DIAGEO PLC
Form 6-K
January 28, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16 OF THE
SECURITIES EXCHANGE ACT OF 1934

28 January 2016

Commission File Number: 001-10691

DIAGEO plc
(Translation of registrant's name into English)

Lakeside Drive, Park Royal, London NW10 7HQ
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

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Interim results, six months ended 31 December 2015
28 January 2016

Momentum continues with stronger top line growth and higher free cash flow

· 1.8% organic net sales growth, on 1.0% organic volume growth

· 2.4% organic operating profit growth

· Adverse exchange and the impact of the disposal of non core assets, reduced net sales by £400 million and operating profit* by £156 million to £5,606 million and £1,717 million, respectively

· Free cash flow £0.8 billion up £140 million on comparable period

· eps of 56.1 pence, up 7%. Pre-exceptional eps 51.3 pence, down 4%

· Interim dividend up 5% to 22.6 pence per share

*Before exceptional items

Ivan Menezes, Chief Executive, commenting on the first half said:

"Diageo has become a stronger, more competitive business. We have delivered volume growth, a stronger top line, improved the performance of our key brands, driven cost productivity and continued to generate strong cash flow. While trading conditions remain challenging in some markets, Diageo's brands, capabilities in marketing and innovation and our route to consumer have proved resilient. I am confident that Diageo can deliver improved, sustained performance.

For the full year we expect volume growth to drive stronger top line performance, margin to slightly improve and strong cash conversion to continue. This will set us up to deliver better momentum in F17, with productivity gains supporting margin expansion and investment in growth. We remain confident of achieving our objective of mid-single digit top line growth and 100bps of organic operating margin improvement in the three years ending fiscal 19."

Ends

Key financial information
For six months ended 31 December 2015

Summary financial information

| | | First Half F16 Reported | First Half F15 Reported | Organic growth % | Reported growth % |
|---|---|---|---|---|---|
| Volume | EUm | 130.3 | 134.1 | 1 | (3) |
| Net sales | £ million | 5,606 | 5,900 | 2 | (5) |
| Marketing spend | £ million | 822 | 896 | (5) | (8) |
| Operating profit before exceptional items | £ million | 1,717 | 1,839 | 2 | (7) |
| Operating profit(i) | £ million | 1,613 | 1,668 | | (3) |
| Share of associates and joint ventures profit after tax | £ million | 136 | 113 | | 20 |
| Exceptional items | £ million | 107 | (73) | | - |
| Net finance charges | £ million | 176 | 239 | | - |
| Tax rate | % | 16.6 | 16.8 | | (1) |
| Tax rate before exceptional items | % | 19.0 | 18.3 | | 4 |
| Profit attributable to parent company's shareholders | £ million | 1,406 | 1,311 | | 7 |
| Basic earnings per share | pence | 56.1 | 52.3 | | 7 |
| Earnings per share before exceptional items | pence | 51.3 | 53.7 | | (4) |
| Interim dividend per share | pence | 22.6 | 21.5 | | 5 |

(i) Operating profit for the six months ended 31 December 2015 includes an exceptional operating charge of £104 million (2014 - £171 million).

Exceptional items

| | First Half F16 |
|---|---|
| Operating items before taxation | £ million |
| Impairment of Ypióca brand and goodwill | (104) |
| Non-operating items before taxation | |
| Sale of wines in the United States and Percy Fox | (123) |
| Sale of Jamaican, Singapore and Malaysia brewing businesses | 457 |
| Provision for a receivable related to a loan guarantee | (92) |
| Other | (31) |
| Total non-operating items before taxation | 211 |
| Total exceptional items before taxation | 107 |

Tax relief in respect of the exceptional operating item was £10 million. Tax relief in respect of the exceptional non-operating items was £12 million. For further details of exceptional items see Notes 3 'Exceptional items'.

Net sales growth (£ million)
Organic net sales growth of 1.8% driven by volume and mix
Adverse exchange and sale of non core assets reduced reported net sales

| Net sales | £ million |
|---|---|
| F15 H1 Reported | 5,900 |
| Exchange | (282) |
| Disposals completed in F15 and H1 F16 | (118) |
| Disposals announced in F16 and completed since 31 December 2015 | (43) |
| Acquisitions | 52 |
| Volume | 55 |
| Price/mix | 42 |
| F16 H1 Reported | 5,606 |

Reported net sales declined primarily as a result of the adverse impact of exchange and the disposals of non core assets. Organic net sales growth was 1.8% with volume growth and positive price/mix.

Later timing of innovations and new processes for innovation launches (the replenishment model) in the United States led to a decline in net sales of Cîroc which reduced Diageo net sales growth by approximately 1ppt and impacted performance of Diageo North America by approximately 3pps and reserve brands by some 7pps.

Operating profit growth (£ million)
Organic operating profit growth 2.4%
Adverse exchange and sale of non core assets reduced reported operating profit

| Operating profit | £ million |
|---|---|
| F15 H1 Reported | 1,839 |
| Exchange | (125) |
| Disposals completed in F15 and H1 F16 | (31) |
| Disposals announced in F16 and completed since 31 December 2015 | (26) |
| Acquisitions | 21 |
| Organic Growth | 39 |
| F16 H1 Reported | 1,717 |

Reported operating profit declined mainly as a result of adverse exchange and the sale of non core assets. Organic operating profit was up 2.4%.

Exchange

The exchange rate movement reflects the translation of prior year reported results at current exchange rates.

Reported net sales and operating profit were impacted by adverse exchange movements driven by the weakness of many currencies against sterling, in particular the euro, the Venezuelan bolivar and the Brazilian real partially offset by the strenghtening of the US dollar.

Using current exchange rates (£1 = $1.45; £1 = €1.33), the exchange rate movement for the year ending 30 June 2016 is estimated to adversely impact net sales by approximately £260 million and operating profit by approximately £85 million. This estimate excludes the impact of IAS 21 and IAS 39.

Acquisitions and disposals

Acquisitions made in the year ended 30 June 2015 increased net sales in the first half by £52 million and operating profit by £21 million, largely due to the acquisition of the remaining 50% shareholdings in Don Julio and United National Breweries.

Disposals, primarily the sale of Bushmills and Gleneagles in the year ended 30 June 2015 and the sale of wines in the United States and Percy Fox in Great Britain and beer assets in Jamaica and Asia in the year ending 30 June 2016 contributed net sales of £332 million and operating profit of £74 million in the six months ended 31 December 2014 and net sales of £171 million and operating profit of £17 million in the six months ended 31 December 2015.

For further details on the impact of acquisitions and disposals see ’Explanatory Notes’ section.

Organic growth by region

| | Volume | | Net sales | | Marketing spend | | Operating profit* | |
|---|---|---|---|---|---|---|---|---|
| | % | EUm | % | £ million | % | £ million | % | £ million |
| North America | (2) | (0.4) | (2) | (31) | (12) | (36) | (2) | (19) |
| Europe, Russia and Turkey | 2 | 0.5 | 3 | 42 | - | - | 5 | 20 |
| Africa | 7 | 0.9 | 3 | 19 | (4) | (3) | - | - |
| Latin America and Caribbean | 4 | 0.4 | 9 | 40 | 4 | 3 | 5 | 7 |
| Asia Pacific | - | (0.1) | 2 | 26 | (2) | (4) | 18 | 36 |
| Corporate | - | - | 6 | 1 | - | - | (8) | (5) |
| Diageo | 1 | 1.3 | 2 | 97 | (5) | (40) | 2 | 39 |

* before exceptionals

Change in operating margin (%)
Organic margin improved by 16bps
Exchange reduced operating margin by 66bps

| Operating margin | ppt |
|---|---|
| F15 H1 Reported | 31.17 |
| Exchange | (0.66) |
| Acquisitions and disposals | (0.04) |
| Gross margin | (0.23) |
| Marketing spend | 1.04 |
| Overheads | (1.07) |
| Other income and expenses | 0.42 |
| F16 H1 Reported | 30.63 |

Reported margin decreased by 54bps mainly due to adverse exchange which reduced margin by 66bps. Organic operating margin improved by 16bps. Gross margin decline was driven by negative market mix. Marketing efficiencies, together with lower spend on innovation launches in US Spirits, led to margin improvement. Overheads increased primarily driven by a higher bonus accrual. Margin improvement from other income includes the profit on the sale by United Spirits Limited (USL) of its shareholding in United Breweries Limited shares of £28 million in the period.

