

Making occasions special  
Every day, everywhere  
2000 Annual Report and Accounts

DIAGEO



Statements by the Chairman and the Group Chief Executive are included in a separate document entitled 2000 Annual Review. That document and this Annual Report and Accounts together comprise the full annual reports and accounts of Diageo plc for the year ended 30 June 2000.

|                                |
|--------------------------------|
| Contents                       |
| Operating and financial review |
| 01 Results summary             |
| Operating review               |
| 05 Financial review            |
| Directors' reports             |
| 08 Directors' report           |
| 09 Corporate governance report |
| 11 Remuneration report         |

|   |
|---|
| Financial statements  |
| 17 Directors' responsibilities                              |
| Report of the auditors                                      |
| 18 Consolidated profit and loss account                     |
| Consolidated statement of total recognised gains and losses |
| Notes of consolidated historical cost profits and losses    |
| 19 Consolidated balance sheet                               |
| 20 Consolidated cash flow statement                         |
| 21 Accounting policies                                      |
| 23 Notes to the consolidated accounts                       |
| 38 Company balance sheet                                    |
| 39 Notes to the company balance sheet                       |
| 41 Principal group companies                                |

# Operating and financial review

## Results summary

Turnover for the year ended 30 June 2000 was £11,870 million compared with £11,795 million for the year ended 30 June 1999. Group operating profit before goodwill amortisation and exceptional items for the year was £1,980 million compared with £1,903 million for 1999. There was a £347 million charge for exceptional items before tax and £17 million of goodwill amortisation. Profit before tax for the year was £1,451 million compared with £1,467 million for the prior year. After dividends of £713 million, retained earnings were £263 million.

## Highlights

### Operating profit growth for the year ended 30 June 2000

|                           | Operating profit<br>£ million | Organic growth<br>at level<br>exchange<br>% |
|---------------------------|-------------------------------|---|
| Spirits and Wine          | 1,002                         | 15  |
| Beer                      | 284                           | 14  |
| Packaged Food             | 492                           | 1   |
| Quick Service Restaurants | 202                           | 6   |
|                           | 1,980                         | 11  |

Unless otherwise stated percentage movements for turnover, operating profit and marketing expenditure throughout the operating and financial review are organic movements (at level exchange and after adjusting for acquisitions and disposals). They include merger synergy achieved in the year and are before goodwill amortisation and exceptional items. Comparisons are with the equivalent period last year.

## Operating review

### Spirits and Wine

- > Volume up 2%
- > Volume of the global priority brands up 5%
- > Turnover up 8%
- > Marketing expenditure up 12%
- > Marketing expenditure up 19% on global priority brands
- > Operating profit growth 15% to £1,002 million
- > Operating margin up 1.4 percentage points at 20.2%

### Organic volume growth was 2%

Organic volume growth was 2%, driven by growth in the spirits portfolio of brands owned at the year end of 4%. Wine volume was down 7%.

|   | Volume growth<br>% | Share of total volume<br>% |
|---|--------------------|----------------------------|
| Global priority brands excluding ready to drink | 5                  | 51                         |
| Local priority brand market units               | 9                  | 15                         |
| Category management and other spirits brands    | (2)                | 20                         |
| Total spirits (continuing brands)               | 4                  | 86                         |
| Wine  | (7)                | 11                         |
| Disposal brands                                 | (10)               | 3                          |
| Total Spirits and Wine volume                   | 2                  | 100                        |

### Turnover increased 8% on an organic basis

Reported turnover was £4,971 million (1999 – £4,929 million), an increase of 1%. Organic growth of 8% offset a £276 million reduction due to brand disposals made since the beginning of the prior year.

### Mix and price improvements have contributed 6 percentage points of the organic growth in turnover

In a very competitive and sophisticated market place, the incremental investment in marketing made behind individual brands has led to further selective price increases during the year and strong volume growth of the global priority brands across the majority of regions. The successful launch of new products such as Smirnoff Ice has also led to improved mix.

### Marketing spend increased 12% on an organic basis

Reported investment in marketing was up 7% to £679 million (1999 – £633 million). Organic growth of 12% was offset by a reduction of £20 million in respect of disposals made since the beginning of the prior year. Marketing spend on the global priority brands was up 19% and now represents 69% of total UDV spend, up 4 percentage points over the prior year. Marketing spend on other spirits brands was up 2%.

### The performance of the global priority brands continues to improve strongly to over 50 million cases

The performance of the global priority brands for the year ended 30 June 2000 has strengthened further in the year on all measures including volume, up 5% excluding ready to drink (RTD) formats and up 6% including RTD at equivalent units. This improvement in performance was most marked in the United States, United Kingdom and Spain, where volume of the global priority brands increased by 7%. Net sales (i.e. sales excluding excise duty) were up 9% and contribution after marketing grew 6% on the global priority brands. Further price increases were achieved in the year and these, together with the benefits of price increases implemented in the prior year, have led to significant growth in net sales as the chart below shows:

|  | Cases<br>million* | Volume<br>growth*<br>% | Net sales<br>growth*<br>% |
|--|-------------------|------------------------|---------------------------|
| Johnnie Walker Black and Deluxe Labels | 3.4               | 7                      | 9                         |
| Johnnie Walker Red Label               | 6.9               | 5                      | 5                         |
| Smirnoff                               | 15.9              | 4                      | 11                        |
| J&B Rare                               | 6.0               | 1                      | 4                         |
| Baileys                                | 4.7               | 8                      | 14                        |
| Cuervo                                 | 4.3               | 13                     | 19                        |
| Tanqueray                              | 1.8               | 2                      | 6                         |
| Malibu                                 | 2.0               | 12                     | 15                        |
| Gordon's                               | 5.2               | 4                      | 4                         |

\*Excluding RTD

### Local priority brands also continued to improve with net sales up 21%

Local priority brand market units have again performed very strongly with volume up 9% and net sales up 21%, supported by incremental marketing spend which was up 21%. The key drivers include Dimple in Korea, which has continued to grow strongly, Stolichnaya in the United States, which grew volume by 22% and net sales by 26%, and Smirnoff Ice in the United Kingdom.

Operating profit increased 15% on an organic basis

|               | Operating profit<br>£ million | Organic growth<br>% |
|---------------|-------------------------------|---------------------|
| Europe        | 379                           | 12                  |
| North America | 318                           | 13                  |
| Asia Pacific  | 124                           | 41                  |
| Latin America | 126                           | 9                   |
| Rest of World | 55                            | 25                  |
|               | 1,002                         | 15                  |

Reported operating profit was £1,002 million (1999 – £967 million), an increase of 4%. Organic growth of 15% was partly offset by a £69 million reduction in operating profit due to brand disposals made since the beginning of the prior year.

**In Europe, volume grew 4% and net sales were up 12%**

Total volume in Europe grew 4%, driven by global priority brands up 6% and the successful launch of new ready to drink products such as Gordon's Space and Smirnoff Ice. Price harmonisation across the region was supported by focused marketing investment. The one-off uplift due to the millennium, which was estimated to have benefited operating profit by £10 million, was offset by the abolition of intra-EU duty free allowances from 1 July 1999.

**UK performance was driven by 17% volume growth led by key brands and the successful launch of Smirnoff Ice**

All the global priority brands performed well in the UK in the year. The UK spirits market grew in the year and was particularly strong in the categories in which UDV leads. The vodka category grew over 10%, the liqueur category grew more than 15% and speciality drinks grew over 5%. This category growth was driven by UDV brands. Smirnoff volume was up 13% and its market share of branded vodka grew 8 percentage points to 68%. While about a quarter of this growth was attributable to the one-off increase in demand around the millennium, the majority was due to distribution gains and marketing spend including the new 'No imperfections' campaign. Baileys volume grew 21% as the brand is being successfully repositioned away from its traditional seasonal bias. With only about one-third of this growth due to the millennium, the further sustained growth of the brand was driven by successful advertising around 'The Thief' campaign and extensive sampling.

|  | Volume growth*<br>% | Net sales growth*<br>% |
|--|---------------------|------------------------|
| Johnnie Walker Black and Deluxe Labels | 35                  | 32                     |
| Johnnie Walker Red Label               | n/a                 | n/a                    |
| Smirnoff                               | 13                  | 14                     |
| J&B Rare                               | 30                  | 32                     |
| Baileys                                | 21                  | 20                     |
| Cuervo                                 | 23                  | 24                     |
| Tanqueray                              | 44                  | 44                     |
| Malibu                                 | 3                   | 3                      |
| Gordon's                               | 9                   | 8                      |

\*Excluding RTD

In its first year, Smirnoff Ice has sold 124 million bottles and, including ready to drink volume at equivalent units, total Smirnoff volume in the United Kingdom improved by 33%.

**In Spain, strong growth in the global priority brands has also delivered continued improved performance**

Total volume growth in Spain was 12%, led by 12% volume growth of the global priority brands as shown in the table below:

|  | Volume growth*<br>% | Net sales growth*<br>% |
|--|---------------------|------------------------|
| Johnnie Walker Black and Deluxe Labels | 71                  | 68                     |
| Johnnie Walker Red Label               | 8                   | 11                     |
| Smirnoff                               | 15                  | 31                     |
| J&B Rare                               | 10                  | 12                     |
| Baileys                                | 9                   | 16                     |
| Cuervo                                 | 28                  | 31                     |
| Tanqueray                              | 14                  | 18                     |
| Malibu                                 | 45                  | 52                     |
| Gordon's                               | 7                   | 15                     |

\*Excluding RTD

Price increases were implemented on most brands at between 3% and 7% of net sales. This had an impact on volume growth in the second half; however, continued focused advertising, mainly behind the priority brands, ensured that net sales continued to grow strongly.

**The withdrawal of intra-EU duty free reduced total Spirits and Wine volume by 2%**

The withdrawal of intra-EU duty free in July 1999 is estimated to have resulted in a net reduction of 1.4 million cases, of which 900,000 cases related to the global priority brands, and a £14 million reduction in contribution after marketing.

**In North America, strong sales growth in the global priority brands has continued to drive operating profit growth, up 13% in the year**

Reported operating profit was flat year on year at £318 million. On an organic basis, volume was flat with spirits up 4% and wine down 15%. Volume growth of 4% and price increases of 4% on the global priority brands, which represent about 60% of total net sales, contributed to strong sales growth, up 6% on an organic basis. On a reported basis, sales were down 2% to £1,488 million (1999 – £1,512 million) due mainly to disposals. Marketing spend increased 6% on an organic basis and marketing investment behind the global priority brands grew 17%.

Growth of the global priority brands in North America is shown below:

|  | Volume growth*<br>% | Net sales growth*<br>% |
|--|---------------------|------------------------|
| Johnnie Walker Black and Deluxe Labels | 14                  | 17                     |
| Johnnie Walker Red Label               | (1)                 | (1)                    |
| Smirnoff                               | –                   | 11                     |
| J&B Rare                               | (15)                | (10)                   |
| Baileys                                | 10                  | 9                      |
| Cuervo                                 | 14                  | 20                     |
| Tanqueray                              | 3                   | 7                      |
| Malibu                                 | 22                  | 26                     |
| Gordon's                               | (7)                 | (1)                    |

\*Excluding RTD

As the table shows, the Johnnie Walker brands in total continued to perform strongly on the back of further significant incremental marketing investment, up 7% this year following an 8% increase in the previous year. Marketing investment has been focused on the Black and Deluxe Labels of the Johnnie Walker brand in the United States with spend there up 25%. Therefore, despite a small decline in volume and net sales of Johnnie Walker Red Label, net sales of the Johnnie Walker brand have increased

9% year on year and contribution after advertising and promotion has increased over 13%. Volume performance in Smirnoff exceeded expectations as, despite a 12% price increase in the second half as part of a process to reposition the brand, volume was flat with an 11% increase in net sales. Volume of J&B Rare continued to decline overall although marketing spend has increased by over 50% in the year behind the new marketing campaign. This campaign, targeted towards 24–28 year old males, is driving incremental volume up 12% in those test markets against a year ago and up 18% in the on trade in these markets.

Baileys volume improved 10% as the brand was repositioned away from a special occasion image. In some markets the price was reduced to reflect this. The new market positioning has been successful and contribution after marketing increased about 20%. Volume and net sales of Cuervo grew, despite competition from lower priced competitors, as a result of strong performance from Cuervo 1800 and price increases of 2%. The agave shortage, which did not impact Cuervo in the year, is being closely managed. Volume of Tanqueray was up, despite a reduction in stock levels, and net sales increased due to price increases and the successful launch of Tanqueray No. TEN in the year.

#### Economic recovery in Asia Pacific has led to recovery in the premium spirits market

Operating profit was up over 40% in Asia Pacific to £124 million. This has been driven by strong volume recovery in premium brands. In Thailand, Johnnie Walker continues to lead the premium and standard Scotch categories with volume of Johnnie Walker Red Label up 16% and Black and Deluxe Labels up 11%. In the secondary Scotch category, Spey Royal volume increased by 50% and net sales increased 60%. In Korea, Dimple grew market share in the premium category by 4 percentage points to 29% with volume up over 80%. In Taiwan, the Johnnie Walker Deluxe Labels all grew market share. Sales of Johnnie Walker Black and Deluxe Labels continued to improve throughout the year and volume was up 21% year on year. In Japan, the market has continued to move away from premium products and volume of Old Parr and Johnnie Walker Black Label has continued to decline in line with the market. In Australia, Bundaberg, Baileys and Johnnie Walker continued to perform well. The spirits based ready to drink category remains an important part of the total beverage alcohol market, representing nearly half of total spirits economic profit in Australia. A decline in the volume of Stoli Lemon Ruski against the previous year adversely affected market share in this category, however, Bundaberg Gold and Cola and UDL grew volume by 21% and 5% respectively. This category will benefit in the coming year from duty changes, resulting in parity with beer, and further new brand introductions.

#### In Latin America, reduced overheads led to a 9% increase in organic operating profit despite a 7% decline in sales

The economic situation in Latin America remained difficult throughout the year. However, there are signs of some improvement, particularly in the two largest economies, Brazil and Mexico. Brazil is recovering well following the devaluation of January 1999 and Mexico is benefiting from continued growth in the US economy. Colombia and Venezuela, however, have continued in recession. Overall, volume in priority brands fell year on year, though market share gains were achieved across most brands and markets. In Brazil, Johnnie Walker Red Label was up 6%, Smirnoff up 7% and Baileys up 29%. In Venezuela, the local priority brands, Buchanans and Old Parr, showed strong growth, as did Johnnie Walker and Baileys in Mexico and Baileys and Johnnie Walker Red Label in Colombia.

#### In Rest of World, operating profit increased by 25% due to continued margin improvement and strategic restructuring

In Rest of World, turnover grew by 6% and operating profit grew by 25%. Increased focus on higher margin brands in many markets improved overall mix. In addition, the restructuring of operations in Russia resulted in increased volume of imported brands and delivered significant overhead savings.

#### Premium wines continue to perform well but weakness in low margin categories led to a decline in total wine volume

Full year volume for wine brands declined by 7%. The Beaulieu Vineyards brand continued to gain distribution in the United States and benefited from price rises. However, Glen Ellen and Blossom Hill in the United States face increased competition at the lower end of the market and volume has declined and marketing spend was reduced. Increased advertising and promotion for Blossom Hill in the United Kingdom and Ireland has been successful in increasing distribution and volume.

#### Beer

- > Total volume up 1%, with Guinness volume up 2%
- > Turnover up 3%
- > Marketing expenditure up 5%
- > Operating profit growth 14% to £284 million
- > Operating margin up 1.2 percentage points at 13.2%

#### Turnover increased 3% on an organic basis

Reported turnover was £2,146 million (1999 – £2,234 million), down 4%. The disposal of Cruzcampo in January 2000 reduced turnover by £118 million and adverse exchange rate movements, in particular the euro, reduced turnover by over £100 million. Turnover benefited by £63 million over last year following the acquisition of United Beverages Holdings in March 1999.

#### Guinness brand volume up 2%

Comparable total volume was up 1% in the year. Guinness volume continued to grow, although the reported increase for the year slowed due to the decline in volume in Ireland and the decision to reduce stock levels in the United States as a new logistics network was introduced. Organic volume growth by region was as follows:

|                                | Total volume % | Guinness % |
|--------------------------------|----------------|------------|
| Ireland                        | (1)            | (4)        |
| Great Britain                  | 2              | 3          |
| Africa                         | 4              | 7          |
| United States                  | 4              | (1)        |
| Asia Pacific                   | (3)            | 2          |
| Other (including discontinued) | 1              | 2          |
| Total                          | 1              | 2          |

#### Organic operating profit growth was 14%

Operating profit grew to £284 million (1999 – £273 million) as continued operating profit growth in Europe offset the impact of the disposal of Cruzcampo during the year.

#### In Ireland, operating profit grew as a result of overhead reductions despite a 1% decline in volume

In Ireland, total volume was down 1% and Guinness volume was down 4%, reflecting the changes in the beverage alcohol market in both the Republic of Ireland and in Northern Ireland. In Northern Ireland, total volume was down 8% and Guinness volume was down 10% due to a shift out of beer to spirits based options. In the Republic of Ireland, total volume grew 1%, which was broadly in line with the overall beer market. However, there has been a marked decline over the last 18 months in the draught beer market where Guinness is strongest as a result of a considerable reduction in the level of pub visits by consumers. This change is being addressed and Guinness marketing investment is now being spent on a programme to make the brand increasingly relevant to a younger customer – 18–34 year old men and women. The 'Live Life to the Power of Guinness' campaign, which began in July 1999, achieved significant changes in brand perception and has made the brand more youthful and approachable. In June 2000, a unique recruitment initiative 'Witness' was introduced targeted at this younger consumer, creating experiences with which to drive adoption of the Guinness brand. Price increases had a favourable impact on profit in the year. Marketing spend was increased but cost reductions have led to margin improvement and operating profit was up.



### In Great Britain, Guinness volume growth of 3% continued to drive profitable growth

Guinness Great Britain performed strongly with total volume for the year up 2% and Guinness up 3%. While the on trade beer market declined 5%, Guinness Draught performed well and volume was up 1% and market share increased. In the off trade, Guinness volume growth was in line with the market and market share was maintained.

Volume growth, reflecting the success of the Rugby World Cup sponsorship, improved sales mix with the focus on Guinness, and price increases in May 1999 and April 2000 led to significant operating profit growth. Marketing investment on the Guinness brand has increased although overall spend declined following the licensing of Harp. Savings in overheads further contributed to profit growth.

### In Africa, operating profit increased due to continued volume growth despite worsening economic conditions

In Africa, total volume was up 4%, due mainly to growth in Nigeria and Ghana, where total volume for each market was up 8%. Guinness volume grew 7% for the year, reflecting strong performances across all subsidiaries. Operating profit again grew significantly despite worsening economic situations in a number of markets. In Nigeria, Guinness volume was up 12% despite the re-introduction of excise duty in January 2000. In Ghana, Guinness volume grew 2% despite significant price increases taken following the rapid devaluation of the local currency.

### In the United States, Guinness continued to increase market share

In the United States depletions were up 10% with Guinness Draught up 12% for the year. Shipments were up 4% in total and down 1% for Guinness as a result of changes introduced in the first half to the logistics network to reduce stock levels at wholesalers. This decision, which led to improved product quality, resulted in inventory reduction of almost 20% overall and of nearly 30% on Guinness. A decision has been made to move forward with the rollout of warehouses nationwide by the end of 2000. This is not expected to have a significant impact on shipment volume next year given that much of the change in stock levels has already been effected at the wholesaler level. Operating profit growth of 20% has been achieved as a result of volume growth and cost savings. Marketing investment was down 8% on the prior year due to purchasing efficiencies and a decision to defer funds to invest behind new promotional opportunities taking place next year. In the coming year, Harp and bottled Guinness Extra will be brewed under contract in Canada for the North American market and this will further improve the profitability of those brands and hence the North American business.

### In Asia Pacific, operating profit has declined as a result of lower volume

Total volume for the year was down 3% with Guinness volume up 2%. Strong growth in Indonesia partially offset the impact of overall market decline in Malaysia and Singapore. In Malaysia, declining retail consumption together with a reduction of wholesaler stock levels resulted in overall volume down 6%. Guinness, however, performed well and volume was up 1% despite increased competition. In Singapore, total volume was down 10% and Guinness volume was down 9% against a market decline of 3%. Indonesia has delivered strong volume growth in a difficult economic environment and Guinness volume was up 5% in the year.

