pimm s, another local priority brand, showed strong growth, with volume up 18%, as innovation such as Pimm s Draught broadened the reach of the brand. In addition, the Diageo wine portfolio had an excellent year, with Blossom Hill volume growing 45%.

***Other business performance drivers*** Innovation was an important element of the overall growth. There were new Smirnoff Ice offerings, including new pack formats such as multi-packs and a larger 70cl bottle. Gordon s Edge and Archers Aqua Raspberry were also launched in the year. Great Britain has shown great success in the ready to drink category. Smirnoff Ice volume was up 19% year on year, significantly outpacing the growing ready to drink category and market share grew to 28%. Archers Aqua volume grew 179,000 equivalent units, up from 41,000 equivalent units in the prior year. In April 2002, the excise duty rate for ready to drink products was increased and was passed through into an increase in retail prices. Subsequent market data suggests a negative impact on rate of sale in the on trade across the category as a consequence. Diageo has already responded to this new challenge with the launch in August of Smirnoff Black Ice, a new vodka-based ready to drink designed to appeal to male consumers, and increased marketing support behind Archers Aqua and Smirnoff Ice.

## Ireland

***Key measures:***

| | **2002 £ million** | 2001 £ million | **Reported movement %** | **Organic movement %** |
|---|---|---|---|---|
| Volume | | | **(1)** | |
| Turnover | **937** | 942 | **(1)** | **(1)** |
| Net sales(after deducting excise duties) | **625** | 627 | | **(1)** |
| Marketing | **65** | 63 | **3** | **3** |
| Operating profit before exceptional items | **151** | 155 | | |