Earnings per share before exceptional items (pence)
Organic operating profit growth increased eps by 1.54 pence
eps adversely impacted by exchange and disposals

| eps before exceptional items | pence |
|---|---|
| F15 H1 Reported | 53.7 |
| Exchange on operating profit | (5.00) |
| Acquisitions and disposals | (1.39) |
| Operating profit excluding exchange | (1.54) |
| Associates and joint ventures | 0.91 |
| Finance charges | 2.48 |
| Tax | (0.16) |
| Non-controlling interests | (0.81) |
| F16 H1 Reported | 51.3 |

Earnings per share decreased 2.4 pence largely driven by adverse exchange. Disposals adversely impacted eps because of low interest rates on the sale proceeds. Lower finance charges from lower debt, reduced hyperinflation charge and higher associate income increased eps. Operating profit growth in USL was the main driver of the increase in non-controlling interests which reduced eps.

Movement in net finance charges

£ million

| | |
|---|---|
| First Half F15 | 239 |
| Net interest charge reduction | (31) |
| Reduction in other finance charges | (32) |
| First Half F16 | 176 |

| | First Half F16 | First Half F15 |
|---|---|---|
| Average monthly net borrowings (£ million) | 9,671 | 10,698 |
| Effective interest rate (i) | 3.4% | 3.7% |

(i) For the calculation of the effective interest rate, the net interest charge excludes fair value adjustments to derivative financial instruments and borrowings. Average monthly net borrowings include the impact of interest rate swaps that are no longer in a hedge relationship but excludes the market value adjustment for cross currency interest rate swaps.

The decrease in average net borrowings arose from the disposals proceeds and stronger cash flow offset by the increase in the dividend payment. The effective interest rate decreased in the six months ended 31 December 2015 largely driven by the reduction of debt in USL together with the repayment of Diageo bonds with a higher interest rate.

Free cash flow (£ million)

Free cash flow up £140 million with lower interest and tax payments and higher operating profit offset by exchange.

| Free cash flow | £ million |
|---|---|
| F15 H1 Reported | 699 |
| Exchange(i) | (125) |
| Operating profit before exchange(ii) | 123 |
| Working capital movement | (45) |
| Net capex movement | 38 |
| Interest and tax | 124 |
| Other items(iii) | 25 |
| F16 H1 Reported | 839 |

(i) Exchange on operating profit before exceptional items.

(ii) Movement on operating profit before exchange and after exceptional items adjusted for depreciation and amortisation, post employment payments and non-cash items.

(iii) Other items include post employment payments, dividends received from associates and joint ventures and movements in loans and other investments.

Growth in free cash flow from operating profit before exchange results from the organic operating profit improvement, and the higher operating exceptional items in respect of restructuring in the comparative period. In the first half the operating exceptional item (impairment of Ypióca brand and goodwill) has no cash impact. The negative working capital movement was mainly driven by a reduction in provisions following the settlement of the Korean customs dispute in the second half of last year.

Return on average invested capital (%)(i)

Adverse exchange movements reduced ROIC by 0.9pps.

| Return on average invested capital(i) | ppt |
|---|---|
| F15 H1 Reported(ii) | 14.6 |
| Exchange | (0.9) |

| | |
|---|---|
| Acquisitions and disposals | (0.2) |
| Operating profit | 0.4 |
| Associates and joint ventures | 0.1 |
| Tax | 0.1 |
| Non-controlling interests | (0.2) |
| F16 H1 Reported | 13.9 |

(i) ROIC calculation excludes exceptional items.
(ii) The group revised the calculation of ROIC at 30 June 2015 by excluding the net assets and net profit attributable to non-controlling interests. Prior to this adjustment, in the six months ended 31 December 2014 the ROIC reported was 13.9%.

Adverse exchange reduced ROIC by 0.9pps. Increased operating profit, higher income from associates and lower tax payments all had a positive impact on ROIC. Increased profit in USL was the main driver of higher non-controlling interests, which had a negative impact on ROIC.

## Notes to the business and financial review

Unless otherwise stated:

- commentary refers to organic movements
- volume is in millions of equivalent units (EUm)
- net sales are sales after deducting excise duties
- percentage movements are organic movements
- share refers to value share
- GTME refers to Global Travel Asia and Middle East

Diageo has disposed of the majority of its wine interests in the United States and Great Britain and is expected to complete the sale of its Argentinian wine interests in the second half of the year. In the six months ended 31 December 2015 net sales of wine were £189 million (2014 - £231 million) and operating profit was £19 million (2014- £43 million). As the remaining wine businesses are immaterial no organic figures for wine are disclosed in the business and financial review for the six months ended 31 December 2015.

See 'Explanatory Notes' section for explanation of non-GAAP measures.

## BUSINESS REVIEW
Six months ended 31 December 2015

### North America

Performance in North America was in line with expectations. In US Spirits, later innovation launches in the half and the implementation of the replenishment model for innovations reduced the level of shipments against the first half last year, especially for Cîroc, however most key brands delivered stronger performance in the half. Action taken on Smirnoff and Captain Morgan led to net sales growth. Crown Royal performed strongly as a result of the continued success of Crown Royal Regal Apple. Performance in scotch benefitted from mix, especially on Johnnie Walker. Bulleit and Don Julio each continued to deliver double digit net sales growth. In addition Diageo delivered improved performance in DGUSA as net sales grew 2% and in Canada with net sales up 5%. The number and timing of innovation launches, together with procurement benefits resulted in marketing spend down 12%. Excluding these impacts, marketing would have been broadly flat. However net sales and negative mix impacted gross margin and operating margin declined 29bps. In the drive for stronger, sustained performance the new management team in Diageo North America have made a number of changes to refocus marketing activity, upweight on premise activity and enhance distributor relationships.

Key financials £ million:

| | First Half F15 Reported | FX | Acquisitions and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 1,867 | 83 | (52) | (31) | 1,867 | - |
| Marketing spend | 304 | 10 | (3) | (36) | 275 | (10) |
| Operating profit before exceptional items | 819 | 30 | (21) | (19) | 809 | (1) |
| Exceptional items | (11) | | | | - | |
| Operating profit | 808 | | | | 809 | - |

Markets:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| North America | (2) | (3) | (2) | - |
| | | | | |
| US Spirits and Wines | (2) | (4) | (3) | - |
| DGUSA | - | - | 2 | 7 |
| Canada | 4 | 3 | 5 | (7) |
| | | | | |
| Spirits | (2) | (2) | (3) | 1 |
| Beer | (1) | (1) | (1) | 2 |
| Ready to drink | 3 | (3) | 6 | 5 |

Global giants and local stars(i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Crown Royal | 8 | 8 | 13 |
| Smirnoff | 2 | 4 | 7 |
| Captain Morgan | 3 | 1 | 5 |
| Johnnie Walker | (6) | - | 5 |
| Ketel One vodka | (1) | (2) | 4 |
| Cîroc | (42) | (43) | (40) |
| Baileys | 2 | 4 | 7 |
| Guinness | 1 | - | 3 |
| Tanqueray | 1 | 2 | 7 |
| Don Julio | 25 | 28 | 35 |

| | | | |
|---|---|---|---|
| Bulleit | 24 | 27 | 34 |
| Buchanan’s | 4 | 9 | 15 |

(i) Spirits brands excluding ready to drink.