### Packaged Food

- > Volume down 1%
- > Turnover level at £3,812 million
- > Marketing expenditure up 4%
- > Operating profit up 1% to £492 million
- > Operating margin up 0.2 percentage points at 12.9%

### Turnover was in line with prior year on an organic basis

Turnover was £3,812 million (1999 – £3,757 million). The disposal of non-core brands in the last financial year and the formation in October 1999 of Ice Cream Partners, the joint venture with Nestlé for Häagen-Dazs in the United States, resulted in a decline in turnover of £219 million while the Foodservice and other acquisitions increased turnover in the year by £207 million. Volume declined 1% on an organic basis. In Pillsbury North America, volume and sales declined 2% reflecting the strong competitive environment.

### Operating profit was up 1% on an organic basis and marketing spend increased by 4%

Reported operating profit was £492 million (1999 – £478 million), an increase of 3%. On an organic basis operating profit was up 1% and marketing spend increased by 4% to £774 million (1999 – £740 million). Marketing as a percentage of sales increased 0.8 percentage points against last year.

### Sales and consumer takeaway trends for Pillsbury North America

|                                | Pillsbury<br>N A sales<br>growth<br>% | Category<br>growth<br>% | Pillsbury<br>N A<br>consumer<br>takeaway<br>growth<br>% |
|--------------------------------|---------------------------------------|-------------------------|---|
| Dough products                 | (1)                                   | 4                       | –   |
| Non-dough products             | (4)                                   | –                       | (2)   |
| Total Pillsbury North America* | (2)                                   | 1                       | (2)   |

\*Excluding ice cream

Source: AC Nielsen. Consumer takeaway (US dollar retail sales) in the 52 weeks ended 1 July 2000.

Consumer takeaway for Ice Cream Partners increased 6% against category growth of 3%.

### Foodservice continued to perform strongly and reported volume increased 35%

Pillsbury Bakeries and Foodservice continued to expand profitably, due principally to growth in frozen dough, and margins improved over 2 percentage points. Reported volume was up 35% reflecting the benefit of acquisitions and 5% organic volume growth. Turnover on an organic basis grew 6% and operating profit grew significantly.

### Turnover in International grew 4% and margins improved

In International, on an organic basis, volume grew 1% and turnover grew 4%. Strong growth was achieved in Europe and Asia Pacific while organic volume declined in Latin America due to difficult economic conditions in Argentina and Brazil. Marketing investment was up 14%.

### Quick Service Restaurants

- > Dollar system sales up 5% to \$11,417 million
- > Total restaurants up 6% compared with 30 June 1999 to 11,161 units
- > Worldwide comparable restaurant sales up 0.1%
- > Turnover was up 5% from £875 million to £941 million
- > Operating profit growth 6% to £202 million
- > Operating margin up 0.3 percentage points at 21.5%

### 6% growth in restaurant numbers and comparable restaurant sales in line with the prior year have delivered growth in worldwide system sales

At 30 June 2000, there were 11,161 restaurants, a net increase of 635 in the year.

### Organic growth in operating profit was 6%

Operating profit was £202 million (1999 – £185 million). Operating margin rose 0.3 percentage points due to margin improvement in the United States, partially offset by one-off costs in Europe relating to legal costs associated with litigation in Israel and Portugal, and charges relating to the bank default of the franchisee in Poland.

### In North America, operating performance improved during the year

Turnover grew 2% on an organic basis in North America. Comparable restaurant sales were slightly negative and the system expanded by 309 new restaurants in the year. Despite disruption to the system caused by the transition away from AmeriServe to a new regional distribution system, the North American business delivered 8% operating profit growth in the year.

## The United Kingdom, Germany and Spain continue to deliver strong sales growth

In each of the key markets, the United Kingdom, Spain and Germany, system sales were up over 10%. Comparable restaurant sales grew 2% in the United Kingdom and 8% in Spain. The strongest performance continued to be in Germany where market share increased as system sales grew 23% due to over 50 new restaurants and comparable restaurant sales up 2%. In addition, company restaurants continued to perform strongly and operating profit grew.

## Latin America delivered positive comparable restaurant sales and strong operating profit growth

Comparable restaurant sales grew 4% in Latin America. In addition, restaurant numbers grew 12% and there was strong operating profit growth.

## Financial review

### Exchange rates

Exchange rate movements during the year adversely impacted profit before exceptional items and tax by £41 million. The adverse impact of exchange rate movements on the translation of overseas operating profit was £14 million and on transactions in the year was £17 million, giving a total impact on operating profit of £31 million. Exchange rate movements also adversely affected the share of profits of associates by £9 million and the interest charge by £1 million.

Based on current exchange rates, it is estimated that there will be no material impact from exchange rate movements on profit before exceptionals and tax for the year ending 30 June 2001.

### Associates

The group's share of profits of associates before interest and exceptional items was £198 million for the year compared with £188 million for last year, an organic growth of 10%.

### Goodwill

Goodwill amortisation in the year was £17 million (1999 – £4 million), mainly in respect of the Packaged Food acquisitions last year.

### Exceptional items

In addition to the final merger integration costs of £83 million, operating cost exceptional items included £43 million integration and restructuring costs incurred by Pillsbury in the year. These costs related to organisational changes announced in March 2000, which are resulting in the elimination of approximately 400 positions, and to the integration of the recent acquisitions into its Bakeries and Foodservice operations.

Exceptional items also included three exceptional items relating to Burger King. Litigation damages of £34 million were awarded by an Australian court in a legal dispute with Burger King's Australian franchisee, Hungry Jack's Pty Ltd. In addition, £38 million was incurred to minimise the interruption of product supply to its entire US system and to ensure a smooth transition to Burger King's new US regional distributors following AmeriServe's bankruptcy filing in January 2000. These costs have been partly offset by exceptional income of £17 million. Burger King, as part of its transformation programme, has incentivised franchisees with phased royalty changes for a specified time if they agree to a new franchise agreement and to upgrade and migrate their existing restaurants to the current image requirements within 18 months for the financial year 2000 programme and 12 months for the financial year 2001 programme. The successor franchise agreement involves the receipt of franchise renewal fees which are being reported as exceptional income in 2000 and 2001.

The disposals of spirits and wine brands, principally in Europe, resulted in a charge of £247 million, of which £214 million was in respect of goodwill previously written off. The sale of Grupo Cruzcampo SA to Heineken NV resulted in an exceptional gain of £82 million, after charging £224 million in respect of goodwill.

## Interest

The interest charge in the year increased to £363 million from £324 million in the comparable year. Funding the various share repurchases cost £60 million, partly offset by a £41 million benefit in respect of the disposal of businesses.

## Taxation

The effective rate of taxation on profit before goodwill amortisation and exceptional items for the year was 26.2%, the same as the rate for the year ended 30 June 1999.

## Dividend

The directors recommend a final dividend of 12.6 pence per share to be paid on 15 November 2000 to shareholders on the register on 13 October 2000. Dividends for the year will total 21.0 pence per share, an increase of 8% on last year's dividends. A dividend reinvestment plan is available in respect of this dividend and the plan notice date is 25 October 2000.

## Cash flow

Free cash inflow was £864 million, compared with £373 million in the prior year. Cash inflow from operating activities was £2,043 million compared with £1,966 million. This inflow was after £198 million of restructuring and integration costs and a £62 million increase in working capital. Net interest payments were £405 million against £432 million in the comparable year (which included the cost of closing out certain long dated financial instruments in August 1998). Purchases of tangible fixed assets in the year amounted to £547 million, an increase of £13 million. Tax payments were £285 million compared with £566 million, the reduction being due to the receipt of advance corporation tax paid in previous years and lower capital gains payments on disposals.

Sale of businesses generated £638 million, which was partly offset by acquisitions costing £151 million. 9.5 million ordinary shares were purchased for cancellation in the year at a cost of £54 million, compared with the cancellation of 175 million ordinary and B shares at a cost of £1,211 million last year.

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Operating profit before exceptionals    | 1,963             | 1,899             |
| Depreciation and amortisation charge    | 365               | 339               |
| Working capital                         | (62)              | 47                |
| Restructuring and integration           | (198)             | (301)             |
| Other items                             | (25)              | (18)              |
| Operating cash flow                     | 2,043             | 1,966             |
| Interest less dividends from associates | (368)             | (408)             |
| Taxation                                | (285)             | (566)             |
| Purchase of own shares                  | (38)              | (175)             |
| Net capital expenditure                 | (488)             | (444)             |
| Free cash flow                          | 864               | 373               |

## Balance sheet

Total shareholders' funds were £4,711 million at 30 June 2000 compared with £4,026 million at 30 June 1999. The principal reasons for the increase were the £263 million retained income for the year and the reversal of the £446 million goodwill charged to the profit and loss account on disposals.

Net borrowings were £5,545 million, a decrease of £511 million from 30 June 1999. This decrease reflects the free cash inflow of £864 million noted above and net receipts from sales/purchases of businesses of £487 million, partly offset by dividends paid of £683 million and increases due to exchange movements of £119 million.

### Share repurchase

The group's management is committed to enhancing shareholder value, both by investing in the businesses and brands so as to maximise the return on investment and by managing the capital structure so as to minimise the cost of capital, whilst maintaining prudent financial ratios.

The company acquired, and subsequently cancelled, 9.5 million ordinary shares in the financial year, pursuant to the company's authority from shareholders granted in 1999. This repurchase represented 0.28% of the issued share capital at 30 June 2000 and cost £54 million. The group will continue to review its capital structure in the light of market conditions and to conduct share buy-backs when appropriate. The group has authority to repurchase up to 10% of its shares.

### Adoption of new accounting standards

During the year the group adopted two new accounting standards – FRS 15 and 16. These are described in note 1 to the financial statements. The adoption of these two standards did not give rise to any restatement of prior periods.

### Risk management

The group's funding, liquidity and exposure to interest rate and foreign exchange rate risks are managed by the group's treasury department. Treasury operations are conducted within a framework of policies and guidelines authorised by the board, and are reported bi-monthly to the board. This framework provides flexibility for the best execution of board approved strategies. The group uses derivative instruments for risk management purposes only, and these are transacted by specialist treasury personnel. The internal control environment is reviewed regularly.

**Currency risk** The group publishes its financial statements in sterling and conducts business in many foreign currencies. As a result, it is subject to foreign currency exchange risk due to exchange rate movements which will affect the group's transaction costs, and the translation of the results and underlying net assets of its foreign subsidiaries.

The group hedges a substantial portion of its exposure to fluctuations on the translation into sterling of its foreign currency net assets by holding net borrowings in foreign currencies and by using foreign currency swaps and cross currency interest rate swaps. The group's current policy is to hedge currency exposure on its net assets before net borrowings at approximately the following percentages – 75% for US dollars, 90% for euro currencies and 50% for other significant currencies. Although this leaves the remaining part of the group's net assets subject to currency movements, this policy reduces the volatility of interest charge, interest cover, gearing and absolute debt levels. Exchange differences arising on the retranslation of foreign currency net borrowings and foreign exchange swaps are recognised in the statement of total recognised gains and losses to match exchange differences on foreign equity investments, in accordance with SSAP 20.

It is group policy to hedge, on a rolling 12 month basis, the translation of a proportion of its forecast future profits denominated in US dollars and euro currencies, primarily with currency option cylinders (which consist of separate put and call options). This limits in part the translation exposure of the group's profit to movements in the exchange rates. For the profits hedged with currency option cylinders, the group is only exposed to exchange rate movements within a specified range. The impact of exchange rate movements outside that range is taken by the counterparty to the hedge. Gains and losses on option cylinders are recognised in the underlying hedged periods.

For currencies in which there is an active market, the group hedges between 80% and 100% of transactional foreign exchange rate risk, up to 18 months forward, using forward exchange contracts. The gain or loss on the hedge is recognised at the same time as the underlying transaction.

**Interest rate risk** The group has an exposure to interest rate risk and, within this category of market risk, is most vulnerable to changes in US dollar, sterling and euro interest rates. To manage interest rate risk, the group manages its proportion of fixed to variable rate borrowings within limits approved by the board, primarily through issuing long term fixed rate bonds, medium term notes and floating rate commercial paper, and by utilising interest rate swaps, cross-currency interest rate swaps and swaptions. The profile of fixed rate to floating rate net borrowings is maintained such that projected net borrowings are fully floating after five years, and are approximately 50% fixed and 50% floating within five years. The floating element of US dollar net borrowings within five years is partly protected using interest rate collars. In addition, where appropriate, the group uses forward rate agreements to manage short term interest rate exposures. Swaps, swaptions, forward rate agreements and collars are accounted for as hedges.

Such management serves to increase the accuracy of the business planning process and to help manage the interest cover ratio, which the group currently aims to maintain at a minimum level of five times over the long term. The group's interest cover ratio may, however, go below such minimum level in the short term.

**Liquidity risk** The group's strategy with regard to the maturity profile of borrowings is to maintain the proportion of borrowings maturing within one year at below 60% of total borrowings, and to maintain the level of commercial paper at below 50% of total borrowings. In addition, it is group policy to maintain backstop facility terms from relationship banks to support commercial paper obligations.

**Credit risk** A large number of major international financial institutions are counterparties to the interest rate swaps, foreign exchange contracts and deposits transacted by the group. Counterparties for such transactions entered into during the year have a long term credit rating of A or better. The group monitors its credit exposure to its counterparties, together with their credit ratings.

**Commodity price risk** The group uses commodity futures and options to hedge against price risk in certain major agricultural commodities purchased by the Packaged Food business. All commodity futures and options contracts hedge a projected future purchase of raw material. Commodity futures are then either sold at the time the raw material is purchased or they are exchanged with the company manufacturing the raw material to determine the contract price. Commodity contracts are held in the balance sheet at fair value but any gains and losses are deferred until the contracts are sold or exchanged. Open contracts at 30 June 2000 and gains and losses realised in the period or deferred at the balance sheet date were not significant.

**Employee share schemes** From 1999, awards granted under the various employee share schemes will be satisfied by the transfer of existing shares. Previously, awards under certain schemes were satisfied by the issue of new equity. In general, awards made under equity schemes, including the LTIP, are hedged through the purchase of shares, while option grants, including those to be granted under SAYE schemes, are hedged through the purchase of call options. As an exception to this, options granted under pre 1999 SAYE schemes have been hedged through the purchase of shares.

### Sensitivity analysis

For financial instruments held, the group has used a sensitivity analysis technique that measures the change in the fair value of the group's financial instruments from hypothetical changes in market rates.

The amounts generated from the sensitivity analysis are forward-looking estimates of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from those projected results due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below, which therefore should not be considered a projection of likely future events and losses.



The estimated changes in the fair values of borrowings, the guaranteed preferred securities and the associated derivative financial instruments at 30 June 2000 are set out in the table below. The basis of the estimated fair values is set out in note 18 to the financial statements.

The estimated changes in fair values for interest rate movements are based on an instantaneous decrease of 1% (100 basis points) in the specific rate of interest applicable to each class of financial instruments from the levels effective at 30 June 2000, with all other variables remaining constant. The estimated changes in the fair value for foreign exchange rates are based on an instantaneous 10% weakening in sterling against all other currencies from the levels applicable at 30 June 2000, with all other variables remaining constant. Such analysis is for illustrative purposes only – in practice market rates rarely change in isolation.

#### Sensitivity analysis table at 30 June 2000

|  | Estimated fair value<br>£ million | Fair value changes arising from:             |  |
|--|-----------------------------------|--|--|
|  |                                   | 1% fall<br>in interest<br>rates<br>£ million | 10%<br>weakening<br>in sterling<br>£ million |
| Borrowings                                     | (6,809)                           | (179)  | (606)  |
| Interest rate contracts                        | 208                               | 94   | (3)  |
| Foreign exchange contracts:                    |                                   |  |  |
| Transaction                                    | (22)                              | –  | (120)  |
| Balance sheet translation                      | (6)                               | –  | (3)  |
| Foreign exchange options<br>profit translation | (23)                              | –  | (84)   |
| Guaranteed preferred<br>securities             | (443)                             | (15)   | (49)   |
| Commodity contracts                            | (3)                               | –  | –  |
| Other financial net assets                     | 188                               | 4  | 18   |

#### Euro

In accordance with the Treaty on European Union, signed at Maastricht on 7 February 1992, the third stage of Economic and Monetary Union (EMU) commenced on 1 January 1999. The following 11 member states transferred authority for conducting monetary policy to a European Central Bank: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal and Spain. A single currency called the euro was introduced and its value as against the currencies of each of the participating member states was irrevocably fixed. The euro exists in parallel with national currencies, and transactions may be denominated in either currency until 31 December 2001. From 1 January 2002, euro notes and coins will be introduced and national currencies will be withdrawn by 30 June 2002.

The group has significant operations within the European Union. The implications include: preparing business systems for trading in euros and converting the accounting systems of companies in the common currency area from their national currency to euros; the benefit of the elimination of exchange rate risk in cross border transactions within the common currency area; the potential impact of increased pricing transparency on price differentials between member states; and training and human resources issues. In addition, monetary union may have a significant impact on macroeconomic factors, including interest and foreign exchange rates.

All businesses, and the corporate centre, have systems and procedures in place which enable them to conduct euro transactions appropriate to their local market requirements.

#### Litigation

On 3 April 2000, partial summary judgment was granted against UDV North America, Inc. (UDVNA) in US litigation on the loss of control provision in its arrangements with Tequila Cuervo La Rojena, SA de CV for the distribution of Jose Cuervo tequila brands. The loss of control issue arose as a result of the merger between GrandMet and Guinness in 1997. The effect of the court's decision, if upheld in all respects, would be to recognise the right of Tequila Cuervo La Rojena, SA de CV to terminate the current arrangement of the distribution of Jose Cuervo brands in the United States by UDVNA. The judgment will be appealed and litigation continues on other issues. The distribution arrangements remain currently in effect under a standstill agreement during negotiations on a new distribution agreement. The Jose Cuervo brands contributed approximately £260 million to group sales and approximately £65 million, before the allocation of certain overhead costs, to group operating profit in the year ended 30 June 2000. In the ordinary course of business, UDVNA does not allocate such overhead costs to individual brands, and in the event that the distribution rights were terminated the directors do not expect that the reduction in such costs would be material. The group's 45% holding of the ordinary share capital of Jose Cuervo SA is not directly affected by this judgment.

On 14 April 2000, La-Van Hawkins, La-Van Hawkins UrbanCityFoods-Maryland and La-Van Hawkins UrbanCityFoods (the claimants) issued proceedings against Burger King Corporation (BKC), a wholly-owned subsidiary of the company, in the United States District Court for the Eastern District of Michigan. They are franchisees of 24 Burger King restaurants. In the proceedings, they allege that they were fraudulently induced to develop their properties based upon alleged oral promises that they would be permitted to develop 225 Burger King restaurants. They also allege racial discrimination by BKC against La-Van Hawkins. No specific amount of damages is sought in the court papers, but La-Van Hawkins and his lawyers have indicated in press releases that they are seeking approximately US\$1.9 billion (£1.3 billion) in damages. BKC has filed a motion to transfer the action to Florida. The claimants have filed a motion to enjoin BKC from proceeding with the Florida action (see below). The Michigan court will hear these motions on 12 October 2000. BKC issued proceedings against the claimants in the United States District Court for the Southern District of Florida on 19 April 2000, seeking an injunction to preclude the claimants' alleged unauthorised use of BKC trademarks and for the collection of in excess of US\$6 million (£4 million) in alleged unpaid royalties. A motion by the claimants to join the proceedings with the Michigan action (described above) is pending. The Florida court has stayed these proceedings until the Michigan court determines the motions pending before that court. It is unlikely that a final resolution of either the Michigan or Florida proceedings will be reached in the immediate future. However, the directors believe that the claimants' allegations are without foundation and intend that BKC should vigorously defend and prosecute the respective claims. The directors believe that BKC's position is strong and that therefore the Diageo group's exposure to the claims is minimal.

Diageo has recently learned that the Governors of the Departments of the Republic of Colombia and the City of Bogota are considering initiating legal proceedings against major spirits companies in relation to unpaid excise duties and taxes on products which are smuggled into Colombia by third parties. Such proceedings are thought to be likely to be similar to those brought against RJR Reynolds Tobacco Holdings, Inc. (RJR) in December 1999 by the Attorney General of Canada in the Northern District of New York. In the latter proceedings, the complaint was dismissed on RJR's motion to dismiss on 30 June 2000. An appeal against that decision is currently pending. The directors intend that any proceedings of this kind which might be brought against Diageo will be strenuously defended.

Save as disclosed above, neither Diageo nor any member of the Diageo group is or has been engaged in, nor (so far as Diageo is aware) is there pending or threatened by or against it, any legal or arbitration proceedings which may have a significant effect on the financial position of the Diageo group.

