

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

**Table of Contents**

---

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 20-F/A**

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

For the fiscal year ended: **30 June 2003**

Commission file number: **1-10691**

**DIAGEO plc**

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

**England**

*(Jurisdiction of incorporation or organisation)*

**8 Henrietta Place, London W1G 0NB, England**

*(Address of principal executive offices)*

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
American Depositary Shares	New York Stock Exchange
Ordinary shares of 28 <sup>101/108</sup> pence each	New York Stock Exchange*
9.42% Cumulative guaranteed preferred securities, series A**	New York Stock Exchange

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

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

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

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

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report: 3,099,593,537 ordinary shares of 28 <sup>101/108</sup> pence each.

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

Yes  No

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

Item 17  Item 18

## Edgar Filing: DIAGEO PLC - Form 20-F/A

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

---

---

---

**TABLE OF CONTENTS**

Five year information  
Discontinued operations  
Risk factors  
Cautionary statement concerning forward-looking statements  
Operating and financial review  
Introduction  
Operating results 2003 compared with 2002  
Operating results 2002 compared with 2001  
Trend information  
Liquidity and capital resources  
Risk management  
Critical UK GAAP accounting policies  
New accounting standards  
Discussion of US GAAP differences  
Independent auditor's report  
Consolidated profit and loss account  
Consolidated balance sheet  
Consolidated cash flow statement  
Consolidated statement of total recognised gains and losses  
Note of consolidated historical cost profits and losses  
Accounting policies  
Notes to the consolidated financial statements  
Principal group companies  
Unaudited computation of ratio of earnings to fixed charges and preferred share dividends  
Signatures  
Exhibits  
Cross reference to Form 20-F  
Glossary of terms and US equivalents  
EXHIBIT 12.1  
EXHIBIT 12.2  
EXHIBIT 13.1  
EXHIBIT 13.2  
EXHIBIT 14.1

---

**Table of Contents**

Contents

2	Five year information
7	Business description
7	Overview
7	Strategy
7	Premium drinks
14	Other businesses
15	Discontinued operations
15	Risk factors
18	Cautionary statement concerning forward-looking statements
19	Operating and financial review
19	Introduction
20	Operating results 2003 compared with 2002
32	Operating results 2002 compared with 2001
43	Trend information
44	Liquidity and capital resources
47	Risk management
49	Critical UK GAAP accounting policies
49	New accounting standards
50	Discussion of US GAAP differences
52	Directors and senior management
55	Directors' remuneration report
63	Corporate governance report
68	Directors' report
69	Independent auditor's report
70	Consolidated profit and loss account
72	Consolidated balance sheet
73	Consolidated cash flow statement
74	Consolidated statement of total recognised gains and losses
74	Note of consolidated historical cost profits and losses
75	Accounting policies
77	Notes to the consolidated financial statements
127	Company balance sheet
128	Notes to the company balance sheet
130	Principal group companies
131	Unaudited computation of ratio of earnings to fixed charges and preferred share dividends
132	<b>Additional information for shareholders</b>
132	Legal proceedings
132	Material contracts
134	Related party transactions
134	Share capital
136	Memorandum and articles of association
138	Exchange controls
138	Documents on display
139	Taxation
142	Signatures
143	Exhibits
144	Cross reference to Form 20-F
145	Glossary of terms and US equivalents

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

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

## Edgar Filing: DIAGEO PLC - Form 20-F/A

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

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

This report includes names of Diageo's products, which constitute trademarks or trade names which Diageo owns or which others own and licence to Diageo for use. In this report, the term company refers to Diageo plc and the terms group and Diageo refer to the company and its consolidated subsidiaries, except as the context otherwise requires. A glossary of terms used in this report is included at the end of the document.