- Volume in US Spirits declined 2% with shipments down nearly 500k cases in the half. This was mainly driven by the reduction in the volume of Cîroc against the prior period when 750k cases were shipped for the launch of Cîroc Pineapple. In comparison, in this half for the launch of the new Cîroc flavour, Cîroc Apple, which occurred later in the half, 250k cases were shipped.
- Net sales declined 3% as the decline in volume in Cîroc led to negative mix which was only partially offset by the higher net sales growth of Diageo’s North American whiskey brands. Smirnoff has returned to growth although it continues to underperform the vodka category growth. Smirnoff has increased the activation behind electronic dance music (EDM) in the half and has further amplified this through social media and retail programming. Captain Morgan has also improved and the brand has outperformed the declining rum category, driven by the launch of Cannon Blast and the growth of Captain Morgan Original Spiced Rum (OSR) as on premise programming was stepped up using the activation army to revitalise recruitment. Strong growth of Johnnie Walker super deluxe variants drove positive mix with volume decline of Johnnie Walker Red and Black Label. The growth of North American whiskey is driven by flavours which is broadening reach to mass appeal and in the shot occasion, and growth in unflavoured driven by authenticity, craftsmanship and premiumisation. Crown Royal has variants for each of these growth drivers and therefore depletions grew double digit and net sales grew 8% despite lapping the high level of shipments associated with the launch of Crown Royal Regal Apple in the first half last year. In contrast depletions of Cîroc declined in the half. With 80% of sales from flavour variants, growth of the Cîroc brand is more reliant on a pipeline of high impact flavours and therefore lapping the very successful innovation of Cîroc Pineapple last year did impact performance. With the move to a replenishment model for innovations and with the launch of the new Cîroc Apple innovation later in the year, shipments of Cîroc were lower which together with weaker depletions led to a 43% decline in net sales. Cîroc marketing spend was refocused to drive broader reach though digital and high profile PR events and increased sampling. For Buchanan’s, premiumisation and positioning within the Hispanic consumer base continues to be the core strategy for growth, despite slower growth in the half as a result of price increases to support the new packaging and brand positioning. Don Julio and Bulleit continued to build their positions in their respective categories with another period of industry leading growth, both growing above 25% in the half.
- The marketing organisation in US Spirits was refocused in the half on Release brands(ii), North American whiskey, reserve brands and scotch to create a more efficient structure. Marketing spend benefitted from the achievement of further marketing spend efficiencies and a reduction in the level of spend on innovations against the prior period, reflecting the later timing of innovation launches.
- DGUSA delivered net sales growth through mix with strong growth of Smirnoff ready to drink driven by new marketing programmes and flavours. Beer was down as the launch of Guinness Nitro IPA was offset by the decline in Guinness Keg, Smithwicks and Harp.
- In Canada strong growth across the portfolio drove volume growth and mix.

(ii) Release brands include Smirnoff, Captain Morgan and Cîroc.

## Europe, Russia and Turkey

The region’s performance reflected continued momentum in Europe, growth in Turkey and net sales growth in Russia against the prior period although the trading environment there remains challenging. In Europe net sales were up 2% and Diageo gained share, with continued growth in Great Britain and improved performance in Continental Europe and France. Reserve brands in Europe delivered another strong performance with net sales up 18%. In both Great Britain and Ireland Guinness momentum continued with innovations from ‘The Brewers Project’. Baileys was back to growth as a result of increased in-outlet activation and consumer sampling. Continued investment in our route to consumer led to a 10% increase in outlets covered and coverage is expected to increase further in the second half. In Russia price increases to offset devaluation led to a volume decline of 12% however net sales grew 20% driven by positive brand mix and Diageo gained share in rum although scotch share declined. In Turkey net sales were up 9% with premiumisation in the raki category and double digit growth of Johnnie Walker and Smirnoff. Total operating margin for the region improved 46bps largely driven by procurement savings in marketing spend.

Key financials £ million:

| | First Half F15 Reported | FX | Acquisitions and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 1,459 | (114) | (26) | 42 | 1,361 | (7) |
| Marketing spend | 225 | (3) | (4) | - | 218 | (3) |
| Operating profit before exceptional items | 480 | (36) | (14) | 20 | 450 | (6) |
| Exceptional items | (4) | | | | - | |
| Operating profit | 476 | | | | 450 | (5) |

Markets:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| Europe, Russia and Turkey | 2 | 1 | 3 | (7) |
| | | | | |
| Europe | 3 | 1 | 2 | (5) |
| Russia | (12) | (15) | 20 | (28) |
| Turkey | 3 | 3 | 9 | (11) |
| | | | | |
| Spirits | 2 | 1 | 5 | (7) |
| Beer | 2 | 2 | 1 | (5) |
| Ready to drink | (2) | (2) | (5) | (7) |

Global giants and local stars(i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Guinness | 5 | 4 | (1) |
| Johnnie Walker | 2 | 6 | (4) |
| Smirnoff | (2) | (5) | (8) |
| Baileys | 6 | 7 | - |
| Yenì Raki | 5 | 5 | (15) |
| Captain Morgan | 13 | 11 | 2 |
| J B | (4) | (5) | (13) |

(i) Spirits brands excluding ready to drink.

- In Europe net sales were up 2%:
- In Great Britain net sales were up 3%, with spirits and beer in growth. Baileys was back in growth with net sales up 14% driven by increased in-outlet activation and consumer sampling. Captain Morgan net sales were up 2% with growth driven by the launch of Captain Morgan White. Smirnoff volume was up 1%, however net sales were down driven by higher volume sold on promotion during the holidays as part of a strategy to drive our broader vodka portfolio in certain channels. Ready to drink net sales were down 6% due to increased competition in the frozen pouch segment. Beer net sales were up 3% with Guinness net sales up 4% driven by strong Rugby World Cup activation and continued success of 'The Brewers Project' launches. Reserve brands net sales were up 31% driven by Cîroc, scotch malts and Tanqueray No. TEN.
- In Ireland Guinness performance accelerated with net sales up 5%, supported by the continued growth of F15 innovations launched through 'The Brewers Project' – Hop House 13 Lager, Dublin and West Indies Porter. Net sales of agency lager brands declined 6% and net sales in spirits were down 6% driven by channel restructuring.
- In France net sales increased 4% driven by reserve brands up 8%, growth in Johnnie Walker Double Black and Johnnie Walker Red Label, and the strong performance of Captain Morgan which almost doubled net sales.
- In Continental Europe net sales were up 2%:
- Net sales in Iberia were flat. Activation against a broader brand portfolio drove growth in Baileys, Johnnie Walker and Gordon's in a vibrant gin category which offset a decline in J B.
- Net sales in Germany, Austria and Switzerland grew 8% driven by double digit growth in Johnnie Walker, reserve brands, Baileys and Tanqueray.
- Benelux net sales were up 5% driven by growth in reserve brands, Smirnoff, Tanqueray and Gordon's Gin.
- Growth in scotch and gin and double digit growth of reserve brands were the main drivers behind the 4% net sales growth in Italy.
- In Greece, net sales were up 3% driven by route to consumer investment and increased activation.
- Net Sales in Poland were up 1% and net sales declined in the Eastern Europe Partner Markets.
- Performance in Russia continued to be impacted by the events in the region. In Russia price increases were implemented to offset devaluation, which impacted volume, down 12% but net sales grew 20% in part driven by growth of reserve brands where volume grew 24%. While Diageo's share of scotch declined as a result of these price increases, Captain Morgan continued to achieve strong share gains behind the launch of Captain Morgan White.
- In Turkey net sales grew 9%. Raki net sales were up 5% with Yenì Raki and the super premium variant Tekirdağ Raki premiumising the category. Net sales of Johnnie Walker, Smirnoff, Gordon's and Tanqueray all grew double digit.
- Marketing investment was held flat through procurement savings on marketing spend. Excluding procurement savings marketing spend increased 3%. The increased investment was focused on the biggest growth opportunities such as reserve brands, gin, beer and innovation.