## Directors' report

The directors have pleasure in submitting their annual reports and accounts for the year ended 30 June 2000.

### Business activities and development

Statements by the Chairman and the Group Chief Executive on the performance during the year and the future development of the group's businesses are included in the Annual Review. Detailed comments on the activities of the group are set out in the operating and financial review in this annual report.

During the year, the group completed the disposals of certain non-core brands. The group also carried out research and development in support of existing activities, specific new product development and the improvement of production processes.

### Dividends

Diageo paid an interim dividend of 8.4 pence per share on 13 April 2000. The directors recommend a final dividend of 12.6 pence per share. Subject to approval by members, the final dividend will be paid on 15 November 2000 to shareholders on the register on 13 October 2000. A dividend reinvestment plan is available in respect of the final dividend and the plan notice date is 25 October 2000.

### Share capital

At the 1999 Annual General Meeting shareholders gave the company renewed authority to purchase a maximum of 343 million ordinary shares of 28<sup>101/108</sup> pence each. The company purchased a total of 9.5 million shares for cancellation during the financial year; details are given in the operating and financial review and the financial statements.

### Annual General Meeting

The AGM will be held at The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE at 2.30 pm on 9 November 2000.

### Directors

The directors of the company are as follows: Lord Blyth of Rowington (Chairman); PS Walsh (Group Chief Executive); RF Chase; JMJ Keenan; M Lilja (appointed 1 November 1999); JB McGrath; JK Oates; NC Rose; WS Shanahan; CA Storm; and Sir Robert Wilson. In addition, Sir George Bull, Sir Anthony Greener and DN Malamatinas served as directors during the financial year.

JK Oates, PS Walsh and Sir Robert Wilson retire by rotation at the AGM in accordance with the articles and, being eligible, offer themselves for re-election. M Lilja was appointed on 1 November 1999 prior to the 1999 AGM and, in accordance with the articles, resigned and was re-appointed on 9 November 1999. She will retire at the AGM and, being eligible, offers herself for election.

### Auditors

The auditors, KPMG Audit Plc, are willing to continue in office and a resolution for their re-appointment as auditors of the company will be submitted to the AGM.

## Employment policies

Diageo's employment policies are designed to ensure that the group is able to attract the highest calibre of employee from all sections of the communities within which it operates. The group values diversity in the work place and is committed to providing equality of opportunity to all employees and potential employees. It actively encourages continuous training and skill development in all its businesses. Employment policies and training programmes have been developed to attract and retain the best people on the basis of their skills and abilities. This ensures that the group offers people with disability the same opportunities for employment, training and career progression as other employees. If an employee becomes disabled when in the group's employment, full support is given through the provision of training, special equipment or other resources to facilitate continued employment wherever possible.

To support the group's commitment to open communication with employees, a senior manager is responsible for designing management processes and media which encourage employee involvement and foster team working. In addition, the group has an intranet web site – 'Dialogue' – from which employees with access to a computer can obtain timely and accurate news and information.

A Diageo European Forum exists at which employee representatives are briefed and consulted on pan-European issues. The group has formal and informal mechanisms to communicate and consult with employees in all locations, and it ensures that legal obligations to consult with employees and their representatives are complied with by all businesses.

## Corporate citizenship

Diageo published its 2000 Environmental Report on the internet in June 2000. It can be accessed at [www.diageo.com](http://www.diageo.com), together with Diageo's corporate citizenship guidelines, which set out the group's overall approach to social and environmental issues and the measurement of its impact in these areas.

## Community relations and charitable donations

During the year, UK group companies made donations of £5.5 million (1999 – £6.5 million) to charitable organisations including the Diageo Foundation and £2.5 million to the Thalidomide Trust. The Diageo Foundation made charitable donations of £2.4 million (1999 – £2.4 million) during the year. In the rest of the world, group companies made charitable donations of £9.0 million (1999 – £9.4 million). The group made no political donations in the United Kingdom.

## Supplier payment policies and performance

Given the international nature of the group's operations, there is no group standard in respect of payments to suppliers. Operating companies are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to when making payments, subject to the terms and conditions being met by the supplier.

Creditor days have not been calculated as the company had no trade creditors at 30 June 2000. The company's invoices for goods and services are settled by subsidiaries acting as agents for the company.

## Shareholdings in the company

At 1 September 2000, the following substantial interest (3% or more) in the company's ordinary share capital had been notified to the company: nominees for Brandes Investment Partners, L.P. – 3.01%.

By order of the board

Roger H Myddelton  
Secretary  
6 September 2000

## Corporate governance report

### Combined Code

The listing rules of the Financial Services Authority require listed companies to disclose, in relation to Section 1 of the Combined Code produced by the Committee on Corporate Governance in June 1998, how they have applied its principles and whether they have complied with its provisions throughout the accounting period.

### Directors

Diageo's board comprises the non-executive Chairman, five executive directors and five non-executive directors including the senior non-executive director, Sir Robert Wilson. Biographical details of all the directors are given in the Annual Review. The roles of Chairman and Group Chief Executive are clearly defined; the Chairman being responsible primarily for the running of the board and the Group Chief Executive for the day-to-day management of the group's businesses, supported by the executive committee of which he is chairman.

The board meets regularly during the year, normally eight times, including a two-day off-site session specifically to discuss the group's strategy. All directors receive written reports prior to each board meeting which enable them to make an informed decision on the corporate and business issues under consideration. There is a formal schedule of matters specifically reserved for the board's decision and a procedure for directors to take independent professional advice in the course of their duties, if considered appropriate, at the company's expense.

The company secretary is responsible to the board for ensuring that board procedures are followed and all directors have access to his advice and services. The company secretary is also responsible for ensuring that new directors receive appropriate training and induction to Diageo.

All the non-executive directors are considered to be independent, except the Chairman, Lord Blyth, due to the closer relationship he has with the company by virtue of his position. The mix of skills and business experience of the non-executive directors is a major contribution to the proper functioning of the board, ensuring matters are debated and that no individual or group dominates the board decision-making process. Non-executive directors are appointed for a specified term (normally three years), subject to re-election, and all directors are subject to election by shareholders at the first AGM after their appointment. The number of directors, and the requirement of the company's articles of association on rotation, result in each director being re-appointed every three years.

### Board committees

The board has established several committees, each with defined terms of reference, procedures, responsibilities and powers. The minutes of committee meetings are normally sent to all directors and oral updates are given at board meetings. Committee membership is shown in the Annual Review.

**Audit committee** The audit committee comprises all the non-executive directors except for Lord Blyth and is chaired by JK Oates. The group finance director, external auditors and the director of group risk assurance and audit normally attend all meetings and the committee also meets the external auditors without management present. The audit committee is charged with: monitoring the adequacy and effectiveness of the systems of control and the risk assurance function; reviewing the scope and results of the work of the external auditors; and reviewing the annual and interim financial statements and related policies and assumptions.

**Nomination committee** Chaired by Lord Blyth, this committee comprises all the non-executive directors. The committee keeps under review the composition of the board and makes recommendations to the board concerning all new appointments, and re-appointments of non-executive directors.

**Remuneration committee** Comprising all the non-executive directors except for Lord Blyth. The committee is chaired by the senior non-executive director, Sir Robert Wilson, and is responsible for making recommendations to the board concerning matters relating to remuneration policy. Details of the policy and of the remuneration of the directors are given in the remuneration report. The group's incentive plans are generally subject to challenging performance criteria, as required by the Combined Code.

#### **Relations with shareholders**

The company values its dialogue with both institutional and private investors. Institutional shareholders, fund managers and analysts are kept informed through regular meetings and presentations. For the benefit of private investors, Diageo produces the short-form Annual Review which contains the information believed to be of most interest to them. (Approximately 85% of private investors receive only this document rather than the full Annual Report and Accounts.) Shareholders are invited to write in to the Chairman (or any other director) and express their views on any issues of concern at any time and the AGM provides an opportunity for shareholders to put their questions in person. The chairmen of the audit, nomination and remuneration committees are available at AGMs to take any relevant questions.

At general meetings, a schedule of the proxy votes cast is made available to all shareholders. The company proposes a separate resolution on each substantially separate issue and does not bundle resolutions together inappropriately. The receipt of the report and accounts is put to the shareholders.

#### **Accountability and audit**

**Financial reporting** A statement on the responsibilities of the directors in relation to financial statements follows this report.

The directors, having made appropriate enquiries, consider that the company and the group have adequate resources to continue in operational existence for the foreseeable future, and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

**Internal control** The directors acknowledge that they are responsible for the group's systems of internal control and for reviewing their effectiveness.

An ongoing process, in accordance with the guidance of the Turnbull Committee on internal control, has been established for identifying, evaluating and managing risks faced by the group. This process has been in place for the full financial year and up to the date the financial statements were approved. The risk management process and systems of internal control are designed to manage rather than eliminate the risk of failure to achieve the group's strategic objectives. It should be recognised that such systems can only provide reasonable not absolute assurance against material misstatement or loss.

Risk assessment and evaluation takes place as an integral part of the annual strategic planning cycle. Having identified the risks to achievement of their strategic objectives, each business unit is required to document the management and mitigating actions in place and proposed in respect of each significant risk. This information is reviewed by senior management as part of the strategy review.

Each business (UDV, Guinness, Pillsbury and Burger King) then prepares a risk footprint which summarises the risks, the processes for managing and mitigating them and the means for assuring management that the processes are effective. The corporate centre also considers the risks to the group's strategic objectives which are not addressed by the businesses and develops its own risk footprint.

These footprints are then considered by the directors as part of the annual strategic review. Thereafter this subject forms part of the agenda for each business' quarterly performance review meeting with senior management. Control issues arising from assurance processes, including risk assurance and external audit findings, are also discussed at these meetings.

Each business has its own business risk assurance team (incorporating its internal audit function) which is responsible to the business' chief executive officer for ensuring that adequate assurance is gained on the management of risk. Their work is supported by a comprehensive control self-assessment programme which is completed on an annual basis.

The directors obtain assurance directly from each business, and also from the group and business risk assurance and audit team which oversees the work of the business risk assurance teams. Assurance issues are regularly reported to the audit committee.

**Audit committee and auditors** The constitution and remit of the audit committee is described above. The audit committee oversees the work of the group and business risk assurance and audit functions, approving its plans in advance and reviewing its conclusions. Assurance plans are drawn up based on assessments of business risk carried out in conjunction with the businesses and in accordance with the group's risk management framework.

#### **Compliance with the Combined Code**

The company has complied with the requirements of the Financial Services Authority relating to the provisions of the Combined Code throughout the accounting period.

## Remuneration report

The remuneration committee is responsible for making recommendations to the board on remuneration policy as applied to Diageo's senior executives (including executive directors). It consists wholly of independent non-executive directors: Sir Robert Wilson (chairman), RF Chase, M Lilja, JK Oates and WS Shanahan. This report sets out the committee's policy and disclosures on directors' remuneration.

### 1 Executive remuneration policy

Diageo's policy on senior executive remuneration provides a direct link between executive incentives and Managing For Value, in particular the achievement of Diageo's governing objective of being in the top five of a peer group of 20 world class companies within five years from 1998, as measured by total shareholder return.

The senior executives across the group participate in an annual performance bonus plan and long term incentive plans – with variable rewards based on challenging targets for economic profit improvement and total shareholder return performance respectively.

Total remuneration for senior executives is set with regard to the competitive practice for the markets in which Diageo operates. It is essential that the company is able to attract, retain and develop the best executive talent around the world. The remuneration committee annually reviews independent market data and recommends whatever adjustments to the policy as may be necessary.

(i) **Basic salary** Basic salaries are determined according to the competitive market for senior executives, taking into account their experience, contribution and performance.

(ii) **Annual performance bonus** Bonus payments are based on improvement in the economic profit (EP) of Diageo and its businesses for the year in question. The EP targets and level of bonus opportunity are determined by the remuneration committee at the commencement of each year. EP is calculated on a net trading profit after tax, less a capital charge which takes into account returns expected by lenders and shareholders. In addition, certain senior executives were eligible for a merger bonus, which was payable in respect of the period ended 30 June 2000.

(iii) **Long term incentive plans** Senior executives are eligible to be considered for participation in long term incentive plans. From 1 January 1998, this took the form of a Long Term Incentive Plan now called the Total Shareholder Return (TSR) plan. However, in response to competitive pressures and as approved by shareholders in October 1999, a new Senior Executive Share Option Plan (SESOP) was introduced with effect from 1 January 2000. The combined benefits provided under the TSR plan and SESOP are expected to be the same as those previously granted under the TSR plan. For executive directors, the TSR plan and SESOP each comprise 50% of the expected value of their long term incentive plans from 1 January 2000.

(a) **TSR plan** Under this plan, executives are granted a conditional right to receive shares or, exceptionally, a cash sum. The plan is hedged through the purchase of shares to avoid dilution of shareholders' interests – see 'risk management' in the operating and financial review. The rights are awarded with effect from 1 January each year, and vest after a three-year period (the 'performance cycle') provided a performance test is achieved and subject to the discretion of the trustees. The first performance cycle runs from 1 January 1998 to 31 December 2000, with awards potentially vesting in March 2001. The performance test is a comparison of the annualised percentage growth in Diageo's share price (assuming all dividends and capital distributions are re-invested), known as total shareholder return, with the total shareholder returns of a defined peer group of 20 companies over a three-year period. For the performance cycles commencing 1 January 1998, 1999 and 2000, the peer group consists of Diageo and: Allied Domecq, Anheuser-Busch, Bestfoods, Campbell Soup, Carlsberg, Coca-Cola, Colgate-Palmolive, Gillette, Heineken, Heinz, Kellogg, McDonald's, Nestlé, PepsiCo, Philip Morris, Procter & Gamble, Seagram, Tricon and Unilever.

The awards to UK directors were for a number of shares equivalent to 100% of their salaries for the 1998 and 1999 performance cycles, and equivalent to 50% of salaries for the 2000 cycle. For US directors, the awards were equivalent to 300% and 150% of salaries, respectively.

The following table shows the percentage of each award which will normally be released at the end of the relevant performance cycle, depending on the peer group ranking achieved:

|   | Ranking in peer group |     |     |    |    |    |    |    |       |   |
|---|-----------------------|-----|-----|----|----|----|----|----|-------|---|
|   | 1-3                   | 4   | 5   | 6  | 7  | 8  | 9  | 10 | 11-20 |   |
| % | 150                   | 125 | 100 | 90 | 80 | 70 | 60 | 50 |       | 0 |

The remuneration committee will not recommend the release of awards if there has not been an underlying improvement in Diageo's financial performance.

Senior executives are required to hold shares in Diageo to qualify for the full benefits of the TSR plan. This is consistent with the company's belief that the most senior managers in the group should also be shareholders.

(b) **SESOP** Under SESOP an annual grant of options will be made to participants. The remuneration committee will decide the level of awards each year in the light of market practice. Options granted under the option scheme may not normally be exercised unless a performance condition is satisfied. The performance condition applicable to the first grant of options under the option scheme is linked to the increase in earnings per share (EPS), and is initially applied over the three-year period commencing on the date the options are granted. If the increase in Diageo's EPS over this period is at least 15% greater than the increase in the RPI over the same period, then all the options can be exercised. If the EPS increase is at least 12% greater than that of the RPI but less than 15%, half of the options can be exercised. In the event that all or half of the options fail the initial performance condition, the three-year assessment period will be rolled forward by a year and a retest carried out at that time. However, the performance condition can only be rolled forward a maximum of three times.

(iv) **Profit sharing schemes** For most employees in the UK and Ireland, Diageo operates tax favoured profit share plans. Diageo may appropriate shares to individuals annually up to the value of 10% of salary, subject to a cap of £8,000 (IR£10,000 in Ireland). Shares which have been appropriated are held in trust for the individual for a minimum two-year period. If the shares are transferred to the individual after three years from the date of appropriation, no income tax is payable.

(v) **Savings-related share option schemes** The group has established savings-related share option schemes which provide a savings and investment opportunity for employees in the United Kingdom, United States and many other countries. The UK scheme is open to both full-time and part-time employees. The options may normally be exercised after three or five years, at a price equivalent to not less than 80% of the market value of the shares at the time of grant. The US scheme is open to all employees of US participating subsidiaries who work 20 hours or more a week and for more than five months in any calendar year. The options may be exercised after 12 months, at a price equivalent to 85% of the market value of the shares at the time of grant. The international scheme has eligibility and discount criteria devised in accordance with local conditions and practices but within the parameters approved by shareholders.



## 1 Executive remuneration policy continued

(vi) **Directors' contracts** The executive directors have service agreements which provide for 6 months' notice by the director or 12 months by the company and contain non-compete obligations. In the event of early termination by the company without cause, the agreements provide for predetermined compensation to be paid, equivalent to 12 months' basic salary for the notice period and an equal amount in respect of all benefits. The Chairman has a letter of appointment for an intended five year term with an initial period of two years from 1 July 2000. Thereafter it is terminable on six months' notice by either party or, if terminated by the company, by payment of six months' fees in lieu of notice. The independent non-executive directors do not have service contracts.

The executive director proposed for re-election at the forthcoming AGM will have an unexpired contract term of one year. The non-executive directors proposed for election and re-election do not have service contracts.

(vii) **Pre-merger incentive plans** Diageo's current incentive plans have replaced the previous incentive arrangements within GrandMet and Guinness, which were approved by their respective shareholders and

were described in previous annual reports. As awards and options granted under these plans continue to be held and exercised, the previous plans in which the executive directors participate are outlined below. No further grants will be made under these plans.

(a) **Executive share option schemes** Options were granted at market value at the date of grant, generally exercisable between a minimum of three or five years, and a maximum of ten years, after grant. The last grants were made in 1997.

(b) **Long term incentive plans (LTIPs) and restricted share plan (RSP)** Awards over shares were granted to senior executives, with eventual transfer dependent on the performance of total shareholder return against a comparator group of companies at the end of three years after the date of grant. The remaining awards granted by GrandMet and Guinness vested during the year.

(c) **Senior executive phantom share option scheme (SEPSOS)** This share price related bonus scheme was established for a small number of GrandMet senior executives including executive directors. The last grants were made in 1996 and all payments will have been made within ten years from date of grant.

## 2 Directors' emoluments and other payments

|   |                             |                                    |                      |                               | 2000          | 1999          |
|---|-----------------------------|------------------------------------|----------------------|-------------------------------|---------------|---------------|
|   | Basic salary<br>(a)<br>£000 | Performance bonuses<br>(b)<br>£000 | Profit share<br>£000 | Other benefits<br>(c)<br>£000 | Total<br>£000 | Total<br>£000 |
| <b>Executive directors</b>                      |                             |                                    |                      |                               |               |               |
| Sir Anthony Greener, Chairman (retired 30.6.00) | 780                         | –                                  | 8                    | 47                            | 835           | 803           |
| JB McGrath                                      | 601                         | 307                                | 8                    | 36                            | 952           | 813           |
| JMJ Keenan                                      | 556                         | 1,112                              | –                    | 429                           | 2,097         | 898           |
| DN Malamatinas (resigned 30.8.00)               | 481                         | 386                                | –                    | 107                           | 974           | 867           |
| NC Rose   | 350                         | 399                                | 8                    | 111                           | 868           | 7             |
| CA Storm  | 319                         | 265                                | 8                    | 38                            | 630           | 496           |
| PS Walsh  | 633                         | 468                                | 8                    | 396                           | 1,505         | 1,829         |
| Former executive directors                      | –                           | –                                  | –                    | –                             | –             | 854           |
|   | 3,720                       | 2,937                              | 40                   | 1,164                         | 7,861         | 6,567         |
| <b>Non-executive directors – fees</b>           |                             |                                    |                      |                               |               |               |
| Lord Blyth                                      | 30                          | –                                  | –                    | 1                             | 31            | 15            |
| Sir George Bull (resigned 31.5.00)              | 27                          | –                                  | –                    | 3                             | 30            | 28            |
| RF Chase  | 30                          | –                                  | –                    | 1                             | 31            | 15            |
| M Lilja (appointed 1.11.99)                     | 20                          | –                                  | –                    | –                             | 20            | –             |
| JK Oates  | 40                          | –                                  | –                    | 1                             | 41            | 40            |
| WS Shanahan                                     | 30                          | –                                  | –                    | –                             | 30            | 5             |
| Sir Robert Wilson                               | 50                          | –                                  | –                    | 1                             | 51            | 40            |
| Former non-executive directors                  | –                           | –                                  | –                    | –                             | –             | 63            |
|   | 227                         | –                                  | –                    | 7                             | 234           | 206           |
| <b>Total</b>                                    | <b>3,947</b>                | <b>2,937</b>                       | <b>40</b>            | <b>1,171</b>                  | <b>8,095</b>  | <b>6,773</b>  |

### Notes

(a) In addition to the above emoluments, the directors received payments and made gains under former longer term incentive arrangements of £2,422,000 (1999 – £6,682,000). See section 5 below.