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

---

**Table of Contents**

**Explanatory Note**

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

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

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

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

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

---

**Table of Contents**

2 Diageo

Annual Report 2003

**Five year information**

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

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



**Table of Contents**

3 Diageo

Annual Report 2003

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

**Notes to the selected consolidated financial data**

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

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

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

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

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

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

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

**Table of Contents**

4 Diageo

Annual Report 2003  
Five year information**4 Exceptional items** An analysis of exceptional items before taxation under UK GAAP is as follows:

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

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

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

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

**Table of Contents**

5 Diageo

Annual Report 2003

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

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

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

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

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

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

**Table of Contents**

6 Diageo Annual Report 2003  
Five year information

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

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

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

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

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

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

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

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

**Table of Contents**

15 Diageo

Annual Report 2003

**Discontinued operations**

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

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

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

**Risk factors**

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

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

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

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

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

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

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

## Edgar Filing: DIAGEO PLC - Form 20-F/A

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

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

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

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

---

**Table of Contents**

16 Diageo	Annual Report 2003 Business description
-----------	--

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

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

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

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

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

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

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

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

Diageo intends to strenuously defend this purported action.

See Additional information for shareholders Legal proceedings for further detail.

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

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

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

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

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

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

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

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

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



**Table of Contents**

17 Diageo

Annual Report 2003

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

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

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

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

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

**Table of Contents**

18 Diageo	Annual Report 2003 Business description
-----------	--

**Cautionary statement concerning forward-looking statements**

This document contains statements with respect to the financial condition, results of operations and business of Diageo and certain of the plans and objectives of Diageo with respect to these items. These forward-looking statements are made pursuant to the Safe Harbor provisions of the United States Private Securities Litigation Reform Act of 1995. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, margins, growth rates, overall market trends, the impact of interest or exchange rates, the availability of financing to Diageo and parties or consortia who have purchased Diageo's assets, actions of parties or consortia who have purchased Diageo's assets, anticipated cost savings or synergy and the completion of Diageo's strategic transactions, are forward-looking statements. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward-looking statements, including factors that are outside Diageo's control.

These factors include, but are not limited to:

increased competitive product and pricing pressures and unanticipated actions by competitors that could impact Diageo's market share, increase expenses and hinder growth potential;

the effects of business combinations, partnerships, acquisitions or disposals, existing or future, and the ability to realise expected synergy and/or costs savings;

Diageo's ability to complete future acquisitions and disposals;

legal and regulatory developments, including changes in regulations regarding consumption of, or advertising for, beverage alcohol, changes in accounting standards, taxation requirements, such as the impact of excise tax increases with respect to the premium drinks business and environmental laws;

changes in the food industry in the United States, including increased competition and changes in consumer preferences;

changes in consumer preferences and tastes, demographic trends or perceptions about health related issues;

changes in the cost of raw materials and labour costs;

changes in economic conditions in countries in which Diageo operates, including changes in levels of consumer spending;

levels of marketing and promotional expenditure by Diageo and its competitors;

renewal of distribution rights on favourable terms when they expire;

termination of existing distribution rights in respect of agency brands;

technological developments that may affect the distribution of products or impede Diageo's ability to protect its intellectual property rights; and

changes in financial and equity markets, including significant interest rate and foreign currency rate fluctuations, which may affect Diageo's access to or increase the cost of financing.

All oral and written forward-looking statements made on or after the date of this document and attributable to Diageo are expressly qualified in their entirety by the above factors and the Risk factors contained in this document for the year ended 30 June 2003.

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



**Table of Contents****Operating and financial review****Introduction**

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

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

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

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

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

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

**Volume** Volume has been measured on an equivalent units basis to nine litre cases of spirits. Equivalent units are calculated as follows: beer in hectolitres divide by 0.9, wine in nine litre cases divide by five, ready to drink in nine litre cases divide by 10. An equivalent unit represents approximately 272 servings. A serving comprises 33ml of spirits, 165ml of wine, or 330ml of ready to drink or beer.

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

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

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

## Edgar Filing: DIAGEO PLC - Form 20-F/A

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

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

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

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

---

**Table of Contents**

20 Diageo Annual Report 2003  
Operating and financial review

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

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

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

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

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

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

**Operating results 2003 compared with 2002**

**Summary consolidated profit and loss account**

		2003			2002	
Before exceptional items £ million	Exceptional items £ million	Total	Before exceptional items	Exceptional items	Total	