## Africa

Net sales grew 3% in Africa, with strong growth of beer as net sales grew 15%, offset by a significant decline in Orijin following its strong distribution growth in the prior year, and the decline of scotch in South Africa and Angola given the economic conditions. The beer performance was led by the roll back of excise duty increase on Senator in Kenya, growth in Guinness and Malta Guinness in Nigeria, and good performance in the growing value beer segment with Satzenbrau in Nigeria, and Balozi and Allsopps in Kenya. Weaker demand for scotch was offset by the strong growth of vodka and rum in both East Africa and South Africa. In Ghana, the successful launch of Orijin Bitters and ready to drink formats drove net sales growth. Reserve brands have grown net sales 65% driven by the strong performance of Johnnie Walker Blue in Nigeria and Africa Regional Markets.

Key financials £ million:

FX Acquisitions

| | First Half F15 Reported | | and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 746 | (76) | 27 | 19 | 716 | (4) |
| Marketing spend | 85 | (9) | 1 | (3) | 74 | (13) |
| Operating profit before exceptional items | 175 | (38) | 1 | - | 138 | (21) |
| Exceptional items | (1) | | | | - | |
| Operating profit | 174 | | | | 138 | (21) |

Markets:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| Africa | 7 | 17 | 3 | (4) |
| | | | | |
| Nigeria | (8) | (8) | (9) | (18) |
| East Africa | 21 | 21 | 13 | - |
| Africa Regional Markets | 12 | 63 | 6 | 17 |
| South Africa | (5) | (4) | 2 | (12) |
| | | | | |
| Spirits | (3) | (3) | - | (12) |
| Beer | 23 | 45 | 15 | 10 |
| Ready to drink | (35) | (28) | (44) | (43) |

Global giants and local stars(i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Guinness | 14 | 15 | 4 |
| Malta | 24 | 27 | 17 |
| Tusker | (13) | (14) | (26) |
| Senator | 145 | 144 | 111 |
| Harp | (8) | (8) | (17) |
| Johnnie Walker | (17) | (4) | (13) |
| Smirnoff | 2 | 8 | (7) |

(i) Spirits brands excluding ready to drink.

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In Nigeria, net sales declined 9% driven by the comparison against the strong distribution growth on Orijin, which lapped its successful introduction last year when it defined a new category in Nigeria. The brand also saw rate of sale fall as competitors entered the category. A number of interventions to bring new news to the brand and the category have been made, including innovation and packaging changes at appropriate price points. Beer delivered a very strong performance with both volume and net sales up 28%. This is driven by strong double digit shipment growth for Guinness and Malta Guinness, reflecting momentum against a weak prior period, and high single digit growth in underlying depletions benefitting from new marketing, distribution changes and in part as consumers switch back from Orijin. Satzenbrau performed strongly with half year net sales growth of 54% as the brand builds its position in the growing value beer segment.

- In East Africa net sales were up 13% largely driven by the strong growth of beer and mainstream spirits. In Kenya Senator keg volume more than doubled following a duty reduction early in the year. Mainstream spirits net sales were up 17%, largely driven by the strong performance of Kenya Cane and Kane Extra. Guinness, Smirnoff Ice Double Black and Guarana, and reserve brands all grew both volume and net sales by double digits.
- In Africa Regional Markets net sales grew 6% reflecting strong growth in Ghana, Cameroon and Ethiopia. In Ghana net sales were up 27% largely driven by the launch of Orijin Bitters and ready to drink variants, and good performance in beer with net sales up 5%. In Cameroon, net sales growth of 4% was driven by a good performance from Guinness, despite short term supply constraints, and Johnnie Walker which grew 30% as it continued to benefit from an improved route to consumer. In Ethiopia, strong net sales growth of Malta of 63% was partly offset by a small decline in beer, in an increasingly aggressive sector as brewing capacity expands in the market. We have relaunched our Meta beer brand in November. Reported net sales increased £26 million in the half following the acquisition of the remaining 50% of United National Breweries in South Africa in May 2015. Net sales in Angola declined 52% reflecting economic and currency issues leading to reduced stock levels. Reserve brands continue to perform well driven by Johnnie Walker Blue Label.
- In a challenging economic environment net sales in South Africa were up 2%. Net sales of spirits were flat as a 9% growth in vodka was offset by scotch net sales down 6%. Smirnoff 1818 continued its strong performance with net sales growth of 3%, and is now the biggest spirits brand in South Africa. Net sales of Johnnie Walker increased 5%, with Johnnie Walker Black depletions of 12%, as marketing focused on the brand's quality credentials. Overall scotch net sales performance reflects weaker performance of Johnnie Walker Red, J B and Bell's as the economic issues led to lower stock levels in the retail trade. Net sales in rum were up 14% as a result of consumer events to drive awareness. Reserve brands' net sales were up 19% as it benefited from launches of Bulleit, Ketel One, Cîroc Pineapple and Cardhu.
- Marketing investment in Africa decreased 4% driven by Nigeria and East Africa. In Nigeria, investment was down 16% as activity on beer started slowly in the half, reflecting economic uncertainty. In East Africa, investment declined 1% reflecting the growth in the value sector and some re-phasing of marketing to the second half. Investment increased 5% in African Regional Markets reflecting a continued focus on core brands, alongside renovating the Meta brand in Ethiopia and the launch of Orijin in Ghana. Investment behind scotch increased 14% notably behind Johnnie Walker in South Africa and Africa Regional Markets. Ready to drink investment increased driven by Smirnoff Ice Double Black & Guarana in South Africa.

## Latin America and Caribbean

In LAC volume and net sales growth of 4% and 9% respectively reflect strong performances across the domestic markets. Despite difficult market conditions, Brazil net sales were up 12% reflecting price increases and positive shipment phasing ahead of a December duty increase. Perfomance in both Mexico and Colombia was strong with net sales up 20% and 24% respectively, driven by scotch and the introduction of Baileys flavours. Net sales growth in the export channels reflects the comparison against last year when stocks held by customers in the channel were reduced. There has also been a significant decline in depletions in the export channels given the continued currency weakness. Following a number of years of currency devaluation which has impacted demand, net sales in Venezuela were only

£4 million. Scotch net sales across LAC grew 9% reflecting strong Johnnie Walker Red Label performances in Mexico and Brazil, and Buchanan's in Mexico and Colombia, driven by invigourated marketing campaigns, some price increases and growth in reserve scotch brands. Vodka net sales were up 22% driven by growth in Mexico and in Brazil as a result of the pre-duty buy in.

Key financials £ million:

| | First Half F15 Reported | FX | Acquisitions and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 619 | (139) | 2 | 40 | 522 | (16) |
| Marketing spend | 110 | (21) | 4 | 3 | 96 | (13) |
| Operating profit before exceptional items | 207 | (63) | 3 | 7 | 154 | (26) |
| Exceptional items | (4) | | | | (104) | |
| Operating profit | 203 | | | | 50 | (75) |

Markets:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| Latin America and Caribbean | 4 | 5 | 9 | (16) |
| | | | | |
| PUB | 1 | 1 | 9 | (21) |
| Colombia | 5 | 6 | 24 | (11) |
| Mexico | 26 | 41 | 20 | 20 |
| West LAC | 5 | (2) | 4 | (7) |
| Venezuela | 7 | 6 | 39 | (94) |
| | | | | |
| Spirits | 5 | 7 | 9 | (13) |
| Beer | 11 | (28) | 7 | (41) |
| Ready to drink | (9) | (9) | 3 | (33) |

Global giants and local stars(i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Johnnie Walker | 7 | 11 | (7) |
| Buchanan's | (10) | 5 | (27) |
| Smirnoff | 14 | 21 | (14) |
| Old Parr | (11) | - | (24) |
| Baileys | (1) | 5 | (10) |
| Ypióca | (6) | 4 | (28) |
| Black & White | 49 | 72 | 25 |

(i) Spirits brands excluding ready to drink.