(b) In addition to their annual performance bonuses, MJM Keenan and NC Rose received bonuses relating to the merger of £291,000 and £218,000, respectively.

## 2 Directors' emoluments and other payments continued

### Notes continued

(c) Other benefits include company cars, private use of chauffeur, fuel, product allowance, financial counselling, spouse travel, medical insurance and life insurance premiums. Additional payments made to or on behalf of JMJ Keenan and DN Malamatinas, who are expatriates, are treated as other benefits in the above table. They include allowances for working overseas and the provision of accommodation. PS Walsh's other benefits include £279,000 in respect of his relocation to the United Kingdom. NC Rose's other benefits include £75,000 in respect of his participation in an individual deferred compensation agreement entered into in 1998, under which up to a further £175,000 is payable.

(i) **Former director** PE Yea, who resigned as a director on 30 June 1999, received salary, bonus and other benefits of £174,000 after that date.

(ii) **Directors' pension provision** JB McGrath, NC Rose, CA Storm and PS Walsh are members of the Diageo Pension Scheme. They accrue pension rights at the rate of one-thirtieth of basic salary per annum. No actuarial reduction is applied to pensions payable from the age of 57, subject to company consent. Bonus payments are not included in pensionable pay. Their pensions are guaranteed to increase in line with inflation up to a level of 5%, with JB McGrath, NC Rose and PS Walsh also having guarantees that such increases will not be lower than 3% per annum and that their pensions at normal pension age of 62 will not be less than two-thirds of basic salary in the 12 months prior to retirement. On death in service, a lump sum of four times pensionable salary is paid, along with a spouse's pension of two-thirds of the member's prospective pension. When a director dies after retirement, a spouse's pension of two-thirds of the member's pension is paid. None of the directors is required to make pension contributions and no company contributions were paid during the year.

PS Walsh participated in the Pillsbury retirement plan in the United States prior to 31 December 1999. On his return to a UK-based position on 1 January 2000, he was given backdated service in the UK scheme to the date he originally joined the scheme. The pension accrual rate for the backdated service reflects his eligibility for the service membership categories at the relevant times. The benefits accrued in the Pillsbury retirement plan will be offset against those payable from the UK scheme, as will benefits arising from the company matching contributions made to his Pillsbury savings plan, which is a defined contribution plan with a limited company match. No company contributions were made to this plan in the year (1999 – £21,000).

DN Malamatinas participated in the Burger King retirement plan in the United States with effect from 1 July 1998 and in the Diageo Pension Scheme in the United Kingdom prior to this. The UK plan benefits have been fully protected and will be based on his UK equivalent basic salary in the 12 months prior to retirement. The Burger King plan is a defined benefit plan. Spouses' pensions on death after retirement are payable only by waiving part of the member's pension. There is no commitment to the provision of increases to pensions in payment. DN Malamatinas also participated in the Burger King savings plan, which is a defined contribution plan with a limited company match; company contributions in the year were £43,000 (1999 – £26,000).

For executives who entered service after 31 May 1989, the benefits which can be provided from the Diageo Pension Scheme are restricted by the operation of the earnings cap. Such executives, including any directors, receive total pension benefits of the same value as if the earnings cap did not apply. All benefits earned during the year in respect of earnings above the cap will be provided by the company on an unfunded basis; consequently, no contributions were payable during the year in respect of the current directors.

The accrued pension entitlements earned by the directors as at 30 June 2000 are shown in the table below. The increase over inflation reflects entitlements earned during the year ended 30 June 2000.

|                     | Age at<br>30 June 2000<br>Years | Pensionable<br>service<br>Years | Increase<br>over inflation<br>£000 | Accrued<br>pension<br>£000 |
|---------------------|---------------------------------|---------------------------------|------------------------------------|----------------------------|
| Sir Anthony Greener | 60                              | 13                              | 36                                 | 509                        |
| JB McGrath          | 62                              | 15                              | 40                                 | 394                        |
| DN Malamatinas      | 45                              | 10                              | 24                                 | 85                         |
| NC Rose             | 42                              | 8                               | 36                                 | 89                         |
| CA Storm            | 61                              | 39                              | 41                                 | 273                        |
| PS Walsh            | 45                              | 18                              | 107                                | 353                        |

The accrued pensions shown above represent the annual pension to which each director will be entitled at normal retirement age of 62, with the exception of Sir Anthony Greener, based on current salary levels and service up to 30 June 2000. Sir Anthony Greener retired on 30 June 2000 at 60. His accrued pension reflects a guarantee that his pension at 60 (inclusive of benefits transferred into the scheme from previous employments) would be two-thirds of basic salary averaged over the three years prior to retirement (amended to take account of inflation). JMJ Keenan, the highest paid director, did not have any accrued pension at either 30 June 2000 or 30 June 1999.

CA Storm's long pensionable service means that his retirement pension will be restricted to Inland Revenue limits. These limits will take into account bonuses which are yet to be paid to him and which have not been allowed for in the above figures.

### 3 Share and other interests

The beneficial interests of the directors in office at 30 June 2000 in the ordinary shares (or equivalent for ADS awards) awarded under the Diageo TSR plan and in the ordinary shares of the company are shown in the table below.

|                                | TSR plan (a)      |                   |                   | Ordinary shares (b) |                                   |
|--------------------------------|-------------------|-------------------|-------------------|---------------------|-----------------------------------|
|                                | 1 January<br>1998 | 1 January<br>1999 | 1 January<br>2000 | 30 June<br>2000     | 30 June<br>1999 or<br>appointment |
| <b>Executive directors</b>     |                   |                   |                   |                     |                                   |
| Sir Anthony Greener            | 62,607            | 56,926            | –                 | 341,561             | 200,742                           |
| JB McGrath (c)                 | 47,170            | 42,896            | –                 | 38,882              | 24,112                            |
| JMJ Keenan                     | 133,020           | 116,636           | 63,836            | 171,524             | 171,524                           |
| DN Malamatinas (d)             | 101,720           | 100,896           | 54,510            | 3,361               | 3,361                             |
| NC Rose                        | 18,011            | 16,376            | 13,772            | 13,145              | 4,582                             |
| CA Storm                       | 21,441            | 22,935            | 12,333            | 86,696              | 59,149                            |
| PS Walsh                       | 151,048           | 132,442           | 75,935            | 107,132             | 95,880                            |
| <b>Non-executive directors</b> |                   |                   |                   |                     |                                   |
| Lord Blyth                     |                   |                   |                   | 10,206              | 10,000                            |
| RF Chase                       |                   |                   |                   | 10,000              | 10,000                            |
| M Lilja (appointed 1.11.99)    |                   |                   |                   | 1,507               | –                                 |
| JK Oates                       |                   |                   |                   | 2,844               | 2,844                             |
| WS Shanahan                    |                   |                   |                   | 8,000               | –                                 |
| Sir Robert Wilson              |                   |                   |                   | 8,252               | 3,030                             |
| <b>Total</b>                   | <b>535,017</b>    | <b>489,107</b>    | <b>220,386</b>    | <b>803,110</b>      | <b>585,224</b>                    |

#### Notes

(a) For illustrative purposes the TSR plan interests shown above reflect the number of shares which would be released if the company were to be ranked at position 10. The actual positions at 30 June 2000 were 11, 12 and 13 for the performance cycles commencing 1 January 1998, 1999 and 2000, respectively. The number of shares released will normally be based on the company's position within the peer group at the end of the relevant three-year performance period.

(b) At 30 June 2000, Sir Anthony Greener and CA Storm had an interest in 701,628 shares (30 June 1999 – 1,059,541; 1 September 2000 – 625,285) held by trusts to satisfy grants made under ex-Guinness incentive plans; JB McGrath, MJM Keenan, DN Malamatinas, NC Rose and PS Walsh had an interest in 3,123,181 shares subject to call options (30 June 1999 – 3,123,181; 1 September 2000 – 3,063,181 and 60,000 shares) held by trusts to satisfy grants made under ex-GrandMet incentive plans; and the executive directors had an interest in 15,167,223 shares (30 June 1999 – 21,897,568; 1 September 2000 – 15,678,230) held by trusts to satisfy grants made under Diageo incentive plans and savings-related share option schemes.

(c) JB McGrath had a non-beneficial interest at 30 June 2000 in 2,500 (30 June 1999 – 2,500; 1 September 2000 – 2,500) ordinary shares.

(d) In accordance with the rules of the scheme, DN Malamatinas's interests under the TSR plan, as shown in the above table, lapsed on 30 August 2000 following his resignation.

(e) At 1 September 2000, the interests of the continuing directors were unchanged except for JB McGrath whose interests increased by 4,151 shares following the exercise of share options.

Lord Blyth is a senior adviser to Greenhill & Co., which will receive a fee on the completion of the combination of Pillsbury with General Mills, Inc for its advice to Diageo. Lord Blyth did not participate in the selection of advisers, nor did he advise Greenhill & Co., in relation to Pillsbury.

Other than the above, and the share interests shown in sections 4 and 5 below, no director had any interest, beneficial or non-beneficial, in the share capital of the company. The register of directors' interests (which is open to shareholders' inspection) contains full details of directors' share interests. Save as disclosed above, no director has or has had any interest in any transaction which is or was unusual in its nature, or which is or was significant to the business of the group and which was effected by any member of the group during the financial year, or which having been effected during an earlier financial year, remains in any respect outstanding or unperformed.

#### 4 Executive share options and savings-related share options

The following table shows, for the directors who held office during the year, the number of options held under all executive share option schemes and savings-related schemes. Option and market prices in the table are weighted average prices in pence. 'Exercisable' options are those that were vested and could be exercised at the period end; 'not yet exercisable' are those options where the minimum holding period was not then completed. The 'option period' starts from the earliest month any options could have been, or may be, exercised under their terms and ends with the month in which the last options lapse. These definitions also apply to 5(ii) below.

For executive share option schemes, UK grants were between 1992 and 1999 at prices between 314 pence and 533.5 pence with the 1999 grants being at 518 pence, and US grants were between 1993 and 1999 at prices between US \$24.55 and US \$33.63 per ADS with the 1999 grants being at US \$33.63 (equivalent to 525 pence per ordinary share). US options were granted over ADSs at dollar prices (one ADS is equivalent to four ordinary shares); the option holdings and prices in the table are stated as ordinary share equivalents in pence. The mid-market price of the ordinary shares at 30 June 2000 was 593 pence (1999 – 662.5 pence). The highest mid-market price during the year was 696.5 pence and the lowest mid-market price was 384 pence.

|                     |                 | 30 June<br>1999 | Granted | Exercised | Option<br>price | Market<br>price | 30 June<br>2000 | Option price and period |
|---------------------|-----------------|-----------------|---------|-----------|-----------------|-----------------|-----------------|-------------------------|
| <b>UK options</b>   |                 |                 |         |           |                 |                 |                 |                         |
| Sir Anthony Greener | Exercisable     | 717,632         |         |           |                 |                 | 814,608         | 482 May 94 – Apr 07     |
|                     | Not exercisable | 348,010         |         |           |                 |                 | 149,786         | 468 Apr 01 – Apr 07     |
|                     |                 | 1,065,642       | 1,188   | (102,436) | 322             | 515             | 964,394         |                         |
| JB McGrath          | Exercisable     | 478,883         |         |           |                 |                 | 397,628         | 419 Oct 96 – Jun 06     |
|                     | Not exercisable | 4,151           |         |           |                 |                 | 4,151           | 343 Sep 00 – Feb 01     |
|                     |                 | 483,034         | –       | (81,255)  | 423             | 528             | 401,779         |                         |
| DN Malamatinas      | Exercisable     | 36,000          |         |           |                 |                 | 36,000          | 429 Jun 99 – Jun 06     |
|                     | Not exercisable | –               |         |           |                 |                 | –               |                         |
|                     | (b)             | 36,000          | –       | –         |                 |                 | 36,000          |                         |
| NC Rose             | Exercisable     | 171,434         |         |           |                 |                 | 171,434         | 424 Jun 96 – Jun 06     |
|                     | Not exercisable | 4,886           |         |           |                 |                 | 139,998         | 517 Dec 02 – Dec 09     |
|                     |                 | 176,320         | 139,998 | (4,886)   | 353             | 635             | 311,432         |                         |
| CA Storm            | Exercisable     | 172,935         |         |           |                 |                 | 158,933         | 477 May 94 – Apr 07     |
|                     | Not exercisable | 29,999          |         |           |                 |                 | 101,238         | 511 Dec 00 – Dec 09     |
|                     |                 | 202,934         | 77,693  | (20,456)  | 325             | 521             | 260,171         |                         |
| PS Walsh            | Exercisable     | –               |         |           |                 |                 | –               |                         |
|                     | Not exercisable | –               |         |           |                 |                 | 470,559         | 518 Dec 02 – Dec 09     |
|                     |                 | –               | 470,559 | –         |                 |                 | 470,559         |                         |
| <b>US options</b>   |                 |                 |         |           |                 |                 |                 |                         |
| JMJ Keenan          | Exercisable     | –               |         |           |                 |                 | –               |                         |
|                     | Not exercisable | 4,860           |         |           |                 |                 | 400,240         | 525 Dec 02 – Dec 09     |
|                     | (c)             | 4,860           | 400,240 | –         |                 |                 | 400,240         |                         |
| DN Malamatinas      | Exercisable     | –               |         |           |                 |                 | –               |                         |
|                     | Not exercisable | –               |         |           |                 |                 | 341,768         | 525 Dec 02 – Dec 09     |
|                     | (b)             | –               | 341,768 | –         |                 |                 | 341,768         |                         |
| PS Walsh            | Exercisable     | 421,752         |         |           |                 |                 | 421,752         | 419 Jan 98 – Jan 06     |
|                     | Not exercisable | 5,264           |         |           |                 |                 | –               |                         |
|                     |                 | 427,016         | –       | (5,264)   | 489             | 559             | 421,752         |                         |

#### Notes

(a) Options granted during the year to JMJ Keenan, DN Malamatinas, NC Rose, CA Storm and PS Walsh are principally options granted under the SESOP, which are subject to performance conditions.

(b) In accordance with the rules of the schemes, DN Malamatinas's 341,768 US options lapsed on 30 August 2000 following his resignation. He has been granted dispensation to exercise his 36,000 UK options until 30 September 2000.

(c) 4,860 of JMJ Keenan's US options lapsed during the year.

## 5 Pre-merger incentive plans

(i) **Payments and gains under longer term incentive arrangements** The table below shows payments and gains for the year ended 30 June 2000 arising from awards and grants made between 1989 and 1997.

|                                 | Awards vested under pre-merger LTIPs (a) |              | SEPSOS payments (b) | Share option gains (c) | Total<br>£000 | 1999<br>£000 |
|---------------------------------|--|--------------|---------------------|------------------------|---------------|--------------|
|                                 | Shares                                   | £000         | £000                | £000                   |               |              |
| Sir Anthony Greener             | 60,527                                   | 272          | –                   | 198                    | 470           | 267          |
| JB McGrath                      | 52,749                                   | 256          | 46                  | 85                     | 387           | 253          |
| JMJ Keenan                      | 79,372                                   | 385          | –                   | –                      | 385           | –            |
| DN Malamatinas                  | 31,249                                   | 152          | –                   | –                      | 152           | 240          |
| NC Rose                         | 10,948                                   | 53           | –                   | 14                     | 67            | –            |
| CA Storm                        | 9,442                                    | 42           | –                   | 40                     | 82            | 168          |
| PS Walsh                        | 96,276                                   | 462          | 104                 | 4                      | 570           | 2,003        |
| Sir George Bull (until 31.5.00) | 64,374                                   | 309          | –                   | –                      | 309           | 2,727        |
| Former executive directors      | –  | –            | –                   | –                      | –             | 1,024        |
| <b>Total</b>                    | <b>404,937</b>                           | <b>1,931</b> | <b>150</b>          | <b>341</b>             | <b>2,422</b>  | <b>6,682</b> |

### Notes

(a) The awards over shares which have vested under the pre-merger LTIPs were made under plans which commenced in 1997. The numbers of shares which vested on the vesting dates were determined by the remuneration committee as follows: Guinness LTIP award 80% and GrandMet RSP award 56%. The values are calculated as at the date of vesting although the shares may have been retained or not yet released to the director.

(b) SEPSOS payments are attributable to exercises in previous years.

(c) Share option gains are calculated as at the date of exercise although the shares may have been retained.

(ii) **SEPSOS interests** The following table shows the number of options held under SEPSOS which were granted between 1992 and 1996 at prices between 382 pence and 475 pence. Payments are normally spread over the period from exercise to the tenth anniversary of the date of grant. Definitions of terms are given in section 4 above.

|                |                 | 30 June 1999   | Granted | Exercised | Option price | Market price | 30 June 2000   | Option price and period |
|----------------|-----------------|----------------|---------|-----------|--------------|--------------|----------------|-------------------------|
| JB McGrath     | Exercisable     | 216,542        |         |           |              |              | 303,977        | 431 Jan 97 – Jan 05     |
|                | Not exercisable | 162,816        |         |           |              |              | 75,381         | 459 Jan 01 – Jan 06     |
|                |                 | <b>379,358</b> | –       | –         |              |              | <b>379,358</b> |                         |
| DN Malamatinas | Exercisable     | –              |         |           |              |              | 179,327        | 390 Jul 99 – Jun 05     |
|                | Not exercisable | 179,327        |         |           |              |              | –              |                         |
|                | (a)             | <b>179,327</b> | –       | –         |              |              | <b>179,327</b> |                         |
| NC Rose        | Exercisable     | 23,714         |         |           |              |              | 40,075         | 422 Dec 97 – Jun 05     |
|                | Not exercisable | 16,361         |         |           |              |              | –              |                         |
|                |                 | <b>40,075</b>  | –       | –         |              |              | <b>40,075</b>  |                         |
| PS Walsh       | Exercisable     | 74,680         |         |           |              |              | 74,680         | 475 Jan 99 – Jan 04     |
|                | Not exercisable | 127,620        |         |           |              |              | 127,620        | 459 Jan 01 – Jan 06     |
|                |                 | <b>202,300</b> | –       | –         |              |              | <b>202,300</b> |                         |

### Note

(a) In accordance with the rules of the scheme, following DN Malamatinas's resignation on 30 August 2000 he has been granted dispensation to exercise his 179,327 options until 30 September 2000.



# Financial statements

- |   |                                       |
|---|---------------------------------------|
| 18 Consolidated profit and loss account                     | 21 Accounting policies                |
| Consolidated statement of total recognised gains and losses | 23 Notes to the consolidated accounts |
| Note of consolidated historical cost profits and losses     | 38 Company balance sheet              |
| 19 Consolidated balance sheet                               | 39 Notes to the company balance sheet |
| 20 Consolidated cash flow statement                         | 41 Principal group companies          |

## Directors' responsibilities in relation to financial statements

The following statement, which should be read in conjunction with the report of the auditors set out below, is made with a view to distinguishing for shareholders the respective responsibilities of the directors and of the auditors in relation to the financial statements.

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group at the end of the financial year and of the profit or loss for the financial year. The directors, in preparing these financial statements, consider that the company has used appropriate accounting policies, consistently applied and supported by

reasonable and prudent judgements and estimates, and that all applicable accounting standards have been followed.

The directors have responsibility for ensuring that the company keeps accounting records which disclose with reasonable accuracy the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985. The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

## Report of the auditors to the members of Diageo plc

We have audited the financial statements on pages 18 to 41.

**Respective responsibilities of the directors and auditors** The directors are responsible for preparing the Annual Report and Accounts. As described above this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the company is not disclosed.

We review whether the statement on page 10 reflects the company's compliance with the seven provisions of the Combined Code specified for our review by the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement, and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

**Basis of audit opinion** We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

**Opinion** In our opinion the financial statements give a true and fair view of the state of affairs of the company and the group as at 30 June 2000 and of the profit of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**KPMG Audit Plc**  
Chartered Accountants  
Registered Auditor  
London, 6 September 2000

## Consolidated profit and loss account

|   | Notes | Year ended 30 June 2000                            |   |                    | Year ended 30 June 1999                            |   |                    |
|---|-------|--|---|--------------------|--|---|--------------------|
|   |       | Before goodwill and exceptional items<br>£ million | Goodwill and exceptional items<br>£ million | Total<br>£ million | Before goodwill and exceptional items<br>£ million | Goodwill and exceptional items<br>£ million | Total<br>£ million |
| Turnover                                      | 2     | 11,870   | –   | 11,870             | 11,795   | –   | 11,795             |
| Operating costs                               | 4     | (9,890)  | (198)                                       | (10,088)           | (9,892)  | (386)                                       | (10,278)           |
| Operating profit                              | 2     | 1,980  | (198)                                       | 1,782              | 1,903  | (386)                                       | 1,517              |
| Share of profits of associates                | 6     | 198  | (3)   | 195                | 188  | (8)   | 180                |
| Trading profit                                |       | 2,178  | (201)                                       | 1,977              | 2,091  | (394)                                       | 1,697              |
| Disposal of fixed assets                      |       | –  | 5   | 5                  | –  | (10)  | (10)               |
| Sale of businesses                            | 7     | –  | (168)                                       | (168)              | –  | 104   | 104                |
| Interest payable (net)                        | 8     | (363)  | –   | (363)              | (324)  | –   | (324)              |
| Profit on ordinary activities before taxation |       | 1,815  | (364)                                       | 1,451              | 1,767  | (300)                                       | 1,467              |
| Taxation on profit on ordinary activities     | 9     | (476)  | 75  | (401)              | (463)  | 23  | (440)              |
| Profit on ordinary activities after taxation  |       | 1,339  | (289)                                       | 1,050              | 1,304  | (277)                                       | 1,027              |
| Minority interests                            |       |  |   |                    |  |   |                    |
| Equity  |       | (37)   | –   | (37)               | (49)   | –   | (49)               |
| Non-equity                                    |       | (37)   | –   | (37)               | (36)   | –   | (36)               |
| Profit for the year                           |       | 1,265  | (289)                                       | 976                | 1,219  | (277)                                       | 942                |
| Dividends                                     | 10    | (713)  | –   | (713)              | (674)  | –   | (674)              |
| Transferred to reserves                       |       | 552  | (289)                                       | 263                | 545  | (277)                                       | 268                |
| Earnings per share                            | 11    |  |   |                    |  |   |                    |
| Basic   |       | 37.3p  | (8.5)p                                      | 28.8p              | 34.5p  | (7.8)p                                      | 26.7p              |
| Diluted                                       |       | 37.2p  | (8.5)p                                      | 28.7p              | 34.3p  | (7.8)p                                      | 26.5p              |

## Consolidated statement of total recognised gains and losses

|   | Year ended<br>30 June 2000<br>£ million | Year ended<br>30 June 1999<br>£ million |
|---|---|---|
| Profit for the year – group                 | 858                                     | 837                                     |
| – associates                                | 118                                     | 105                                     |
|   | 976                                     | 942                                     |
| Exchange adjustments                        | 25                                      | 78                                      |
| Tax (charge)/relief on exchange in reserves | (7)                                     | 15                                      |
| Total recognised gains and losses           | 994                                     | 1,035                                   |

## Note of consolidated historical cost profits and losses

There is no material difference between the reported profit shown in the consolidated profit and loss account and the profit for the relevant years restated on an historical cost basis.

## Consolidated balance sheet

|   | Notes | 30 June 2000 |           | 30 June 1999 |           |
|---|-------|--------------|-----------|--------------|-----------|
|   |       | £ million    | £ million | £ million    | £ million |
| <b>Fixed assets</b>   |       |              |           |              |           |
| Intangible assets   | 12    |              | 5,289     |              | 5,188     |
| Tangible assets   | 13    |              | 3,078     |              | 3,178     |
| Investments   | 14    |              | 1,496     |              | 1,354     |
|   |       |              | 9,863     |              | 9,720     |
| <b>Current assets</b>   |       |              |           |              |           |
| Stocks  | 15    | 2,139        |           | 2,202        |           |
| Debtors – due within one year   | 16    | 1,845        |           | 1,931        |           |
| Debtors – due after one year  | 16    | 1,187        |           | 1,290        |           |
| Debtors subject to financing arrangements (franchisee loans of £258 million,<br>less non-returnable proceeds of £219 million) | 16    | 39           |           | 38           |           |
| Cash at bank and in hand  | 17    | 1,063        |           | 1,097        |           |
|   |       | 6,273        |           | 6,558        |           |
| <b>Creditors – due within one year</b>  |       |              |           |              |           |
| Borrowings  | 17    | (3,066)      |           | (3,905)      |           |
| Other creditors   | 19    | (3,275)      |           | (3,532)      |           |
|   |       | (6,341)      |           | (7,437)      |           |
| <b>Net current liabilities</b>  |       |              | (68)      |              | (879)     |
| <b>Total assets less current liabilities</b>  |       |              | 9,795     |              | 8,841     |
| <b>Creditors – due after one year</b>   |       |              |           |              |           |
| Borrowings  | 17    | (3,716)      |           | (3,395)      |           |
| Other creditors   | 19    | (100)        |           | (100)        |           |
|   |       |              | (3,816)   |              | (3,495)   |
| <b>Provisions for liabilities and charges</b>   | 20    |              | (694)     |              | (753)     |
|   |       |              | 5,285     |              | 4,593     |
| <b>Capital and reserves</b>   |       |              |           |              |           |
| Called up share capital   | 22    |              | 990       |              | 992       |
| Share premium account   |       | 1,285        |           | 1,268        |           |
| Revaluation reserve   |       | 138          |           | 173          |           |
| Capital redemption reserve  |       | 2,949        |           | 2,936        |           |
| Profit and loss account   |       | (651)        |           | (1,343)      |           |
| Reserves attributable to equity shareholders  | 23    |              | 3,721     |              | 3,034     |
| <b>Shareholders' funds</b>  |       |              | 4,711     |              | 4,026     |
| <b>Minority interests</b>   |       |              |           |              |           |
| Equity  |       | 169          |           | 179          |           |
| Non-equity  | 25    | 405          |           | 388          |           |
|   |       |              | 574       |              | 567       |
|   |       |              | 5,285     |              | 4,593     |

These financial statements were approved by a duly appointed and authorised committee of the Board of Directors on 6 September 2000 and were signed on its behalf by PS Walsh and NC Rose, directors.

## Consolidated cash flow statement

|   | Notes | Year ended 30 June 2000 |           | Year ended 30 June 1999 |           |
|---|-------|-------------------------|-----------|-------------------------|-----------|
|   |       | £ million               | £ million | £ million               | £ million |
| Net cash inflow from operating activities                     | 26    |                         | 2,043     |                         | 1,966     |
| Dividends received from associates                            |       |                         | 64        |                         | 58        |
| Interest paid (net)   |       | (405)                   |           | (432)                   |           |
| Dividends paid to equity minority interests                   |       | (27)                    |           | (34)                    |           |
| Returns on investments and servicing of finance               |       |                         | (432)     |                         | (466)     |
| Taxation  |       |                         | (285)     |                         | (566)     |
| Purchase of tangible fixed assets                             |       | (547)                   |           | (534)                   |           |
| Purchase/sale of own shares                                   |       | (38)                    |           | (175)                   |           |
| Sale of fixed assets  |       | 59                      |           | 90                      |           |
| Capital expenditure and financial investment                  |       |                         | (526)     |                         | (619)     |
| Free cash flow  |       |                         | 864       |                         | 373       |
| Purchase of subsidiaries                                      | 27    | (151)                   |           | (380)                   |           |
| Sale of subsidiaries and businesses                           | 28    | 638                     |           | 330                     |           |
| Sale of associates  |       | -                       |           | 171                     |           |
| Acquisitions and disposals                                    |       |                         | 487       |                         | 121       |
| Equity dividends paid   |       |                         | (683)     |                         | (668)     |
| Cash flow before management of liquid resources and financing |       |                         | 668       |                         | (174)     |
| Management of liquid resources                                |       |                         | (219)     |                         | 2,195     |
| Issue of share capital  |       | 12                      |           | 50                      |           |
| Own shares purchased for cancellation                         |       | (54)                    |           | (1,211)                 |           |
| Decrease in loans   |       | (544)                   |           | (716)                   |           |
| Financing   |       |                         | (586)     |                         | (1,877)   |
| (Decrease)/increase in cash in the year                       |       |                         | (137)     |                         | 144       |
| Movements in net borrowings                                   | 17    |                         |           |                         |           |
| (Decrease)/increase in cash in the year                       |       |                         | (137)     |                         | 144       |
| Cash flow from change in loans                                |       |                         | 544       |                         | 716       |
| Change in liquid resources                                    |       |                         | 219       |                         | (2,195)   |
| Change in net borrowings from cash flows                      |       |                         | 626       |                         | (1,335)   |
| Exchange adjustments  |       |                         | (119)     |                         | (208)     |
| Non-cash items  |       |                         | 4         |                         | (5)       |
| Decrease/(increase) in net borrowings                         |       |                         | 511       |                         | (1,548)   |
| Net borrowings at beginning of the year                       |       |                         | (6,056)   |                         | (4,508)   |
| Net borrowings at end of the year                             |       |                         | (5,545)   |                         | (6,056)   |

## Accounting policies

### Basis of accounting

The accounts are prepared under the historical cost convention, modified by the revaluation of certain land and buildings, and in accordance with applicable UK accounting standards.

### Basis of consolidation

The group accounts include the accounts of the company and its subsidiary undertakings (subsidiaries) together with the attributable share of the group's share of the results of joint arrangements and associated undertakings (associates). Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiaries sold or acquired are included in the profit and loss account up to, or from, the date control passes.

### Acquisitions and disposals

On the acquisition of a business, or of an interest in an associate, fair values, reflecting conditions at the date of acquisition, are attributed to the net assets including significant owned brands acquired. Adjustments are also made to bring accounting policies into line with those of the group. Where statutory merger relief is applicable, the difference between the fair value of the business acquired and the nominal value of shares issued as purchase consideration is treated as a merger reserve.

The profit and loss on the disposal of a previously acquired business includes the attributable amount of purchased goodwill relating to that business, including any goodwill written off direct to reserves prior to 1 July 1998.

### Brands, goodwill and other intangible assets

When the cost of an acquisition exceeds the fair values attributable to the group's share of the net assets acquired, the difference is treated as purchased goodwill. Goodwill arising from 1 July 1998 is capitalised; prior to that date it was eliminated against reserves, and this goodwill has not been restated.

Acquired brands and other intangible assets which are controlled through custody or legal rights and could be sold separately from the rest of the business are capitalised, where fair value can be reliably measured.

Where capitalised goodwill and intangible assets are regarded as having limited useful economic lives, their cost is amortised on a straight-line basis over those lives – up to 20 years. Where goodwill and intangible assets are regarded as having indefinite useful economic lives, they are not amortised. Impairment reviews are carried out to ensure that goodwill and intangible assets are not carried at above their recoverable amounts. Any amortisation or impairment write downs are charged to the profit and loss account.

### Tangible fixed assets

Land and buildings are stated at cost or at professional valuation, less depreciation. Freehold land is not depreciated. Leaseholds are depreciated over the unexpired period of the lease. Other tangible fixed assets are depreciated on a straight-line basis to estimated residual values over their expected useful lives within the following ranges: industrial and other buildings – 10 to 50 years; plant and machinery – 5 to 25 years; fixtures and fittings – 5 to 10 years; casks and containers – 15 to 20 years; and computer software – up to 5 years.

Reviews are carried out if there is some indication that impairment may have occurred, to ensure that fixed assets are not carried at above their recoverable amounts.

### Leases

Where the group has substantially all the risks and rewards of ownership of an asset subject to a lease, the lease is treated as a finance lease. Other leases are treated as operating leases, with payments and receipts taken to the profit and loss account on a straight-line basis over the life of the lease.

### Associates and joint arrangements

An associate is an undertaking in which the group has a long term equity interest and over which it exercises significant influence. The group's interest in the net assets of associates is included in investments in the group balance sheet. Joint arrangements, where each party has its own separate interest in particular risks and rewards, are accounted for by including the attributable share of the assets and liabilities, measured according to the terms of the arrangement.

### Investment in own shares

Investment in own shares are held for the purpose of fulfilling obligations in respect of various employee share plans around the group. The difference between the purchase price of the shares and the exercise price of the option or grant is amortised over the relevant period (generally the three years from the date of an award), except for savings-related options granted prior to 1 July 1999 where the difference was taken as an exceptional charge on acquisition of the shares in 1999.

### Stocks

Stocks are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, and an appropriate proportion of production and other overheads.

### Foreign currencies

The profit and loss accounts and cash flows of overseas subsidiaries and associates are translated into sterling at weighted average rates of exchange, other than substantial exceptional items which are translated at the rate on the date of the transaction. The adjustment to closing rates is taken to reserves.

Balance sheets are translated at closing rates. Exchange differences arising on the re-translation at closing rates of the opening balance sheets of overseas subsidiaries and associates are taken to reserves, less exchange differences arising on related foreign currency borrowings and financial instruments. Tax charges and credits arising on such items are also taken to reserves. Other exchange differences are taken to the profit and loss account.

The results, assets and liabilities of operations in hyper-inflationary economies are determined using an appropriate relatively stable currency as the functional currency. The exchange differences arising from this process are taken to the profit and loss account.

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction, or, if hedged forward, at the rate of exchange under the related foreign currency contract.

### Turnover

Turnover represents the net invoice value of goods and services including excise duties and royalties receivable, but excluding value added tax.

### Advertising

Advertising production costs are charged to the profit and loss account when the advertisement is first shown to the public.

### Franchising

Franchising generates initial franchise fees, as well as profits or losses arising from the franchising of developed or purchased outlets previously operated by the group, and ongoing royalty revenues based on sales made by franchisees. Income from franchising is included in operating profit, apart from any property element which is treated as a disposal of fixed assets.

### Research and development

Research and development expenditure is written off in the period in which it is incurred.



### Pensions and other post employment benefits

The cost of providing pensions and other post employment benefits is charged against profits on a systematic basis, with pension surpluses and deficits arising allocated over the expected average remaining service lives of current employees. Differences between the amounts charged in the profit and loss account and payments made to pension or other plans are treated as assets or liabilities. Deferred tax is accounted for on these assets and liabilities. Unfunded post employment medical benefit liabilities are included in provisions in the balance sheet.

### Deferred taxation

Deferred taxation on differences between the treatment of certain items for accounting and taxation purposes is accounted for to the extent that a liability or an asset is expected to be payable or recoverable within the foreseeable future.

### Financial instruments

The group uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. Instruments accounted for as hedges are structured so as to reduce the market risk associated with the underlying transaction being hedged and are designated as a hedge at the inception of the contract. If the underlying transaction to a hedge ceases to exist, the hedge is terminated and the profit or loss is recognised immediately. If the hedge transaction is terminated, the profit or loss is held in the balance sheet and amortised over the life of the original underlying transaction.

Receipts and payments on interest rate instruments are recognised on an accruals basis over the life of the instrument. Foreign exchange contracts hedging balance sheet assets and liabilities are revalued at closing rates and exchange differences arising are taken to reserves. Gains and losses on contracts hedging forecast transactional cash flows, and on option instruments hedging the sterling value of foreign currency denominated income, are recognised in the hedged periods.

Cash flows associated with derivative financial instruments are classified in the cash flow statement in a manner consistent with those of the transactions being hedged. Finance costs associated with debt issuances are charged to the profit and loss account over the life of the issue.

## Notes to the consolidated accounts

### 1 Compliance with new accounting standards

The financial statements comply with the following new Financial Reporting Standards issued by the Accounting Standards Board.

**FRS 15 – Tangible fixed assets** This standard addresses the measurement, valuation and depreciation of tangible fixed assets. The group has adopted the transitional arrangements of the standard and has retained the book amounts of certain tangible assets which were previously revalued. It is expected that no further valuations will be carried out.

**FRS 16 – Current tax** This standard specifies how current tax, in particular withholding tax and tax credits, should be reflected in financial statements.

Compliance with the above new standards has not given rise to any restatement of figures reported for prior periods.

### 2 Segmental analysis

| Class of business         | 2000                  |                                  |                         | 1999                  |                                  |                         |
|---------------------------|-----------------------|----------------------------------|-------------------------|-----------------------|----------------------------------|-------------------------|
|                           | Turnover<br>£ million | Operating<br>profit<br>£ million | Net assets<br>£ million | Turnover<br>£ million | Operating<br>profit<br>£ million | Net assets<br>£ million |
| Spirits and Wine          | 4,971                 | 1,002                            | 4,221                   | 4,929                 | 967                              | 4,432                   |
| Beer                      | 2,146                 | 284                              | 751                     | 2,234                 | 273                              | 882                     |
| Packaged Food             | 3,812                 | 492                              | 3,734                   | 3,757                 | 478                              | 3,391                   |
| Quick Service Restaurants | 941                   | 202                              | 1,356                   | 875                   | 185                              | 1,226                   |
|                           | 11,870                | 1,980                            | 10,062                  | 11,795                | 1,903                            | 9,931                   |
| Investment in associates  |                       |                                  | 1,230                   |                       |                                  | 1,113                   |
| Tax, dividend and other   |                       |                                  | (462)                   |                       |                                  | (395)                   |
| Net borrowings            |                       |                                  | (5,545)                 |                       |                                  | (6,056)                 |
|                           |                       |                                  | 5,285                   |                       |                                  | 4,593                   |

#### Geographical area

|               |        |       |        |        |       |       |
|---------------|--------|-------|--------|--------|-------|-------|
| Europe        | 4,181  | 585   | 3,804  | 4,230  | 594   | 4,003 |
| North America | 5,639  | 956   | 5,696  | 5,656  | 936   | 5,266 |
| Asia Pacific  | 886    | 170   | 183    | 777    | 131   | 248   |
| Latin America | 697    | 165   | 252    | 716    | 155   | 258   |
| Rest of World | 467    | 104   | 127    | 416    | 87    | 156   |
|               | 11,870 | 1,980 | 10,062 | 11,795 | 1,903 | 9,931 |

(a) Profit before interest and tax for the year relates to the following activities: Spirits and Wine £840 million; Beer £376 million; Packaged Food £456 million; Quick Service Restaurants £145 million; and corporate exceptional costs £(3) million (1999 – £888 million; £414 million; £369 million; £175 million; and £(55) million, respectively).

(b) Profit before interest and tax, excluding the profit attributable to Moët Hennessy, for the year relates to the following geographical areas: Europe £402 million; North America £868 million; Asia Pacific £156 million; Latin America £146 million; and Rest of World £107 million (1999 – £574 million; £774 million; £122 million; £161 million; and £28 million, respectively).

(c) The analyses of operating profit in the tables above are before goodwill amortisation and exceptional items. The geographical analysis of turnover and operating profit is based on the location of the third party customers. The group interest expense is managed centrally and is not attributable to individual activities or geographical areas.

(d) The weighted average exchange rates used in the translation of profit and loss accounts were US dollar – £1 = \$1.60 (1999 – £1 = \$1.64) and euro – £1 = 1.59 (1999 – £1 = 1.48). Exchange rates used to translate assets and liabilities at the balance sheet date were US dollar – £1 = \$1.52 (1999 – £1 = \$1.58) and euro – £1 = 1.58 (1999 – £1 = 1.52).

### 3 Turnover

|  | 2000<br>£ million | 1999<br>£ million |
|--|-------------------|-------------------|
| <b>Geographical area by location of selling company:</b>   |                   |                   |
| Europe   | 4,810             | 4,784             |
| North America  | 6,001             | 5,914             |
| Asia Pacific   | 724               | 744               |
| Latin America  | 525               | 433               |
| Rest of World  | 407               | 439               |
|  | <b>12,467</b>     | <b>12,314</b>     |
| Less: Sales to group companies in other geographical areas | (597)             | (519)             |
|  | <b>11,870</b>     | <b>11,795</b>     |

Exports from the United Kingdom were £1,285 million (1999 – £1,161 million).

### 4 Operating costs

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Change in stocks  | (2)               | (19)              |
| Raw materials and consumables                           | 3,243             | 3,523             |
| Excise duties – United States                           | 328               | 373               |
| – Other   | 1,451             | 1,492             |
| Advertising, marketing and promotion                    | 1,706             | 1,647             |
| Other external charges                                  | 1,433             | 1,265             |
| Staff costs (note 5)                                    | 1,612             | 1,620             |
| Depreciation and other amounts written off fixed assets | 374               | 440               |
| Other operating income                                  | (57)              | (63)              |
|   | <b>10,088</b>     | <b>10,278</b>     |

Other external charges include: operating lease rentals for plant and machinery of £25 million (1999 – £30 million); other operating lease rentals (mainly properties) of £106 million (1999 – £58 million); and research and development expenditure of £69 million (1999 – £61 million). Other operating income includes £17 million (1999 – £17 million) from operating leases and £17 million (1999 – £nil) exceptional income (see note 7(c)).