- Net sales in Paraguay, Uruguay and Brazil (PUB) increased 9% largely driven by Brazil where, despite challenging market conditions, net sales were up 12% reflecting price increases following a currency devaluation and positive shipment phasing ahead of a significant excise duty increase in December 2015. Scotch net sales in Brazil were up 17% with strong performance of Johnnie Walker Red Label, Black and White, and White Horse with Diageo holding share despite price increases, reflecting a consistent and targeted investment behind these brands. Vodka net sales were up 15% driven by Smirnoff and Cîroc as a result of the pre-duty buy in. Despite the decline in the cachaça market, Ypióca net sales were up 4% as on-trade activations focused on increasing coverage in its core region. An impairment charge in respect of the Ypióca brand and its goodwill has been made reflecting the challenging economic environment and a significant adverse change in local tax regulation which will lower its future profitability. Net sales in the duty free zones of Paraguay and Uruguay declined 15% reflecting currency devaluation. Reserve brands' net sales in PUB increased 14% driven by Cîroc and a focus on customer experience through on trade marketing activity.
- Net sales in Colombia were up 24%, with 18pps of positive price/mix. Scotch delivered strong double digit net sales growth in each segment. Johnnie Walker continues to grow with volume up 13%, and net sales up 40% driven by price increases. Old Parr grew net sales 21% and share benefited from the launch of Old Parr Tribute. Buchanan's delivered 37% net sales growth and made share gains primarily due to increases in Buchanan's Deluxe and Special Reserve. Innovation through flavours, plus strong focus behind brilliant execution during peak selling seasons contributed to a 7% increase in Baileys net sales, and increased share in a growing category. As the business looks to widen its portfolio, gin and vodka categories posted net sales growth above 40% and 50% respectively, albeit from a small base, driven by innovation and reserve brands.
- Mexico net sales were up 20% largely driven by scotch where net sales increased 18%, reflecting strong brand momentum and improved execution of marketing campaigns and commercial platforms. A full revamp of the Buchanan's trademark through the launch of a new bottle and the successful 'Good vs Great' campaign contributed to 18% net sales growth. Johnnie Walker net sales grew 17% benefitting from greater visibility with the Keep Walking - 'Walk With Joy' ('Walk With Joy') campaign and digital activations. Black and White net sales grew 87% reflecting strong focus on trade activations. A robust turnaround plan has been implemented for Smirnoff having regained distribution of the brand, focused on brand availability through trade activations. The acquisition of Don Julio drove reported net sales growth. Don Julio is the fastest growing tequila brand in the country nearly doubling category growth.
- In West LAC net sales increased 4%. Net sales growth in the export channels reflects the comparison against last year, when stock held by customers in the channel were reduced, and a significant decline in depletions given the continued currency weakness. Domestic markets' net sales increased 3% driven by Peru, Chile, and Central America and Caribbean. In Peru net sales were up 22% reflecting some pricing actions, with strong contributions from Old Parr and across the Johnnie Walker portfolio on the back of the 'Walk With Joy' campaign and Johnnie Ginger activations in the first half. In Chile, net sales improved 11% driven by strong scotch volume and net sales growth of 18% and 15% respectively benefiting from trade activations. Central America and Caribbean net sales grew 2% driven by Smirnoff ready to drink up 14% reflecting the launch of Smirnoff Ice Double Black and Guarana in Central America in the half. In Argentina, changes in the channel mix reduced net sales by 4% in the half. Diageo has now agreed to sell its Argentina wine business and move to a full distribution sales model, which is expected to complete in the second half. In addition, the beer business in Jamaica was sold in October 2015 as part of a focus on spirits.
- Following the change in consolidation exchange rate to recognise local inflation, net sales for Venezuela in the half were £4 million.
- An increase in marketing investment of 4% supported the expansion of brand portfolios in the region, but spend was reduced in Brazil in line with the weaker economic environment. In Mexico, investment growth of 16% was driven by spend on Smirnoff as we continue to invest having regained distribution, and on ready to drink behind the launch of Smirnoff Ice Double Black & Guarana. Elsewhere, Smirnoff ready to drink investment also increased behind the new Green Apple flavour in Colombia. Scotch spend increased 2% and was focused on Johnnie Walker Black in Brazil, Mexico and West LAC supported by the 'Walk With Joy' campaign, and Buchanan's in Mexico and

Colombia with the relaunch of the new image.

- Net sales in Paraguay, Uruguay and Brazil (PUB) increased 9% largely driven by Brazil where, despite challenging market conditions, net sales were up 12% reflecting price increases following a currency devaluation and positive shipment phasing ahead of a significant excise duty increase in December 2015. Scotch net sales in Brazil were up 17% with strong performance of Johnnie Walker Red Label, Black and White, and White Horse with Diageo holding share despite price increases, reflecting a consistent and targeted investment behind these brands. Vodka net sales were up 15% driven by Smirnoff and Cîroc as a result of the pre-duty buy in. Despite the decline in the cachaça market, Ypióca net sales were up 4% as on-trade activations focused on increasing coverage in its core region. An impairment charge in respect of the Ypióca brand and its goodwill has been made reflecting the challenging economic environment and a significant adverse change in local tax regulation which will lower its future profitability. Net sales in the duty free zones of Paraguay and Uruguay declined 15% reflecting currency devaluation. Reserve brands' net sales in PUB increased 14% driven by Cîroc and a focus on customer experience through on trade marketing activity.
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behind the new Green Apple flavour in Colombia. Scotch spend increased 2% and was focused on Johnnie Walker Black in Brazil, Mexico and West LAC supported by the 'Walk With Joy' campaign, and Buchanan's in Mexico and Colombia with the relaunch of the new image.

## Asia Pacific

The overall performance in Asia Pacific improved, with net sales up 2% as Australia, South East Asia, Greater China and India all grew. The performance of Shui Jing Fang drove growth in Greater China and the successful renovation of Royal Challenge drove top line growth in India. There was some weakness in Korea, driven by a shift towards lower ABV spirits, and in Global Travel Asia and Middle East, given geopolitical developments. The reserve portfolio continued to deliver a strong performance, up 15%, with growth coming from Master Distiller's No.8 brand in Greater China and the reintroduction of Johnnie Walker Green Label in Australia. Marketing spend was down 2% as a result of reduced spend on Johnnie Walker Black Label and Blue Label in China. Operating margin improved strongly as margin in India increased significantly driven by both underlying improvement in operating margin and the sale by USL of United Breweries Limited shares.

Key financials £ million:

| | First Half F15 Reported | FX | Acquisitions and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 1,166 | (34) | (35) | 26 | 1,123 | (4) |
| Marketing spend | 168 | (6) | (1) | (4) | 157 | (7) |
| Operating profit before exceptional items | 214 | (15) | (1) | 36 | 234 | 9 |
| Exceptional items | (147) | | | | - | |
| Operating profit | 67 | | | | 234 | 249 |

Markets:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| Asia Pacific | - | (10) | 2 | (4) |
| South East Asia | (2) | (2) | 6 | 2 |
| Greater China | - | - | 4 | 6 |
| India | - | (12) | 6 | (3) |
| Global Travel Asia & Middle East | (6) | (6) | (12) | (12) |
| Australia | 2 | 2 | 2 | (11) |
| North Asia | 10 | 10 | (2) | (6) |

| | | | | |
|---|---|---|---|---|
| Spirits | - | (10) | 2 | (2) |
| Beer | 2 | 2 | (1) | (8) |
| Ready to drink | (8) | (8) | (9) | (18) |

Global giants and local stars(i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Johnnie Walker | (4) | (5) | (7) |
| McDowell's | 2 | 3 | (2) |
| Windsor | - | (7) | (10) |
| Smirnoff | (3) | (3) | (7) |
| Guinness | 2 | (1) | (8) |
| Bundaberg | (5) | (4) | (17) |
| Shui Jing Fang | 155 | 69 | 73 |

(i) Spirits brands excluding ready to drink.