**Goodwill and exceptional operating costs** Operating costs in the year include goodwill amortisation of £17 million (1999 – £4 million) and exceptional operating costs of £181 million (1999 – £382 million) as follows: other external charges £125 million; staff costs £64 million; depreciation and amortisation of fixed assets £9 million; and other operating income £17 million (1999 – £164 million; £138 million; £80 million; and £nil, respectively).

**Fees paid to auditors** Fees charged to operating profit in respect of the audit during the year were £2,500,000 (1999 – £2,600,000), including the statutory audit of the company of £23,000 (1999 – £23,000). Fees in respect of other services provided by KPMG Audit Plc and its associates were: to UK group companies £4,500,000 (1999 – £1,500,000); and to non-UK group companies £2,500,000 (1999 – £1,700,000).

### 5 Employees

| Average number of employees | 2000          |               |               | 1999          |               |               |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
|                             | Full time     | Part time     | Total         | Full time     | Part time     | Total         |
| Spirits and Wine            | 13,486        | 212           | 13,698        | 16,464        | 233           | 16,697        |
| Beer                        | 10,755        | 238           | 10,993        | 11,682        | 277           | 11,959        |
| Packaged Food               | 18,200        | 1,151         | 19,351        | 16,526        | 1,084         | 17,610        |
| Quick Service Restaurants   | 18,420        | 10,012        | 28,432        | 14,938        | 11,275        | 26,213        |
|                             | <b>60,861</b> | <b>11,613</b> | <b>72,474</b> | <b>59,610</b> | <b>12,869</b> | <b>72,479</b> |

| Aggregate remuneration     | £ million    | £ million    |
|----------------------------|--------------|--------------|
| Wages and salaries         | 1,472        | 1,474        |
| Employer's social security | 129          | 125          |
| Employer's pension         | (7)          | 1            |
| Other post employment      | 18           | 20           |
|                            | <b>1,612</b> | <b>1,620</b> |

## 5 Employees continued

**Pension plans** The group operates a number of pension plans throughout the world, devised in accordance with local conditions and practices. The plans are generally of the defined benefit type and are funded by payments to separately administered funds or insurance companies. The principal plans are in the United Kingdom, the United States and Ireland.

Valuations were carried out in 1999 of the UK, US and Irish plans. All valuations were done by independent actuaries using the projected unit method to determine pension costs. The principal assumptions were: real rate of return on assets 4% (1999 – 4.25% to 4.8%); real annual increase in wages and salaries 2% to 2.5% (1999 – 1.9% to 2.4%); real rate of future dividend growth for UK equities 1% (1999 – 0.75% to 1.25%); and pension increases to be approximately in line with inflation. Surpluses or deficits on the pension plans arising from the actuarial valuations are spread over the expected average service lives of the members (12 to 14 years) of the relevant fund on a straight-line basis using the single variation method. The market values of the assets of the principal funds at the dates of the latest actuarial valuations totalled approximately: UK fund – £3,068 million; US funds – £1,174 million; and Irish funds – £931 million. The actuarial value of the assets of those plans was sufficient to cover approximately 129% of the benefits that had accrued to members after allowing for expected future increases in wages and salaries.

Provision is made in the financial statements for the benefits accruing to members of unfunded pension schemes in accordance with the advice of independent actuaries.

The Diageo Pension Scheme is recharged with the cost of administration and professional fees by the company. The total amount recharged for the year was £13.8 million (1999 – £10.2 million).

**Other post employment plans** The group also operates a number of plans, primarily in the United States, which provide employees with other post employment benefits in respect of medical costs. The plans are generally unfunded and the liability in respect of these benefits is included in provisions. The liability is assessed by qualified independent actuaries under the projected unit method, assuming a liability discount rate of 7.5% (1999 – 8.4%) and medical inflation of 8% reducing by 1% per year to 5% (1999 – 9% reducing by 1% per year to 5%).

## 6 Associates

|  | 2000<br>£ million | 1999<br>£ million |
|--|-------------------|-------------------|
| Share of operating profit before exceptional items | 198               | 188               |
| Share of interest payable (net)                    | (3)               | (3)               |
| Share of exceptional items                         | (3)               | (8)               |
| Share of taxation                                  | (72)              | (72)              |
| Equity minority interests                          | (2)               | (2)               |
| Dividends received by the group                    | (64)              | (58)              |
| Share of profits retained by associates            | 54                | 45                |

Group turnover includes sales to associates of £35 million (1999 – £60 million) and operating costs include purchases from associates of £118 million (1999 – £100 million). The group's share of the operating profit of Moët Hennessy, which is a subsidiary of LVMH, was £135 million (1999 – £132 million).

## 7 Exceptional items

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| <b>Operating costs</b>                          |                   |                   |
| Merger integration (a)                          | (83)              | (262)             |
| Packaged Food integration and restructuring (b) | (43)              | (77)              |
| Quick Service Restaurants (c)                   | (55)              | –                 |
| Sharesave scheme                                | –                 | (43)              |
|   | (181)             | (382)             |

(a) £83 million costs were incurred in the year in respect of the integration of the Spirits and Wine businesses of GrandMet and Guinness. Approximately £40 million costs were employee related, principally redundancy, £14 million were asset write downs, and the balance included consultancy and systems costs.

(b) Packaged Food incurred integration and restructuring costs of £43 million. The integration of DCA Bakery, acquired in February 2000, and Hazelwood Farms Bakeries, acquired in May 1999, into its Pillsbury Bakeries and Foodservice division cost £14 million. The organisational changes announced in March 2000, which are resulting in the elimination of approximately 400 positions, cost £29 million.

(c) Exceptional items relating to Quick Service Restaurants amounted to a net charge of £55 million. Litigation damages of £34 million were awarded by an Australian court in a legal dispute with Burger King's Australian franchisee, Hungry Jack's Pty Ltd. In addition, £38 million was incurred to minimise the interruption of product supply to its entire US system and to ensure a smooth transition to Burger King's new US regional distributors following AmeriServe's bankruptcy filing in January 2000; the principal cost related to short term financing granted to AmeriServe. These costs have been partly offset by exceptional income of £17 million. Burger King, as part of its transformation programme, has incentivised franchisees with phased royalty charges for a specified time if they agree to upgrade and migrate their existing restaurants to the current image requirements within 18 months and 12 months for the 2000 and 2001 programmes, respectively. The successor franchise agreement involves the receipt of early successor fees, which are being reported as exceptional income in financial years 2000 and 2001.

**Associates** The £3 million associate exceptional charge is in respect of reorganisation costs at Ice Cream Partners (1999 – £8 million in respect of East African Breweries Limited).

## 7 Exceptional items continued

|                              |                                 | 2000         | 1999       |
|------------------------------|---------------------------------|--------------|------------|
|                              |                                 | £ million    | £ million  |
| <b>Sale of businesses</b>    |                                 |              |            |
| Spirits and Wine             | European and other brands       | (247)        | 29         |
| Beer                         | Grupo Cruzcampo SA              | 82           | –          |
| Packaged Food                | North American and other brands | (3)          | (38)       |
| Interests in associates      | Cantrell & Cochrane and others  | –            | 113        |
| <b>(Loss)/profit on sale</b> |                                 | <b>(168)</b> | <b>104</b> |

## 8 Interest payable (net)

|  |  | 2000      | 1999      |
|--|--|-----------|-----------|
|  |  | £ million | £ million |
| <b>On bank loans and overdrafts</b>                |  |           |           |
|  |  | 31        | 26        |
| <b>On all other borrowings</b>                     |  |           |           |
|  |  | 435       | 406       |
| <b>Share of net interest payable by associates</b> |  |           |           |
|  |  | 3         | 3         |
|  |  | 469       | 435       |
| <b>Less: Other interest receivable</b>             |  |           |           |
|  |  | (106)     | (111)     |
|  |  | 363       | 324       |

## 9 Taxation

|  |  | 2000      | 1999      |
|--|--|-----------|-----------|
|  |  | £ million | £ million |
| <b>Tax charge</b>                                      |  |           |           |
| UK corporation tax payable at 30% (1999 – 30.75%)      |  | 114       | 172       |
| Less: Double taxation relief                           |  | (35)      | (176)     |
|  |  | 79        | (4)       |
| UK deferred taxation                                   |  | 10        | 11        |
| Overseas corporate taxation                            |  | 227       | 368       |
| Overseas deferred taxation                             |  | 12        | (48)      |
| Taxation on the group's share of profits of associates |  | 72        | 72        |
| Adjustments to prior period taxation charges           |  | 1         | 41        |
|  |  | 401       | 440       |

### Tax reconciliation

|  |  |       |       |
|--|--|-------|-------|
| Profit on ordinary activities before taxation                  |  | 1,451 | 1,467 |
| Notional charge at UK corporation tax rate 30% (1999 – 30.75%) |  | 435   | 451   |
| Differences in effective overseas tax rates                    |  | (29)  | (99)  |
| Exceptional items  |  | 33    | 69    |
| Adjustments to prior period taxation charges                   |  | 1     | 41    |
| Other items  |  | (39)  | (22)  |
| Actual charge for taxation                                     |  | 401   | 440   |

The tax charge includes tax relief of £71 million (1999 – £23 million) in respect of exceptional items and £4 million (1999 – £nil) in respect of goodwill amortisation.

## 10 Dividends

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Interim 8.4 pence per share (1999 – 7.8 pence)          | 285               | 276               |
| Proposed final 12.6 pence per share (1999 – 11.7 pence) | 428               | 398               |
|   | <b>713</b>        | <b>674</b>        |

## 11 Earnings per share

|  | 2000                  |                   | 1999                  |                   |
|--|-----------------------|-------------------|-----------------------|-------------------|
|  | Earnings<br>£ million | Shares<br>million | Earnings<br>£ million | Shares<br>million |
| Basic (profit/weighted average number of shares) | 976                   | 3,393             | 942                   | 3,533             |
| Adjustments – potential employee share issues    | –                     | 5                 | –                     | 16                |
| – B shares                                       | –                     | –                 | –                     | 1                 |
| Diluted  | 976                   | 3,398             | 942                   | 3,550             |

Basic and diluted earnings per share are also shown on the face of the profit and loss account calculated by reference to earnings before the £289 million (1999 – £277 million) charge for goodwill amortisation and exceptional items, and the related tax, since the directors consider that this gives a useful additional indication of underlying performance.

## 12 Fixed assets – intangible assets

|                          | Brands<br>£ million | Goodwill<br>£ million | Other<br>intangibles<br>£ million | Total<br>£ million |
|--------------------------|---------------------|-----------------------|-----------------------------------|--------------------|
| <b>Cost</b>              |                     |                       |                                   |                    |
| At 30 June 1999          | 4,875               | 297                   | 22                                | 5,194              |
| Exchange adjustments     | 149                 | 13                    | –                                 | 162                |
| Additions                | –                   | 106                   | 2                                 | 108                |
| Disposals                | (149)               | –                     | –                                 | (149)              |
| At 30 June 2000          | 4,875               | 416                   | 24                                | 5,315              |
| <b>Amortisation</b>      |                     |                       |                                   |                    |
| At 30 June 1999          | –                   | 4                     | 2                                 | 6                  |
| Provided during the year | –                   | 17                    | 3                                 | 20                 |
| At 30 June 2000          | –                   | 21                    | 5                                 | 26                 |
| <b>Net book value</b>    |                     |                       |                                   |                    |
| At 30 June 2000          | 4,875               | 395                   | 19                                | 5,289              |
| At 30 June 1999          | 4,875               | 293                   | 20                                | 5,188              |

Brands are stated at fair value on acquisition, denominated in the currencies of their principal markets. An annual review is carried out by the directors to consider whether any brand has suffered an impairment in value. The principal acquired brands included above are Johnnie Walker, Smirnoff, Pillsbury, Old El Paso, Progresso and Burger King.



### 13 Fixed assets – tangible assets

|                          | Land and buildings<br>£ million | Plant and machinery<br>£ million | Fixtures and fittings<br>£ million | Assets in course of construction<br>£ million | Total<br>£ million |
|--------------------------|---------------------------------|----------------------------------|------------------------------------|---|--------------------|
| <b>Cost or valuation</b> |                                 |                                  |                                    |   |                    |
| At 30 June 1999          | 1,937                           | 2,654                            | 196                                | 202   | 4,989              |
| Exchange adjustments     | 26                              | (14)                             | 4                                  | 3   | 19                 |
| Additions                | 94                              | 237                              | 35                                 | 199   | 565                |
| Disposals                | (200)                           | (531)                            | (16)                               | (60)  | (807)              |
| Transfers                | 44                              | 32                               | 5                                  | (81)  | –                  |
| At 30 June 2000          | 1,901                           | 2,378                            | 224                                | 263   | 4,766              |
| <b>Depreciation</b>      |                                 |                                  |                                    |   |                    |
| At 30 June 1999          | 495                             | 1,214                            | 102                                | –   | 1,811              |
| Exchange adjustments     | 10                              | (7)                              | 3                                  | –   | 6                  |
| Provided during the year | 68                              | 213                              | 48                                 | –   | 329                |
| Exceptional write downs  | 8                               | 1                                | –                                  | –   | 9                  |
| Disposals                | (89)                            | (373)                            | (5)                                | –   | (467)              |
| At 30 June 2000          | 492                             | 1,048                            | 148                                | –   | 1,688              |
| <b>Net book value</b>    |                                 |                                  |                                    |   |                    |
| At 30 June 2000          | 1,409                           | 1,330                            | 76                                 | 263   | 3,078              |
| At 30 June 1999          | 1,442                           | 1,440                            | 94                                 | 202   | 3,178              |

(a) The net book value of land and buildings comprises: freeholds of £1,265 million (1999 – £1,316 million); long leaseholds of £50 million (1999 – £48 million); and short leaseholds of £94 million (1999 – £78 million). Depreciation was not charged on £322 million (1999 – £335 million) of land.

(b) Included in the total net book value of tangible assets is £41 million (1999 – £39 million) in respect of assets under finance leases; depreciation for the year on these assets was £4 million (1999 – £4 million). Cost included £184 million (1999 – £174 million) in respect of assets held for the purpose of leasing out under operating leases; accumulated depreciation on these assets was £55 million (1999 – £48 million) and depreciation for the year was £4 million (1999 – £4 million).

(c) The total at cost or valuation for land and buildings comprises: £558 million (1999 – £574 million) at 1992 professional valuation; £123 million (1999 – £135 million) at 1988 professional valuation; and £1,220 million (1999 – £1,228 million) at cost. The professional valuations were made on an open market existing use basis except for specialised properties which were valued on a depreciated replacement cost basis.

(d) The historical cost of land and buildings, i.e. the original cost to the group of all land and buildings, was £1,763 million (1999 – £1,764 million) and the related accumulated depreciation was £492 million (1999 – £495 million).

### 14 Fixed assets – investments

|                                | Investment in associates<br>£ million | Investment in own shares<br>£ million | Other investments<br>£ million | Loans<br>£ million | Total<br>£ million |
|--------------------------------|---------------------------------------|---------------------------------------|--------------------------------|--------------------|--------------------|
| <b>Cost</b>                    |                                       |                                       |                                |                    |                    |
| At 30 June 1999                | 1,114                                 | 182                                   | 47                             | 97                 | 1,440              |
| Exchange adjustments           | (14)                                  | –                                     | 1                              | 1                  | (12)               |
| Additions                      | 80                                    | 67                                    | 72                             | 3                  | 222                |
| Share of retained profits      | 54                                    | –                                     | –                              | –                  | 54                 |
| Disposals                      | (1)                                   | (51)                                  | (54)                           | (22)               | (128)              |
| At 30 June 2000                | 1,233                                 | 198                                   | 66                             | 79                 | 1,576              |
| <b>Provisions/amortisation</b> |                                       |                                       |                                |                    |                    |
| At 30 June 1999                | 1                                     | 64                                    | 10                             | 11                 | 86                 |
| Amortisation of own shares     | –                                     | 16                                    | –                              | –                  | 16                 |
| Created                        | 2                                     | –                                     | –                              | –                  | 2                  |
| Disposals                      | –                                     | (24)                                  | –                              | –                  | (24)               |
| At 30 June 2000                | 3                                     | 56                                    | 10                             | 11                 | 80                 |
| <b>Net book value</b>          |                                       |                                       |                                |                    |                    |
| At 30 June 2000                | 1,230                                 | 142                                   | 56                             | 68                 | 1,496              |
| At 30 June 1999                | 1,113                                 | 118                                   | 37                             | 86                 | 1,354              |

## 14 Fixed assets – investments continued

Investment in associates comprises the cost of shares, less goodwill written off on acquisitions prior to 1 July 1998, of £962 million (1999 – £884 million) plus the group's share of post-acquisition reserves of £268 million (1999 – £229 million). Investment in associates include £901 million (1999 – £883 million) in respect of Moët Hennessy.

Investment in own shares at 30 June 2000 comprised 25.1 million ordinary shares held in respect of longer term incentive plans for executive directors and senior executives and 7.3 million ordinary shares held in respect of grants under UK, Irish and US savings-related share option schemes. The market value of these shares at 30 June 2000 was £192 million (1999 – 28.4 million ordinary shares, £188 million).

The net book value of other investments listed on UK stock exchanges was £12 million (1999 – £21 million), and other stock exchanges was £36 million (1999 – £35 million). These investments had a market value of £48 million (1999 – £56 million).

## 15 Stocks

|                                     | 2000<br>£ million | 1999<br>£ million |
|-------------------------------------|-------------------|-------------------|
| Raw materials and consumables       | 234               | 266               |
| Work in progress                    | 34                | 41                |
| Maturing stocks                     | 1,281             | 1,310             |
| Finished goods and goods for resale | 590               | 585               |
|                                     | <b>2,139</b>      | <b>2,202</b>      |

The group estimates that the replacement cost of the maturing stocks at 30 June 2000 was higher than the carrying value by approximately £600 million (1999 – £600 million).

## 16 Debtors

|   | 2000                                |                                    | 1999                                |                                    |
|---|-------------------------------------|------------------------------------|-------------------------------------|------------------------------------|
|   | Due within<br>one year<br>£ million | Due after<br>one year<br>£ million | Due within<br>one year<br>£ million | Due after<br>one year<br>£ million |
| Trade debtors                           | 1,270                               | –                                  | 1,404                               | –                                  |
| Amounts owed by associates              | 1                                   | 3                                  | 6                                   | –                                  |
| Amounts receivable under finance leases | 6                                   | 90                                 | 8                                   | 86                                 |
| Other debtors                           | 320                                 | 243                                | 269                                 | 188                                |
| Pension prepayments                     | –                                   | 711                                | –                                   | 672                                |
| Other prepayments and accrued income    | 130                                 | 36                                 | 165                                 | 19                                 |
| Deferred taxation (note 21)             | 4                                   | 64                                 | 23                                  | 86                                 |
| ACT recoverable                         | 114                                 | 40                                 | 56                                  | 239                                |
|   | <b>1,845</b>                        | <b>1,187</b>                       | <b>1,931</b>                        | <b>1,290</b>                       |

**Debtors subject to financing arrangements** Franchisee loans originated by the group have been sold to a financial institution on a limited recourse basis, with the group retaining the net income from the portfolio after third party costs have been met. Loans outstanding at 30 June 2000 were £258 million (1999 – £234 million). They were subject to recourse of £39 million (1999 – £38 million), which is included in borrowings. The group is not obliged to support any losses in respect of the non-returnable finance and does not intend to do so. In addition, the provider of finance has agreed in writing to seek repayment only to the extent that sufficient funds are generated by the franchisee loans and not to seek recourse in any other form.