- In South East Asia net sales were up 6%. This growth was driven by increased net sales in the wholesale channels which lapped the inventory reduction of Johnnie Walker Black Label and Johnnie Walker Red Label in F15. This inventory reduction has continued in the first half, however while shipments are below depletions, shipments are up on last year. Other countries in the market were weaker. In Indonesia, increased regulation banning off trade sales had a material impact resulting in a net sales reduction of 16%. In Thailand, net sales were down 6% due to the weak scotch market. However, Johnnie Walker grew share by 1ppt. In addition, the successful launch of Smirnoff Midnight 100 in the first quarter contributed to share gains of 40bps in Smirnoff ready to drink. In Vietnam net sales declined by 29% with Johnnie Walker particularly impacted.
  - In Greater China net sales increased 4%. The performance in Shui Jing Fang continued to improve with net sales up 81%, driven by the continuing strong performance of the Master Distiller's No.8 which competes in the premium baijiu segment. In China net sales of international spirits were down 40%, largely due to scotch, which was down 42% as the effects of the government's anti-extravagance measures on the traditional on trade persist and competition increases in the modern on trade channel. In Taiwan, net sales were up 9% driven by the continued success of The Singleton which gained share consolidating its number one scotch position.
- In India, net sales were up 6% for the half. Shipments of Johnnie Walker were down as a result of delays in registration in some states and stock levels of Smirnoff were reduced. IMFL brands, especially prestige and above, performed strongly in Q2 offsetting some weakness in the first quarter. The renovation of the Royal Challenge brand drove net sales growth of 57% and the brand gained share in the category. This offset a temporary pricing related challenge in Karnataka on our lead brand of Haywards which declined 32% and impacted the reported India results by 2pps. In addition, Scotch performed strongly with double digit net sales growth from revamped brand campaigns and category management across the consolidated portfolio. Share gains were achieved in Premium White Spirits driven by Smirnoff despite a softening category. Overall India's gross profit margin improved 3pps due to improved product/price mix and stronger collaboration with third party suppliers and productivity initiatives that delivered a reduction in cost of sales.
- Global Travel Asia and Middle East net sales declined by 12% as geopolitical developments led to softness in the domestic and travel retail business in the Middle East. In Global Travel Asia net sales declined 4% impacted by softness in China and South East Asia.
-

Australia performed well in tough market conditions and net sales grew 2%. Growth in spirits and beer more than offset the continued decline in the ready to drink segment. Smirnoff, Captain Morgan and Baileys performed strongly and all gained share. However, the overall Bundaberg brand net sales were down 2% driven by spirits as ready to drink was flat year on year. Johnnie Walker was down low single digit driven by Johnnie Walker Red Label partially offset by the re-introduction of Johnnie Walker Green Label.

- North Asia net sales were down 2%. In Japan, net sales grew 9%, largely driven by strong growth in scotch which offset the decline in ready to drink, a category that is becoming more competitive due to new entrants in craft beer and wine based ready to drink. In Korea net sales were down 6%. Decline in the whisky category and a shift towards lower ABV spirits was partially offset by continued growth in beer as Diageo broadened its participation. In response to the shift towards lower ABV spirits Korea launched W Ice by Windsor in March 2015 and K Rare by Windsor in November 2015 and initial results show the brands are being well received both by customers and consumers.
- Marketing spend decreased 2% with a significant reduction in Johnnie Walker investment predominantly in China with a planned move away from in-outlet promotion. In North Asia, while marketing spend reduced overall in response to the contraction of the whisky market, Korea increased its investment in Guinness to broaden the portfolio. The spend in South East Asia has increased by 12% with the execution of the Johnnie Walker 'Walk With Joy' marketing campaign and the launch of Smirnoff ready to drink Midnight 100 in Thailand being the key focus. In India marketing spend was down as marketing spend is focused on key brand renovations.

## Corporate

Key financials £ million:

| | First Half F15 Reported | FX | Acquisitions and disposals | Organic movement | First Half F16 Reported | Reported movement % |
|---|---|---|---|---|---|---|
| Net sales | 43 | (2) | (25) | 1 | 17 | (60) |
| Marketing spend | 4 | - | (2) | - | 2 | (50) |
| Operating profit before exceptional items | (56) | (3) | (4) | (5) | (68) | (21) |
| Exceptional items | (7) | | | | - | |
| Operating profit | (63) | | | | (68) | (8) |

Reported corporate net sales in the six months ended 31 December 2015 were £17 million, down 60% from the previous year largely due to the sale of the Gleneagles Hotel. Operating charges in the period were £68 million, as cost savings in global functions were more than offset by the release of provisions which benefited the comparative. There were no exceptional charges in respect of restructuring costs in the half

## CATEGORY AND BRAND REVIEW

For six months ended 31 December 2015

Key categories:

| | Organic volume movement % | Reported volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|---|
| Spirits(i) | - | (5) | 1 | (4) |
| Scotch | (2) | (2) | 1 | (8) |
| North American whiskey | 7 | 7 | 10 | 15 |
| IMFL | (4) | (8) | 2 | (1) |
| Vodka | (1) | (1) | (8) | (9) |
| Rum | 7 | 7 | 4 | - |
| Tequila | 7 | 87 | 6 | 45 |
| Liqueurs | 6 | 6 | 7 | 2 |
| Gin | 2 | 2 | 6 | 3 |
| Beer | 15 | 26 | 7 | 1 |
| Ready to drink | (14) | (14) | (13) | (20) |

(i) Spirits brands excluding ready to drink.

- Scotch represents 25% of Diageo net sales and net sales were up 1%. A good performance in Latin America and Caribbean, with net sales up 9%, was largely driven by Johnnie Walker and Buchanan's, supported by successful marketing campaigns such as Buchanan's 'Good vs Great' campaign and Johnnie Walker's 'Walk With Joy' campaign. Good overall performances by Black & White and White Horse were offset by net sales decline in J B and Bell's. Windsor net sales declined double digit in Korea due to the decline of the whisky category and a market shift towards lower ABV spirits.
- North American whiskey represents 8% of Diageo's net sales and grew 10%. Performance was driven by the success of Crown Royal Regal Apple and the strong growth of Bulleit which continued to gain share in the category in the United States.
- Vodka represents 12% of Diageo's net sales and declined 8%. The decline was largely driven by Cîroc in the United States. Smirnoff, the largest brand in the category, performed well with net sales up 1% in developed markets and 4% in emerging markets.
- Beer represents 17% of Diageo's net sales and grew 7% largely driven by a strong performance in Africa where beer net sales were up 15%. Key contributors were East Africa and Nigeria. In East Africa there was strong growth of Senator, which more than doubled volume following the duty remission early in the fiscal year. In Nigeria, Guinness benefited from trade activations, and a price and quality focus. While Malta continued its distribution drive in to the growing off trade sector. Guinness also gained share and increased net sales in Great Britain by 4% and Ireland by 5%, its two biggest markets.

- Ready to drink represents 5% of Diageo's net sales with net sales down 13%. This was largely driven by a decline of Orijin in Nigeria as it lapped last year's national roll out and faced increased competition in this category. The decline was partially offset by a good performance in Smirnoff Ice Flavours in the United States driven by new marketing programmes and flavours and the launch of Orijin in Ghana. In Thailand, Smirnoff Midnight 100 was successfully launched in the ready to drink segment in the first quarter and contributed to share gains of 40bps in Smirnoff ready to drink.

Global giants, local stars and reserve (i):

| | Organic volume movement % | Organic net sales movement % | Reported net sales movement % |
|---|---|---|---|
| Global giants | | | |
| Johnnie Walker | (1) | 1 | (5) |
| Smirnoff | 2 | 2 | (1) |
| Baileys | 4 | 6 | 2 |
| Captain Morgan | 5 | 3 | 3 |
| Tanqueray | 8 | 8 | 9 |
| Guinness | 8 | 9 | 2 |
| Local stars | | | |
| Crown Royal | 7 | 8 | 13 |
| Yenì Raki | 5 | 5 | (14) |
| Buchanan's | (5) | 7 | (13) |
| J B | (6) | (9) | (16) |
| Windsor | 1 | (7) | (10) |
| Old Parr | (10) | - | (22) |
| Bundaberg | (5) | (4) | (17) |
| Bell's | (2) | (3) | (15) |
| White Horse | (6) | 10 | (18) |
| Ypióca | (6) | 4 | (28) |
| Cacique | 53 | 9 | (56) |
| Shui Jing Fang | 154 | 68 | 72 |
| Reserve | | | |
| Scotch malts | 8 | 10 | 5 |
| Cîroc | (36) | (37) | (34) |
| Ketel One vodka | - | (1) | 4 |
| Don Julio | 24 | 27 | 75 |
| Bulleit | 27 | 29 | 36 |

(i) Spirits brands excluding ready to drink.

- Global giants represent 45% of Diageo net sales and grew 4%.

- Johnnie Walker net sales were up 1% as reserve brands performed well with net sales up 13%, tempered by inventory reductions of Johnnie Walker Red Label in Asia Pacific. Johnnie Walker Black Label net sales were also down 3%, largely driven by the continued effects of the government's anti extravagance measures in Greater China and geopolitical developments which led to softness in the Middle East domestic and travel retail business.

- Smirnoff net sales grew 2%, returning to growth in the United States, its biggest market, where Smirnoff net sales were up 4% driven by Smirnoff Red and the launch of Smirnoff Peppermint. In Europe net sales were down 7% due to decline in Great Britain with higher volume sold on promotion in the holiday season as part of a strategy to drive our broader vodka portfolio in certain channels and a decline in Continental Europe as we restructured trade terms with certain customers to create a more profitable and sustainable business.

- Baileys net sales increased by 6% mainly driven by growth in Great Britain and the United States. In Great Britain Baileys net sales were up 14% supported by increased media, sampling and in-outlet visibility and promotions during the holiday season. In the United States the growth was driven by the launch of Baileys Espresso Crème.

- Captain Morgan net sales were up 3% with growth in Europe, Russia and the United States. In Europe there was double digit net sales growth in Iberia, Poland, Nordics, Italy, Southern Europe and France. In the United States, which accounts for nearly two thirds of Captain Morgan net sales, net sales were up 2% with the launch of Captain Morgan Cannon Blast. In Russia, Captain Morgan continued a strong performance behind the Captain Morgan White launch.

- Tanqueray net sales were up 8% with all regions delivering net sales growth as Europe, Latin America and Caribbean and Asia Pacific all achieved double digit net sales growth. In its biggest market, the United States, net sales were up 1%, driven by Tanqueray No. TEN as the super-premium category continued to expand. Tanqueray No. TEN was supported with variant-specific communication to drive awareness and trial to drive distribution in top-end bars and restaurants nationally.

- Guinness net sales increased 9%. In Nigeria net sales grew 28% as it continued to benefit from the distribution drive launched last year to capture the growing off trade category. In Kenya net sales increased 11% supported by the ‘Get Booked 2’ and ‘Made of Black’ marketing campaigns. Guinness also gained share and increased net sales in Great Britain by 4% and Ireland by 5%.

- Local stars represent 16% of Diageo net sales. Despite tough economic conditions in many of the markets for local stars overall performance was good with net sales up 5%. Net sales growth of 8% in Crown Royal in the United States and high double digit growth in Shui Jing Fang driven by the continuous strong performance of Master Distiller’s No.8 accounted for over 90% of the net sales growth. Elsewhere strong performances in Buchanan’s across North America and LAC and Raki in Turkey offset the decline in J B in Continental Europe and Windsor in Korea.

  - Reserve brands’ net sales decline of 2% was largely driven by lower volume of Cîroc as the United States business moved to a replenishment model on innovations and the launch of Cîroc Apple occurred later in this half than the launch of Cîroc Pineapple last year. Overall scotch reserve brand net sales are up 9% with double digit growth of Johnnie Walker more than offsetting a decline in Haig Club as it laps the launch last year. Bulleit, the fastest growing unflavoured North American whiskey, delivered double digit growth and both Bulleit Bourbon and Bulleit Rye led growth in their respective segments through increased distribution, consumer experience marketing, and the engagement of key trade influencers.

ADDITIONAL FINANCIAL INFORMATION
For the six months ended 31 December 2015

INCOME STATEMENT

| | 31 December 2014 £ million | Exchange (a) £ million | Acquisitions and disposals (b) £ million | Organic movement(ii) £ million | 31 December 2015 £ million |
|---|---|---|---|---|---|
| Sales | 8,724 | (463) | (161) | 167 | 8,267 |
| Excise duties | (2,824) | 181 | 52 | (70) | (2,661) |
| Net sales | 5,900 | (282) | (109) | 97 | 5,606 |
| Cost of sales(i) | (2,418) | 106 | 71 | (51) | (2,292) |
| Gross profit | 3,482 | (176) | (38) | 46 | 3,314 |
| Marketing | (896) | 29 | 5 | 40 | (822) |
| Other operating expenses(i) | (747) | 22 | (3) | (47) | (775) |
| Operating profit before exceptional items | 1,839 | (125) | (36) | 39 | 1,717 |
| Exceptional operating items (c) | (171) | | | | (104) |
| Operating profit | 1,668 | | | | 1,613 |
| Non-operating items (c) | 98 | | | | 211 |

| | | |
|---|---|---|
| Net finance charges | (239) | (176) |
| Share of after tax results of associates and joint ventures | 113 | 136 |
| Profit before taxation | 1,640 | 1,784 |
| Taxation | (276) | (296) |
| Profit for the period | 1,364 | 1,488 |

(i) Before exceptional operating items.
(ii) For the definition of organic movement see 'Explanatory Notes' section.

(a) Exchange
The impact of movements in exchange rates on reported figures is principally in respect of the Venezuelan bolivar, the euro and the Brazilian real partially offset by the US dollar.

Venezuela is a hyper-inflationary economy where the government maintains a regime of strict currency controls with multiple foreign currency rate systems. Access to US dollar on these exchange systems is very limited. The foreign currency denominated transactions and balances of the group's Venezuelan operations are translated into the local functional currency (VEF) at the rate they are expected to be settled, applying the most appropriate official exchange rate. For consolidation purposes, the group converts its Venezuelan operations using management's estimate of the rate that capital and dividend repatriations are expected to be realised. The consolidation rate and the accounting treatment are monitored and reviewed depending on the economic and regulatory developments in the country.

The effect of movements in exchange rates and other movements on profit before exceptional items and taxation for the six months ended 31 December 2015 is set out in the table below.

| | Gains/ (losses) £ million |
|---|---|
| Translation impact | (62) |
| Transaction impact | (63) |
| Operating profit before exceptional items | (125) |
| Net finance charges – translation impact | (3) |
| Mark to market impact of IAS 39 on interest expense | (5) |
| Impact of IAS 21 and IAS 39 on net other finance charges | (2) |
| Interest and other finance charges | (10) |
| Associates – translation impact | (11) |
| Profit before exceptional items and taxation | (146) |

| | Six months ended 31 December 2015 | Six months ended 31 December 2014 |
|---|---|---|
| Exchange rates | | |
| Translation £1 = | $1.52 | $1.61 |
| Transaction £1 = | $1.57 | $1.58 |
| Translation £1 = | €1.39 | €1.26 |
| Transaction £1 = | €1.33 | €1.24 |

(b) Acquisitions and disposals
The impact of acquisitions and disposals on the reported figures was primarily attributable to the disposals of The Old Bushmills Distillery Company Limited on 27 February 2015, Gleneagles Hotels Limited on 30 June 2015, Desnoes & Geddes Limited (D&G) on 7 October 2015, the wine businesses in the United States and the UK Percy Fox wine business on 1 January 2016, partly offset by the acquisition of the 50% equity interest in Don Julio in Mexico that Diageo did not already own on 27 February 2015.