## 17 Net borrowings and facilities

|  | At<br>30 June 1999<br>£ million | Cash flow<br>£ million | Non-cash<br>items<br>£ million | Exchange<br>adjustments<br>£ million | At<br>30 June 2000<br>£ million |
|--|---------------------------------|------------------------|--------------------------------|--------------------------------------|---------------------------------|
| <b>Analysis of net borrowings</b>                    |                                 |                        |                                |                                      |                                 |
| <b>Cash and overdrafts</b>                           |                                 |                        |                                |                                      |                                 |
| Cash at bank and in hand                             | 1,097                           | (27)                   | –                              | (7)                                  | 1,063                           |
| Less: Bank deposits reclassified to liquid resources | (362)                           | (219)                  | –                              | 1                                    | (580)                           |
| Overdrafts   | (293)                           | 109                    | –                              | 5                                    | (179)                           |
|  | 442                             | (137)                  | –                              | (1)                                  | 304                             |
| <b>Borrowings excluding overdrafts</b>               |                                 |                        |                                |                                      |                                 |
| Borrowings due within one year                       | (3,612)                         | 844                    | (68)                           | (51)                                 | (2,887)                         |
| Borrowings due after one year                        | (3,395)                         | (239)                  | 32                             | (114)                                | (3,716)                         |
| Interest rate and foreign currency swaps             | 185                             | (58)                   | 43                             | 43                                   | 213                             |
| Net obligations under finance leases                 | (38)                            | (3)                    | (3)                            | 5                                    | (39)                            |
|  | (6,860)                         | 544                    | 4                              | (117)                                | (6,429)                         |
| <b>Liquid resources</b>                              |                                 |                        |                                |                                      |                                 |
| Bank deposits reclassified from cash                 | 362                             | 219                    | –                              | (1)                                  | 580                             |
| <b>Net borrowings</b>                                | <b>(6,056)</b>                  | <b>626</b>             | <b>4</b>                       | <b>(119)</b>                         | <b>(5,545)</b>                  |

£12 million (1999 – £28 million) of net borrowings due after one year and £109 million (1999 – £97 million) of net borrowings due within one year were secured on assets of the group.

The interest rate swaps included in net borrowings comprise interest accruals on the swaps relating to the zero coupon bonds 2004. The foreign currency swaps comprise the net amount from the translation of the group's foreign currency swap principal amounts. The interest rate and foreign currency swaps are included in other debtors. Bank deposits represent amounts placed with financial institutions which require notice of withdrawal of more than 24 hours in order to avoid an interest penalty.

|  | Currency     | Year end<br>interest rates<br>% | 2000<br>£ million | 1999<br>£ million |
|--|--------------|---------------------------------|-------------------|-------------------|
| <b>Borrowings excluding overdrafts</b> |              |                                 |                   |                   |
| Commercial paper                       | US dollar    | 4.87-5.80                       | 857               | 2,206             |
| Commercial paper                       | Euro         | 2.51-2.82                       | –                 | 122               |
| Guaranteed notes 1999                  | US dollar    | 6.5                             | –                 | 190               |
| Bonds 1999                             | US dollar    | 6.375                           | –                 | 127               |
| Bonds 2000                             | US dollar    | 6.25                            | –                 | 158               |
| Guaranteed bonds 2000                  | US dollar    | 6.24                            | 230               | –                 |
| Guaranteed bonds 2000                  | US dollar    | Variable                        | 329               | –                 |
| Guaranteed bonds 2000                  | US dollar    | Variable                        | 329               | –                 |
| Guaranteed notes 2001                  | US dollar    | 8.625                           | 197               | 189               |
| Bonds 2002                             | French franc | 6.25                            | 145               | 150               |
| Guaranteed bonds 2003                  | US dollar    | 6.0                             | 327               | 314               |
| Guaranteed bonds 2004                  | US dollar    | 6.625                           | 656               | 630               |
| Zero coupon bonds 2004                 | US dollar    | 8.13                            | 609               | 540               |
| Guaranteed notes 2004                  | US dollar    | 7.125                           | 131               | 126               |
| Guaranteed bonds 2005                  | US dollar    | 6.125                           | 327               | 314               |
| Guaranteed bonds 2005                  | Sterling     | 9.0                             | 199               | 199               |
| Guaranteed notes 2005/2035             | US dollar    | 7.45                            | 263               | 253               |
| Guaranteed debentures 2011             | US dollar    | 9.0                             | 196               | 188               |
| Guaranteed debentures 2022             | US dollar    | 8.0                             | 195               | 188               |
| Medium term notes                      | Various      | Various                         | 716               | 567               |
| Bank loans                             | Various      | Various                         | 166               | 336               |
| Repurchase agreement                   | Sterling     | 5.86                            | 500               | –                 |
| Others less swaps                      | Various      | Various                         | 57                | 63                |
| <b>Total</b>                           |              |                                 | <b>6,429</b>      | <b>6,860</b>      |

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection (see note 18). The above loans are stated net of unamortised finance costs of £217 million (1999 – £262 million) of which £197 million (1999 – £234 million) relates to the zero coupon bonds 2004.

## 18 Financial instruments and risk management

A discussion of the group's objectives and policies with regard to risk management and the use of financial instruments can be found in the operating and financial review. Financial instruments comprise net borrowings (see note 17) together with other instruments deemed to be financial instruments including certain fixed asset investments, long term debtors, other long term creditors and provisions for liabilities and charges. Disclosures dealt with in this note exclude short term debtors and creditors where permitted by the accounting standard on derivatives and other financial instruments (FRS 13).

(i) **Currency risk management** At 30 June 2000, the group's net assets before net borrowings of £10.8 billion were principally denominated in US dollars £5.6 billion, sterling £3.1 billion and euro £1.3 billion. Net borrowings of £5.5 billion include amounts denominated in US dollars of £4.2 billion, euro of £1.2 billion and net sterling cash of £0.1 billion, after taking into account the impact of interest rate and currency swaps. Consequently, US dollar and euro net assets before net borrowings at 30 June 2000 were approximately 75% and 92% hedged respectively.

As at 30 June 2000 and 6 September 2000 currency cylinders and options protect the translation of estimated overseas profits for the year ending 30 June 2001 within the following weighted average ranges:

|                       | 30 June 2000               |               | 6 September 2000           |               |
|-----------------------|----------------------------|---------------|----------------------------|---------------|
|                       | Hedged amount<br>£ million | Average range | Hedged amount<br>£ million | Average range |
| US dollar – cylinders | 681                        | 1.58-1.63     | 530                        | 1.58-1.64     |
| Euro – cylinders      | 57                         | 1.41-1.49     | 89                         | 1.56-1.63     |
| – options             | 161                        | 1.64          | 203                        | 1.65          |

The group's expected transaction exposure, for currencies in which there is an active market, is hedged forward between 80% and 100% for the period ending 31 December 2001.

At 30 June 2000 there were no material monetary assets or liabilities in currencies other than the functional currencies of group companies, having taken into account the effect of forward contract and other derivative financial instruments that have been utilised to match foreign currency exposure.

(ii) **Interest risk management** At 30 June 2000, after taking account of interest rate swaps, cross currency interest rate swaps and forward rate agreements, the currency and interest rate profile of the financial liabilities and assets of the group was as follows:

|  | Floating rate<br>£ million | Fixed rate<br>£ million | Interest free<br>£ million | Total<br>£ million | Impact of foreign currency swaps<br>£ million | Total<br>£ million | Weighted average fixed rate<br>% | Weighted average time to maturity<br>Years |
|--|----------------------------|-------------------------|----------------------------|--------------------|---|--------------------|----------------------------------|--|
| <b>Financial liabilities:</b>          |                            |                         |                            |                    |   |                    |                                  |  |
| US dollar                              | (2,576)                    | (2,231)                 | (144)                      | (4,951)            | 382   | (4,569)            | 6.4                              | 2.7  |
| Euro                                   | (298)                      | (644)                   | (9)                        | (951)              | (412)   | (1,363)            | 4.2                              | 2.5  |
| Sterling                               | (585)                      | (525)                   | (42)                       | (1,152)            | 710   | (442)              | 5.4                              | 2.4  |
| Other                                  | (88)                       | (122)                   | –                          | (210)              | (215)   | (425)              | 5.0                              | 0.8  |
|  | (3,547)                    | (3,522)                 | (195)                      | (7,264)            | 465   | (6,799)            | 5.8                              | 2.6  |
| <b>Guaranteed preferred securities</b> | –                          | (405)                   | –                          | (405)              | –   | (405)              | 9.3                              | 4.5  |
| <b>Financial assets:</b>               |                            |                         |                            |                    |   |                    |                                  |  |
| US dollar                              | 225                        | 133                     | 159                        | 517                | –   | 517                | 7.5                              | 8.4  |
| Euro                                   | 109                        | –                       | 12                         | 121                | –   | 121                | –                                | –  |
| Sterling                               | 188                        | 341                     | 32                         | 561                | –   | 561                | 7.1                              | 2.5  |
| Other                                  | 244                        | –                       | 6                          | 250                | –   | 250                | –                                | –  |
|  | 766                        | 474                     | 209                        | 1,449              | –   | 1,449              | 7.2                              | 4.2  |
| <b>Net financial liabilities</b>       | <b>(2,781)</b>             | <b>(3,453)</b>          | <b>14</b>                  | <b>(6,220)</b>     | <b>465</b>                                    | <b>(5,755)</b>     | <b>6.0</b>                       | <b>2.6</b>                                 |

Floating rate financial liabilities bear interest based on short term interbank rates (predominantly six months LIBOR) and commercial paper rates.

Interest bearing financial liabilities comprise bonds, medium term notes, commercial paper issued, money market loans, repurchase and forward rate agreements, net obligations under finance leases and bank overdrafts. Financial liabilities on which no interest is paid consist of: provisions for liabilities and charges payable after one year in respect of employee incentive plans and disposals of £25 million; long term creditors of £65 million; and derivative financial instruments of £105 million. Interest bearing financial assets comprise cash, money market deposits and certain fixed asset investments, loans and debtors. Financial assets on which no interest is paid include certain fixed asset investments, loans and debtors.

The foreign currency swaps, in the table above, adjust the currency basis of borrowings as part of the group's policy to hedge its exposure to fluctuations on translation into sterling of its foreign currency net assets (see (i) above). The foreign currency swaps are short term in nature and therefore have a floating interest basis. They are shown after taking account of fixing interest rate swaps which transfer £480 million of euro floating rate interest liabilities arising from foreign currency swaps into euro fixed rate financial liabilities.

In addition to the interest rate and currency swaps reflected in the table above, the group has £2,007 million notional principal of US dollar interest rate collars which mature between 31 December 2001 and 31 December 2004 and have floors of 5.03%–6.32% and caps of 7.30%–8.75%.

## 18 Financial instruments and risk management continued

### (iii) Maturity of financial liabilities

|                                       | 2000                                   |                               |                                       |                    | 1999                                   |                               |                                       |                    |
|---------------------------------------|--|-------------------------------|---------------------------------------|--------------------|--|-------------------------------|---------------------------------------|--------------------|
|                                       | Bank loans and overdrafts<br>£ million | Other borrowings<br>£ million | Finance leases and other<br>£ million | Total<br>£ million | Bank loans and overdrafts<br>£ million | Other borrowings<br>£ million | Finance leases and other<br>£ million | Total<br>£ million |
| <b>Analysis by year of repayment:</b> |  |                               |                                       |                    |  |                               |                                       |                    |
| After five years                      | 1                                      | 962                           | 25                                    | 988                | 12                                     | 1,316                         | 51                                    | 1,379              |
| From two to five years                | 9                                      | 2,176                         | 28                                    | 2,213              | 18                                     | 1,797                         | 90                                    | 1,905              |
| From one to two years                 | 7                                      | 333                           | 72                                    | 412                | 15                                     | 62                            | 41                                    | 118                |
| Due after one year                    | 17                                     | 3,471                         | 125                                   | 3,613              | 45                                     | 3,175                         | 182                                   | 3,402              |
| Due within one year                   | 328                                    | 2,753                         | 105                                   | 3,186              | 584                                    | 3,311                         | 23                                    | 3,918              |
|                                       | 345                                    | 6,224                         | 230                                   | 6,799              | 629                                    | 6,486                         | 205                                   | 7,320              |

Other borrowings are net of interest rate and foreign currency swaps.

The group had available undrawn committed bank facilities at 30 June 2000 as follows:

|                                 | £ million |
|---------------------------------|-----------|
| Expiring within one year        | 1,263     |
| Expiring in more than two years | 1,007     |
|                                 | 2,270     |

Commitment fees are paid on the undrawn portion of these facilities. Borrowings under these facilities will be at prevailing LIBOR rates plus an agreed margin, which is dependent on the period of drawdown. These facilities can be used for general corporate purposes and together with cash and cash equivalents support the group's commercial paper programmes.

(iv) **Fair values** The estimated fair values of borrowings, guaranteed preferred securities, associated derivative financial instruments and other financial liabilities and assets at 30 June 2000 are set out below. The fair values of quoted borrowings and guaranteed preferred securities are based on year end mid-market quoted prices. The fair values of other borrowings, derivative financial instruments and other financial liabilities and assets are estimated by discounting the future cash flows to net present values using appropriate market rates prevailing at the year end. These are based on fair values obtained from third parties.

|   | 2000                             |                                   | 1999                             |                                   |
|---|----------------------------------|-----------------------------------|----------------------------------|-----------------------------------|
|   | Net carrying amount<br>£ million | Estimated fair value<br>£ million | Net carrying amount<br>£ million | Estimated fair value<br>£ million |
| <b>Primary financial instruments:</b>                           |                                  |                                   |                                  |                                   |
| Borrowings due within one year including overdrafts             | (3,066)                          | (3,064)                           | (3,905)                          | (3,899)                           |
| Borrowings due after one year                                   | (3,716)                          | (3,745)                           | (3,395)                          | (3,534)                           |
| Cash at bank and in hand  | 1,063                            | 1,063                             | 1,097                            | 1,097                             |
| Guaranteed preferred securities                                 | (405)                            | (443)                             | (388)                            | (429)                             |
| <b>Derivatives – interest rate contracts:</b>                   |                                  |                                   |                                  |                                   |
| Interest rate swaps – positive values                           | 309                              | 316                               | 224                              | 286                               |
| – negative values   | (77)                             | (120)                             | (6)                              | (73)                              |
| Collars   | (17)                             | 7                                 | (20)                             | 8                                 |
| Other interest rate contracts                                   | 2                                | 5                                 | (1)                              | (6)                               |
| <b>Derivatives – foreign exchange contracts:</b>                |                                  |                                   |                                  |                                   |
| Transaction – positive values                                   | –                                | 28                                | –                                | 16                                |
| – negative values   | –                                | (50)                              | –                                | (38)                              |
| Balance sheet translation – positive values                     | 13                               | 22                                | 14                               | 21                                |
| – negative values   | (28)                             | (28)                              | (2)                              | (10)                              |
| Foreign exchange options (profit translation) – positive values | –                                | 5                                 | –                                | 9                                 |
| – negative values   | (2)                              | (28)                              | (3)                              | (15)                              |
| <b>Other:</b>   |                                  |                                   |                                  |                                   |
| Derivatives – futures and option commodity contracts            | –                                | (3)                               | –                                | 3                                 |
| Other financial liabilities                                     | (109)                            | (110)                             | (154)                            | (156)                             |
| Other financial assets  | 278                              | 298                               | 260                              | 259                               |

The difference between net carrying amount and estimated fair value reflects unrealised gains or losses inherent in the instrument based on valuations at 30 June 2000. The volatile nature of the markets means that values at any subsequent date could be significantly different from the values reported above.

## 18 Financial instruments and risk management continued

(v) **Hedges** Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. The table below shows the extent to which the group has unrecognised gains and losses on financial instruments, and deferred gains and losses in respect of financial instruments and terminated financial instruments used as hedges, at the beginning and end of the year.

| Gains/(losses):   | Unrecognised       |                     |                    | Deferred           |                     |                    |
|---|--------------------|---------------------|--------------------|--------------------|---------------------|--------------------|
|   | Gains<br>£ million | Losses<br>£ million | Total<br>£ million | Gains<br>£ million | Losses<br>£ million | Total<br>£ million |
| On hedges at 30 June 1999   | 121                | (116)               | 5                  | 20                 | (28)                | (8)                |
| Arising in previous years recognised during the year ended 30 June 2000 | 102                | (80)                | 22                 | 11                 | (6)                 | 5                  |
| On hedges at 30 June 2000   | 81                 | (122)               | (41)               | 12                 | (27)                | (15)               |
| Of which gains/(losses) expected to be recognised in:                   |                    |                     |                    |                    |                     |                    |
| – year ending 30 June 2001  | 35                 | (72)                | (37)               | 3                  | (6)                 | (3)                |
| – year ending 30 June 2002 or later                                     | 46                 | (50)                | (4)                | 9                  | (21)                | (12)               |

## 19 Other creditors

|  | 2000                             |                                 | 1999                             |                                 |
|--|----------------------------------|---------------------------------|----------------------------------|---------------------------------|
|  | Due within one year<br>£ million | Due after one year<br>£ million | Due within one year<br>£ million | Due after one year<br>£ million |
| Trade creditors                          | 652                              | 2                               | 684                              | –                               |
| Corporate taxation                       | 574                              | –                               | 704                              | –                               |
| Other taxation including social security | 217                              | –                               | 201                              | –                               |
| Net obligations under finance leases     | 4                                | 35                              | 4                                | 34                              |
| Other creditors                          | 653                              | 47                              | 687                              | 60                              |
| Ordinary dividends payable               | 428                              | –                               | 398                              | –                               |
| Accruals and deferred income             | 747                              | 16                              | 854                              | 6                               |
|  | 3,275                            | 100                             | 3,532                            | 100                             |

### Gross obligation under finance leases due:

|                              |      |      |
|------------------------------|------|------|
| After five years             | 51   | 43   |
| From one to five years       | 30   | 30   |
|                              | 81   | 73   |
| Less: Future finance charges | (46) | (39) |
|                              | 35   | 34   |

## 20 Provisions for liabilities and charges

|                                | Post employment<br>£ million | Restructuring and integration<br>£ million | Disposal<br>£ million | Deferred taxation<br>£ million | Other<br>£ million | Total<br>£ million |
|--------------------------------|------------------------------|--|-----------------------|--------------------------------|--------------------|--------------------|
| At 30 June 1999                | 336                          | 60   | 69                    | 41                             | 247                | 753                |
| Exchange adjustments           | 4                            | 2  | –                     | –                              | 4                  | 10                 |
| Profit and loss account charge | 23                           | 44   | 6                     | 9                              | 89                 | 171                |
| Disposals                      | (89)                         | –  | –                     | –                              | (3)                | (92)               |
| Utilised                       | (5)                          | (51)                                       | (38)                  | –                              | (54)               | (148)              |
| At 30 June 2000                | 269                          | 55   | 37                    | 50                             | 283                | 694                |



## 20 Provisions for liabilities and charges continued

### Provisions at 30 June 2000

(a) Post employment provisions were £269 million, comprising £197 million post employment benefits in respect of US medical costs and £72 million in respect of unfunded pension liabilities (1999 – £179 million and £157 million, respectively). These provisions are mainly actuarially assessed and are long term.

(b) Restructuring and integration provisions were £55 million, comprising £8 million for merger integration (principally the UK production operations of Spirits and Wine), £29 million for the integration of acquired businesses into the Pillsbury Bakeries and Foodservice division and £18 million in respect of other restructuring costs. The majority of these provisions will be utilised in the next financial year.

(c) Disposal provisions were £37 million arising from commitments in respect of businesses sold. These provisions will predominately be utilised within the next few years.

(d) Deferred taxation was £50 million (see note 21).

(e) Other provisions were £283 million, including £66 million for the estimated discounted rental shortfall in respect of vacant properties, £57 million for actuarially assessed non-insured claims and £38 million for employee incentive plans (1999 – £71 million, £62 million and £38 million, respectively). The vacant property provision is based on the estimated discounted rental shortfall over the terms of the leases; the non-insured claims are long term and the timing of their utilisation is not known; and the incentive plan provision will be utilised within the next few years.

## 21 Deferred taxation

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Accelerated depreciation                            | 124               | 129               |
| Pension prepayments and provisions                  | 195               | 149               |
| Post employment benefits other than pensions        | (67)              | (62)              |
| Restructuring and integration costs                 | (21)              | (22)              |
| Vacant properties                                   | (20)              | (22)              |
| Other timing differences                            | (229)             | (240)             |
| Net asset   | (18)              | (68)              |
| US and other overseas deferred tax assets (note 16) | 68                | 109               |
| UK deferred tax provision (note 20)                 | 50                | 41                |

Provision for tax on capital gains payable on the disposal of revalued properties is made only when it is decided in principle to dispose of the asset. Other deferred taxation not provided, principally in respect of accelerated depreciation, amounted to £2 million (1999 – £26 million). Deferred tax is not generally provided in respect of liabilities which might arise on the distribution of unappropriated profits of overseas subsidiaries and associates, except where distributions of such profits are planned.

## 22 Called up share capital

**Authorised and issued share capital** The authorised share capital of the company at 30 June 2000 was £1,542 million (1999 – £1,542 million). The allotted and fully paid share capital was 3,422 million ordinary shares of 28<sup>101/108</sup> pence each with an aggregate nominal value of £990 million (1999 – 3,428 million shares, aggregate nominal value £992 million).