(c) Exceptional items
Exceptional operating charges in the six months ended 31 December 2015 included an impairment charge in respect of the Ypióca brand and goodwill allocated to the Paraguay, Uruguay and Brazil (PUB) cash-generating unit of £62 million and £42 million, respectively. Forecast cash flow assumptions have been reduced principally due to a challenging economic environment in Brazil and significant adverse changes in local tax regulation. A pre-tax discount rate of 17% (2014 – 14%) and 19% (2014 – 18%) have been used to calculate the net present value of the future cash flows expected to be generated by Ypióca and PUB, respectively.

In the six months ended 31 December 2014 exceptional operating charges included £145 million in respect of a settlement agreement of disputes with the Korean customs authorities and £26 million in respect of restructuring programmes.

Non-operating items in the six months ended 31 December 2015 included an exceptional gain of £457 million in respect of the sale of Diageo's 57.87% shareholding in D&G (Jamaican Red Stripe business) and a 49.99% stake in GAPL Pte Limited (Singapore and Malaysian beer business) to Heineken, which completed on 7 October 2015. The gain is net of a £13 million cumulative exchange loss, in respect of prior years, recycled from other comprehensive income and transaction costs of £8 million. As part of the transaction, Diageo agreed to purchase an additional 20% shareholding in Guinness Ghana Breweries Limited (GGBL) from Heineken which increased Diageo's shareholding in GGBL to 72.42%.

On 1 December 2015, Diageo disposed of its 42.25% equity interests in DHN Drinks, 25% equity stake in Sedibeng Breweries Limited and its 15.01% equity stake in Namibia Breweries Limited (South African associate interests). The net cash consideration received was £120 million, which includes £31 million in respect of loans made to DHN Drinks and Sedibeng Breweries Limited. An exceptional non-operating loss of £28 million, net of a £30 million cumulative exchange loss, in respect of prior years, recycled from other comprehensive income, was accounted for in the income statement.

On 1 January 2016, Diageo completed the sale of the majority of its wine interests in the United States and its UK based Percy Fox businesses to Treasury Wine Estates. As at 31 December 2015 the assets and liabilities of the US wine business and Percy Fox were transferred to assets and liabilities held for sale on the consolidated balance sheet. Together with the sale of the group’s other wine interests in the United States the transactions resulted in an exceptional loss of £123 million in the period including an estimated provision for the settlement of a guarantee given in respect of the lease payments due to the lessor of the vineyards. In the full year it is expected that the sale of the businesses will result in an exceptional loss before taxation on disposal of approximately £135 million. A cumulative exchange gain of £12 million, in respect of prior years, to be recycled from other comprehensive income and other costs of approximately £24 million will be accounted for in the second half of the year.

On 30 September 2015, the group completed the disposal of its shareholding in Central Glass Industries Limited (CGI), a Kenyan glass bottle manufacturer, resulting in an exceptional gain of £14 million, net of £1 million transaction costs. £7 million of the gain is attributable to non-controlling interests.

On 5 November 2015, Diageo agreed the sale of its interests in Argentina to Grupo Peñaflor. The transaction will be completed in the second half of the year. Net balances were transferred to assets and liabilities held for sale on the consolidated balance sheet and resulted in an exceptional loss of £17 million in the six months ended 31 December 2015. It is expected that for the full year the transaction will result in an exceptional loss on disposal of approximately £45 million. The cumulative exchange loss, in respect of prior years, of approximately £20 million to be recycled from other comprehensive income and other directly attributable costs of some £8 million will be accounted for in the second half of the year.

In May 2015, a loan of $135 million (£92 million) provided by Standard Chartered Bank (SCB) to Watson Limited guaranteed by Diageo Holdings Netherlands B.V became due. The date from which the guarantee can be called was extended to 29 January 2016 and $135 million was deposited during the period into an escrow account with SCB. Given the risks in relation to the enforcement and recoverability of associated security and counter-indemnities, Diageo believes that the outstanding amounts may not be fully recoverable. Therefore the $135 million deposited with SCB has been provided for (see note 13(a)).

In the six months ended 31 December 2014 a gain of £103 million arose on the increase of the group's investment in United Spirits Limited (USL) from 25.02% to 54.78% (excluding the 2.38% interest owned by USL Benefit Trust) and the group incurred £5 million transaction costs in respect of the sale of the group's shareholding in Bushmills.

Cash payments in the six months ended 31 December 2015 for exceptional restructuring and for the deposit into the escrow account with SCB in respect of the Watson guarantee (reported in 'movements in loans and other investments' in the consolidated statement of cash flows) were £33 million (2014 – £62 million) and £92 million (2014 – £nil), respectively. Cash expenditure on exceptional restructuring in the second half of the year is expected to be approximately £30 million.

(d) Dividend

An interim dividend of 22.6 pence per share will be paid to holders of ordinary shares and ADRs on the register as of 26 February 2016. The ex-dividend date is 25 February 2016. This represents an increase of 5% on last year's interim dividend. The interim dividend will be paid to shareholders on 7 April 2016. Payment to US ADR holders will be made on 12 April 2016. A dividend reinvestment plan is available to holders of ordinary shares in respect of the interim dividend and the plan notice date is 15 March 2016.

## MOVEMENT IN NET BORROWINGS AND EQUITY

Movement in net borrowings

| | 2015 £ million | 2014 £ million |
|---|---|---|
| Net borrowings at 30 June | (9,527) | (8,850) |
| Free cash flow (a) | 839 | 699 |
| Acquisition and sale of businesses (b) | 643 | (664) |
| Net purchase of own shares for share schemes (c) | (20) | (7) |
| Dividends paid to non-controlling interests | (56) | (34) |
| Purchase of shares of non-controlling interests (d) | (21) | - |
| Net movements in bonds (e) | (489) | (371) |
| Net movements in other borrowings (f) | 94 | 1,316 |
| Equity dividends paid | (876) | (801) |
| Net increase in cash and cash equivalents | 114 | 138 |
| Net decrease/(increase) in bonds and other borrowings | 395 | (945) |
| Exchange differences (g) | (259) | (143) |
| Borrowings on acquisition of businesses | - | (849) |
| Borrowings disposed through sale of businesses | 7 | - |
| Other non-cash items | 42 | (19) |
| Net borrowings at 31 December | (9,228) | (10,668) |

(a) See 'Key financial information' section for the analysis of free cash flow.

(b) Acquisitions and sale of businesses include the disposal of the group's shareholdings in D&G and GAPL on 7 October 2015 for a net cash consideration, including disposal costs, of $752 million (£490 million), the disposal of the group's equity stake in its South African associate interests on 1 December 2015 for a cash consideration of ZAR

2,517 million (£119 million), net of disposal costs and the proceeds from the sale of CGI, a Kenyan glass manufacturer, for KES 3,931 million (£25 million). In the six months ended 31 December 2014 cash payments primarily comprised £1,118 million in respect of the acquisition of additional 26% investment in USL partially offset by £395 million in respect of sale of the Whyte and Mackay Group.

(c) Net purchase of own shares comprised purchase of treasury shares for the future settlement of obligations under the employee share option schemes of £39 million (2014 – £39 million) less receipts from employees on the exercise of share options of £19 million (2014 – £32 million).

(d) In the six months ended 31 December 2015 Diageo purchased an additional 20% shareholding in Guinness Ghana Breweries Limited for £21 million.

(e) In the six months ended 31 December 2015, the group repaid bonds of $750 million (£489 million). In the comparable period, the group repaid bonds of €1,000 million (£792 million) and issued bonds of €1,000 million (£791 million), and a bond of £370 million acquired on the purchase of USL was repaid using the proceeds from the sale of the Whyte and Mackay Group.

(f) Net movements in other borrowings are primarily in respect of the net drawdown of short term commercial paper which is used to finance day-to-day operations.