### Movements in called up share capital

(a) During the year 4 million ordinary shares (nominal value £1 million) were allotted under the share option schemes for a total consideration of £12 million (1999 – 13 million ordinary shares, nominal value £4 million, consideration £50 million).

(b) The company purchased, and subsequently cancelled, 9.5 million ordinary shares (nominal value £3 million) during the year for a consideration including expenses of £54 million (1999 – 175 million ordinary and B shares, consideration £1,211 million).

### Potential issues of ordinary shares

(a) Under the executive share option schemes, directors and executives hold options to subscribe for up to 12 million (1999 – 15 million) ordinary shares at prices ranging between 391 pence and 581 pence per share exercisable by 2007.

(b) Under the savings-related share option schemes for employees, employees hold options to subscribe for up to 1 million (1999 – 1 million) ordinary shares at prices ranging between 252 pence and 567 pence per share exercisable by 2005.

### 23 Reserves attributable to equity shareholders

|   | Share premium account<br>£ million | Revaluation reserve<br>£ million | Capital redemption reserve<br>£ million | Profit and loss account<br>£ million | Total<br>£ million |
|---|------------------------------------|----------------------------------|---|--------------------------------------|--------------------|
| At 30 June 1999                         | 1,268                              | 173                              | 2,936                                   | (1,343)                              | 3,034              |
| Retained earnings                       | -                                  | -                                | -                                       | 263                                  | 263                |
| Exchange adjustments                    | -                                  | (2)                              | -                                       | 27                                   | 25                 |
| Tax charge on exchange in reserves      | -                                  | -                                | -                                       | (7)                                  | (7)                |
| Premiums on share issues, less expenses | 17                                 | -                                | -                                       | (6)                                  | 11                 |
| Repurchase of own shares                | -                                  | -                                | 3                                       | (54)                                 | (51)               |
| Goodwill on disposals of businesses     | -                                  | -                                | -                                       | 446                                  | 446                |
| Transfers                               | -                                  | (33)                             | 10                                      | 23                                   | -                  |
| At 30 June 2000                         | 1,285                              | 138                              | 2,949                                   | (651)                                | 3,721              |

Aggregate goodwill written off against the profit and loss account, net of disposals, is £4,094 million (1999 – £4,498 million) including £156 million (1999 – £162 million) in respect of associates. The exchange adjustments include losses of £119 million in respect of foreign currency net borrowings (1999 – £208 million).

### 24 Movements in consolidated shareholders' funds

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Profit for the year                                 | 976               | 942               |
| Dividends   | (713)             | (674)             |
|   | 263               | 268               |
| Exchange adjustments                                | 25                | 78                |
| Tax (charge)/relief on exchange in reserves         | (7)               | 15                |
| New share capital issued                            | 12                | 52                |
| Provision for share issues                          | -                 | 8                 |
| Repurchase of own shares                            | (54)              | (1,211)           |
| Goodwill on disposals of businesses                 | 446               | 187               |
| <b>Net movement in shareholders' funds</b>          | <b>685</b>        | <b>(603)</b>      |
| <b>Shareholders' funds at beginning of the year</b> | <b>4,026</b>      | <b>4,629</b>      |
| <b>Shareholders' funds at end of the year</b>       | <b>4,711</b>      | <b>4,026</b>      |

### 25 Minority interests – non-equity

Non-equity minority interests of £405 million (1999 – £388 million) comprise £368 million of 9.42% and £37 million of 7.973% cumulative guaranteed preferred securities issued by subsidiaries. The holders of these securities have no rights against group companies other than the issuing entity and, to the extent prescribed by the guarantee, the company. To the extent that payments due under the guarantee are not made because the company has insufficient distributable profits, the company has covenanted that it will not make any distribution on any share capital which ranks junior to these securities.

## 26 Net cash inflow from operating activities

|   | 2000<br>£ million | 1999<br>£ million |
|---|-------------------|-------------------|
| Operating profit                                | 1,782             | 1,517             |
| Exceptional operating costs                     | 181               | 382               |
| Restructuring and integration payments          | (198)             | (301)             |
| Depreciation and amortisation charge            | 365               | 339               |
| Increase in stocks                              | (21)              | (2)               |
| Decrease in debtors                             | 4                 | 11                |
| (Decrease)/increase in creditors and provisions | (45)              | 38                |
| Other items                                     | (25)              | (18)              |
| Net cash inflow from operating activities       | 2,043             | 1,966             |

## 27 Purchase of subsidiaries

|                                 | Balance sheet at acquisition<br>£ million | Fair value adjustments<br>£ million | 2000<br>Fair value balance sheets<br>£ million | 1999<br>Fair value balance sheets<br>£ million |
|---------------------------------|---|-------------------------------------|--|--|
| Fixed assets                    | 34  | –                                   | 34   | 85   |
| Working capital                 | 13  | (2)                                 | 11   | 6  |
| Net assets acquired             | 47  | (2)                                 | 45   | 91   |
| Goodwill arising on acquisition |   |                                     | 106  | 289  |
| Purchase consideration paid     |   |                                     | 151  | 380  |

Subsidiaries acquired during the year include DCA Bakery and Brisco (which sells under the Forno de Minas brand name) in Packaged Food.

## 28 Sale of subsidiaries and businesses

|                                | 2000<br>£ million | 1999<br>£ million |
|--------------------------------|-------------------|-------------------|
| Brands                         | 149               | 60                |
| Other fixed assets             | 222               | 36                |
| Working capital and provisions | (1)               | 102               |
| Cash                           | 71                | –                 |
| Minority interest              | (10)              | –                 |
| Goodwill                       | 446               | 141               |
| Loss on sale                   | (168)             | (9)               |
| Sale consideration             | 709               | 330               |
| Cash                           | (71)              | –                 |
| Sale consideration received    | 638               | 330               |

The sale consideration received includes the net proceeds in respect of the sale of Grupo Cruzcampo SA to Heineken NV and the sales of four European Spirits and Wine brands.

## 29 Contingent liabilities

The group has given performance guarantees and indemnities to third parties of £37 million (1999 – £40 million).

There are a number of legal claims or potential claims against the group, the outcome of which cannot at present be foreseen. Provision is made in these financial statements for all liabilities which are expected to materialise.

### 30 Commitments

Capital expenditure Commitments not provided for in these financial statements are estimated at £50 million (1999 – £101 million).

|   | 2000                            |                    |                    | 1999                            |                    |                    |
|---|---------------------------------|--------------------|--------------------|---------------------------------|--------------------|--------------------|
| Annual operating lease commitments            | Land and buildings<br>£ million | Other<br>£ million | Total<br>£ million | Land and buildings<br>£ million | Other<br>£ million | Total<br>£ million |
| <b>Annual payments under leases expiring:</b> |                                 |                    |                    |                                 |                    |                    |
| After five years                              | 88                              | 4                  | 92                 | 78                              | 1                  | 79                 |
| From one to five years                        | 44                              | 16                 | 60                 | 22                              | 10                 | 32                 |
| Within one year                               | 3                               | 6                  | 9                  | 1                               | 5                  | 6                  |
|   | <b>135</b>                      | <b>26</b>          | <b>161</b>         | <b>101</b>                      | <b>16</b>          | <b>117</b>         |

### 31 Post balance sheet events

On 17 July 2000, Diageo announced an agreement on the terms of the combination of Pillsbury, its packaged food business, with General Mills, Inc (General Mills). General Mills will, subject to the approval of shareholders and certain regulatory clearances, acquire Pillsbury. At completion, Diageo will receive 141 million General Mills shares, comprising approximately 33% of General Mills enlarged issued share capital, and General Mills will acquire Pillsbury, which will have up to US\$5,142 million of debt outstanding.

Also on 17 July 2000, Diageo announced the integration of its spirits, wine and beer businesses, UDV and Guinness. These measures, together with the announcement on 22 June 2000 of preparation for the partial flotation of Burger King, reflect Diageo's strategic focus on beverage alcohol.

## Company balance sheet

|   | Notes | 30 June 2000 |           | 30 June 1999 |           |
|---|-------|--------------|-----------|--------------|-----------|
|   |       | £ million    | £ million | £ million    | £ million |
| <b>Fixed assets</b>                           |       |              |           |              |           |
| Tangible assets                               | 34    |              | 3         |              | 2         |
| Investments                                   | 34    |              | 25,633    |              | 24,996    |
|   |       |              | 25,636    |              | 24,998    |
| <b>Current assets</b>                         |       |              |           |              |           |
| Amounts owed by subsidiaries                  |       | 5,455        |           | 3,106        |           |
| Other debtors – due within one year           | 35    | 137          |           | 47           |           |
| Other debtors – due after one year            | 35    | 46           |           | 208          |           |
| Cash at bank                                  |       | 13           |           | 168          |           |
|   |       | 5,651        |           | 3,529        |           |
| <b>Creditors – due within one year</b>        |       |              |           |              |           |
| Borrowings                                    | 37    | (130)        |           | (468)        |           |
| Other creditors                               | 36    | (482)        |           | (459)        |           |
|   |       | (612)        |           | (927)        |           |
| <b>Net current assets</b>                     |       |              | 5,039     |              | 2,602     |
| <b>Total assets less current liabilities</b>  |       |              | 30,675    |              | 27,600    |
| <b>Creditors – due after one year</b>         |       |              |           |              |           |
| Borrowings                                    | 37    | (226)        |           | (270)        |           |
| Amounts owed to subsidiaries                  | 38    | (15,110)     |           | (10,586)     |           |
|   |       |              | (15,336)  |              | (10,856)  |
| <b>Provisions for liabilities and charges</b> |       |              | (11)      |              | (6)       |
|   |       |              | 15,328    |              | 16,738    |
| <b>Capital and reserves</b>                   |       |              |           |              |           |
| Called up share capital                       | 22    |              | 990       |              | 992       |
| Share premium account                         |       | 1,285        |           | 1,268        |           |
| Merger reserve                                |       | 9,161        |           | 9,161        |           |
| Capital redemption reserve                    |       | 2,949        |           | 2,946        |           |
| Profit and loss account                       |       | 943          |           | 2,371        |           |
| Reserves attributable to equity shareholders  | 39    |              | 14,338    |              | 15,746    |
| <b>Shareholders' funds</b>                    |       |              | 15,328    |              | 16,738    |

These financial statements were approved by a duly appointed and authorised committee of the Board of Directors on 6 September 2000 and were signed on its behalf by PS Walsh and NC Rose, directors.

## Notes to the company balance sheet

### 32 Company profit and loss account

The company's results are included in the consolidated profit and loss account so a separate profit and loss account is not presented.

### 33 Directors' emoluments

|  | 2000<br>£000 | 1999<br>£000 |
|--|--------------|--------------|
| Executive directors – remuneration including bonuses | 7,861        | 6,567        |
| Fees to non-executive directors                      | 234          | 206          |
|  | <b>8,095</b> | <b>6,773</b> |

The total emoluments, share option gains and payments under other longer term incentive plans received by the highest paid director were £2,482,000 (1999 – £3,832,000). There were pension contributions of £43,000 (1999 – £47,000) to defined contribution schemes and no contributions (1999 – £79,000) to other schemes in the year in respect of executive directors. The aggregate amount of gains made by the directors from the exercise of share options and from the vesting of awards during the year was £2,272,000 (1999 – £5,145,000) and payments under other longer term incentive plans totalled £150,000 (1999 – £1,537,000). Further information on directors' emoluments and share interests is included in the remuneration report.

### 34 Fixed assets

|                                      | Tangible<br>assets<br>£ million | Shares in<br>subsidiaries<br>£ million | Own<br>shares<br>£ million | Investments                       |                    |
|--------------------------------------|---------------------------------|--|----------------------------|-----------------------------------|--------------------|
|                                      |                                 |  |                            | Other<br>investments<br>£ million | Total<br>£ million |
| <b>Cost</b>                          |                                 |  |                            |                                   |                    |
| At 30 June 1999                      | 17                              | 24,862                                 | 182                        | –                                 | 25,044             |
| Additions                            | 2                               | 628                                    | 67                         | 2                                 | 697                |
| Disposals                            | (1)                             | –                                      | (51)                       | –                                 | (51)               |
| At 30 June 2000                      | 18                              | 25,490                                 | 198                        | 2                                 | 25,690             |
| <b>Provisions/amortisation</b>       |                                 |  |                            |                                   |                    |
| At 30 June 1999                      | 15                              | –                                      | 48                         | –                                 | 48                 |
| Amortisation of own shares – company | –                               | –                                      | 3                          | –                                 | 3                  |
| – subsidiaries                       | –                               | –                                      | 30                         | –                                 | 30                 |
| Disposals                            | –                               | –                                      | (24)                       | –                                 | (24)               |
| At 30 June 2000                      | 15                              | –                                      | 57                         | –                                 | 57                 |
| <b>Net book value</b>                |                                 |  |                            |                                   |                    |
| At 30 June 2000                      | 3                               | 25,490                                 | 141                        | 2                                 | 25,633             |
| At 30 June 1999                      | 2                               | 24,862                                 | 134                        | –                                 | 24,996             |

Investment in own shares at 30 June 2000, comprised 32.3 million ordinary shares (1999 – 28.1 million shares). The shares are held by employee trusts for the sole purpose of satisfying obligations under employee share schemes operated by the group. Details of the principal group companies are given at the end of these financial statements.

### 35 Other debtors

Debtors include ACT recoverable of £123 million, of which £97 million was due within one year and £26 million was due after one year (1999 – £220 million, £12 million and £208 million, respectively).

### 36 Other creditors – due within one year

|                              | 2000<br>£ million | 1999<br>£ million |
|------------------------------|-------------------|-------------------|
| Ordinary dividends payable   | 428               | 398               |
| Other creditors and accruals | 54                | 61                |
|                              | <b>482</b>        | <b>459</b>        |



### 37 Borrowings

| Analysis by year of repayment | 2000                                   |                               |                    | 1999                                   |                               |                    |
|-------------------------------|--|-------------------------------|--------------------|--|-------------------------------|--------------------|
|                               | Bank loans and overdrafts<br>£ million | Other borrowings<br>£ million | Total<br>£ million | Bank loans and overdrafts<br>£ million | Other borrowings<br>£ million | Total<br>£ million |
| From two to five years        | –                                      | 145                           | 145                | –                                      | 228                           | 228                |
| From one to two years         | –                                      | 81                            | 81                 | –                                      | 42                            | 42                 |
| Due after one year            | –                                      | 226                           | 226                | –                                      | 270                           | 270                |
| Due within one year           | 90                                     | 40                            | 130                | 72                                     | 396                           | 468                |
|                               | 90                                     | 266                           | 356                | 72                                     | 666                           | 738                |

| Other borrowings | Currency     | Year end interest rates<br>% | 2000<br>£ million | 1999<br>£ million |
|------------------|--------------|------------------------------|-------------------|-------------------|
| Commercial paper | Euro         | 2.51 – 2.82                  | –                 | 122               |
| Bonds 1999       | US dollar    | 6.375                        | –                 | 127               |
| Bonds 2000       | US dollar    | 6.25                         | –                 | 158               |
| Bonds 2002       | Swiss franc  | 3.0                          | 121               | 82                |
| Bonds 2002       | French franc | 6.25                         | 145               | 150               |
| Others           | Various      | Various                      | –                 | 27                |
|                  |              |                              | 266               | 666               |

The interest rates shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate protection.

### 38 Amounts owed to subsidiaries

The amounts owed to subsidiaries include £372 million of 9.42% and £37 million of 7.973% unsecured cumulative capital interests (1999 – £358 million and £36 million, respectively). These securities are subordinated to all other liabilities of the company. The securities are redeemable only at the option of the company in or after 2004 or in the event of certain fiscal or legal changes in the United States or the United Kingdom. Interest and redemption payments may only be made to the extent that the company has adequate distributable profits or, in the case of a redemption, out of the proceeds of an issue of shares. To the extent that dividend or redemption payments have not been made when due, the company has covenanted that it will not make any distribution on any share capital which ranks junior to these securities.

### 39 Reserves attributable to equity shareholders

|   | Share premium account<br>£ million | Merger reserve<br>£ million | Capital redemption reserve<br>£ million | Profit and loss account<br>£ million | Total<br>£ million |
|---|------------------------------------|-----------------------------|---|--------------------------------------|--------------------|
| At 30 June 1999                         | 1,268                              | 9,161                       | 2,946                                   | 2,371                                | 15,746             |
| Loss for the year                       | –                                  | –                           | –                                       | (661)                                | (661)              |
| Dividends                               | –                                  | –                           | –                                       | (713)                                | (713)              |
| Premiums on share issues, less expenses | 17                                 | –                           | –                                       | –                                    | 17                 |
| Repurchase of own shares                | –                                  | –                           | 3                                       | (54)                                 | (51)               |
| At 30 June 2000                         | 1,285                              | 9,161                       | 2,949                                   | 943                                  | 14,338             |

### 40 Contingent liabilities

The company has guaranteed certain borrowings of subsidiaries which at 30 June 2000 amounted to £5,339 million (1999 – £3,892 million). The company has also provided irrevocable guarantees relating to the liabilities of certain of its Irish and Dutch subsidiaries. In addition, the company has certain obligations with regard to the group's non-equity minority interests (see note 25).

## Principal group companies

The companies listed below include those which principally affect the profits and assets of the group. The operating companies listed below may carry on the business described in the countries listed in conjunction with their subsidiaries and other group companies. A full list of subsidiaries, all of which are consolidated, will be included in the company's next annual return.

|   | Country of incorporation | Country of operation | Percentage of equity owned | Business description  |
|---|--------------------------|----------------------|----------------------------|---|
| <b>Spirits and Wine</b>                   |                          |                      |                            |   |
| United Distillers & Vintners (ER) Limited | Scotland                 | Worldwide            | 100%                       | Production, distribution, marketing, exporting and importing of spirits and wine.   |
| United Distillers & Vintners (HP) Limited | England                  | Worldwide            | 100%                       | Production, distribution, marketing, exporting and importing of spirits and wine.   |
| UDV North America, Inc                    | United States            | Worldwide            | 100%                       | Production, importing and marketing of spirits and wine.  |
| Moët Hennessy, SA (a)                     | France                   | Worldwide            | 34%                        | Production and distribution of spirits and wine.  |
| <b>Packaged Food</b>                      |                          |                      |                            |   |
| The Pillsbury Company                     | United States            | United States        | 100%                       | Manufacturing, marketing and distribution of refrigerated dough products, breakfast and dessert products, frozen pizza, frozen and canned vegetables, Mexican foods, canned soups and foodservice baking mixes and frozen products. |
| <b>Beer</b>                               |                          |                      |                            |   |
| Guinness Limited (b)                      | England                  | Worldwide            | 100%                       | Brewing, marketing and distribution of beer.  |
| Guinness Ireland Group                    | Ireland                  | Worldwide            | 100%                       | Brewing, marketing and distribution of beer.  |
| <b>Quick Service Restaurants</b>          |                          |                      |                            |   |
| Burger King Corporation                   | United States            | Worldwide            | 100%                       | Quick service restaurants.  |
| <b>Corporate</b>                          |                          |                      |                            |   |
| Diageo Capital plc (b)                    | Scotland                 | United Kingdom       | 100%                       | Financing company for the group.  |
| Diageo Finance plc (b)                    | England                  | United Kingdom       | 100%                       | Financing company for the group.  |
| Diageo Investment Corporation             | United States            | United States        | 100%                       | Financing company for the US group.   |

(a) Issued share capital comprises 34,648,386 A class shares of FF50 each and 17,849,169 B class shares of FF50 each. The group's effective interest is 100% in the B class shares.

(b) Directly owned by Diageo plc.

All percentages, unless otherwise stated, relate to holdings of ordinary share capital and are equivalent to the percentages of voting rights held by the group.

© 2000 Diageo plc. All rights reserved.

All brands mentioned in this Annual Report are trademarks and are registered and/or otherwise protected in accordance with national laws worldwide.

Designed and produced by Bamber Forsyth Limited.  
Printed in England by CTD Printers Ltd.

The paper used in this report is acid free, biodegradable and fully recyclable.

If you have access to the internet, you are invited to visit Diageo's web site at: [www.diageo.com](http://www.diageo.com). This includes the full annual reports and accounts and, in due course, will include Diageo's US Annual Report filing on Form 20-F.

Diageo plc  
8 Henrietta Place  
London W1M 9AG  
United Kingdom  
Tel +44 (0) 20 7927 5200  
Fax +44 (0) 20 7927 4600  
[www.diageo.com](http://www.diageo.com)

Registered in England No. 23307.

