Diageo Scotland Limited

Annual report and Financial Statements
30 June 2018

Registered number: SC000750

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Strategic report

The directors present their strategic report for the year ended 30 June 2018.

Activities

The company's principal activities are the distillation, warehousing, maturation, bottling and packaging of Scotch whisky and other spirits and distribution to fellow group undertakings and third parties. The company performs manufacturing services on behalf of a number of Diageo brand owning companies.

In addition to the production activities the company is also the brand owner of Bell's, Cardhu, the Classic Malt whiskies and other malt whiskies and owns the worldwide distribution rights for the Captain Morgan brand (excluding Canada and the United States of America).

From 1 July 2017 the company manages and controls Diageo's Global Travel Business, and for the year ended 30 June 2018 the company distributes, markets, imports and sells spirits and beer in travel retail outlets throughout the world.

In addition to the above activities, the company performs a number of support services for other group companies. These services are principally in respect of the Diageo Brand Technical Centre, which provides risk management, technical support, innovation and engineering services to Diageo brand owners.

Business review

Development and performance of the business of the company during the financial year and position of the company as at 30 June 2018

The development, performance and principal activities of the company were, for the year ended 30 June 2018, predominantly dependent on the requirements of the Diageo subsidiaries with whom it trades.

The company entered into option agreements with Lakeside MWS Limited Liability Partnership ("Lakeside"), a fellow group undertaking, in 2010. The company was granted a put option to require Lakeside to purchase maturing spirit from the company and a call option to enable it to repurchase the maturing spirit from Lakeside at any point in time. During the year, the company paid a premium of £50 million (2017 - £71 million) as consideration for call and put options to repurchase and sell the maturing spirit. This amount is included in finance charges.

Financial and other key performance indicators

The principal key performance indicators used by the company's management to analyse the development, performance and position of the company's business are generally the same as those disclosed in the consolidated financial statements of Diageo plc. The directors consider company key performance indicators to measure the performance of the company, such as net sales and operating profit. Other financial performance indicators (including contribution to the free cash flow initiatives of the group) and non-financial performance indicators used to measure the company's performance are the same as those disclosed in Diageo plc's 2018 Annual Report on pages 8 and 9.

Strategic report (continued)

Business review (continued)

Financial and other key performance indicators (continued)

The company's principal key performance indicators are analysed below for the year ended 30 June 2018.

The principal reason for the 41% increase in sales of £467 million and 49% increase in operating costs of £389 million is the contribution of the newly integrated Global Travel business in the year ended 30 June 2018.

Maturing spirit inventories increased by £140 million to £2,991 million in order to satisfy future anticipated demand.

Principal risks and uncertainties facing the company as at 30 June 2018

The company believes the following to be the principal risks and uncertainties it faces. If any of these risks occur, the company's business, financial condition and operational results could suffer.

The company's operating results may be adversely affected by disruption to production facilities and by the loss of maturing spirit and the quantity of maturing spirit laid down

The company would be affected if there were industrial actions or catastrophic failure of its major production facilities and warehouses. If there were a technical integrity failure, fire or explosion at one of the company's production facilities, it could result in damage to the facilities, plant or equipment, their surroundings or the environment, which could lead to a loss in production capacity, or could result in regulatory action, legal liability or damage to the company's reputation.

The company has a substantial inventory of aged product categories, principally Scotch whisky, which generally mature over 7 years but whose maturation period may be up to 30 years or more. The loss through contamination, fire or other natural disaster of all or a portion of the inventory of any one of those aged product categories could result in a significant reduction in supply of those products, and consequently, the company would not be able to meet consumer demand for those products as it arises. There can be no assurance that insurance proceeds would cover the replacement value of the company's maturing spirit 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. In addition, in relation to the company's own brands, there is an inherent risk of forecasting error in determining the quantity of maturing spirit to lay down in a given year for future consumption. This could lead to an inability to meet future demand or lead to a future surplus of inventories and consequent write down in value of maturing spirit. This risk is unaffected by the arrangement with Lakeside as the company remains the beneficial owner of the maturing spirit sold, and therefore continues to bear all the risks and rewards of ownership of that inventory.

Strategic report (continued)

Business review (continued)

Principal risks and uncertainties facing the company as at 30 June 2018 (continued)

The company's business may be adversely impacted by unfavourable economic conditions

The company's business is dependent on general economic conditions in the United Kingdom and in other important markets. A significant deterioration in such conditions, including as a result of reduced consumer spending levels due to economic slowdowns or recessions, the imposition of tariffs or other trade restrictions, inflationary pressures, disruptions to credit markets, and/or the failure of a significant customer, could have a material adverse effect on the company's business and operational results. In addition, the United Kingdom's withdrawal process from the European Union has resulted in political and economic uncertainty and complexity, which could negatively impact economic conditions in the United Kingdom and in Europe more generally.

The company faces competition that may reduce its market share and margins

The company is dependent on the requirements of its fellow subsidiary undertakings throughout the world. These companies only require whisky when there is a demand from third party customers. The fellow subsidiary companies face substantial competition from several international companies as well as local and regional companies in the countries in which they operate. Increased competition and unanticipated actions by competitors or customers could lead to downward pressure on prices and/or a decline in the company's market share in any of these categories which would adversely affect the company's results and hinder its growth potential.

Demand for the company's products may be adversely affected by changes in consumer preferences and tastes and adverse impacts of a declining economy

The brands which the company produces and distributes include some of the world's leading beverage alcohol brands. Maintaining the company'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, public health regulations, vacation or leisure activity patterns, weather effects and a downturn in economic conditions, which may reduce consumers' willingness to purchase premium branded products. In addition, potential 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 the company's profitability.
Any significant changes in consumer preferences and failure to anticipate and react to such changes could result in reduced demand for the company's products and erosion of its competitive and financial position. Continued economic pressures could lead to consumer selection of products at lower price points, whether the company's or those of competitors, which may have an adverse effect on the company's profitability.

An increase in the cost of raw materials or energy could affect the company's profitability in relation to its own brands

Price changes could result in unexpected increases in the cost of raw materials, glass bottles and other packaging materials and the company's beverage products. The company could also be adversely affected by shortages of packaging materials. In addition, energy cost increases would result in higher transportation, freight and other operating costs. The company may not be able to increase its prices to offset these increased costs without suffering reduced volume, sales and operating profit. The company could experience significant increases in energy costs.

Strategic report (continued)

Business review (continued)

The company's operations and financial results may be adversely affected by movements in the value of the Diageo UK pension funds

Many current and former employees of the company are members of the Diageo UK pension funds. These funds may be affected by, among other things, the performance of assets owned by these plans, the underlying actuarial assumptions used to calculate the surplus or deficit in the plans, in particular the discount rate and long-term inflation rates used to calculate the liabilities of the pension funds, and any changes in applicable laws and regulations. If there are significant declines in financial markets and/or a deterioration in the value of fund assets or changes in discount rates or inflation rates, the company may need to make additional contributions to the pension funds in the future. (Note 22)

As these pension plans are treated as defined contribution schemes in the company's financial statements, these contributions are accounted for as a cost to the income statement and may adversely affect the company's financial results.

The company's operations, financial results and reputation may be adversely affected by the theft, loss and misappropriation of the company's most important digital assets

Cyber-attacks or incidents could result in financial loss, operational disruption and reputational damage. The company could also be adversely affected by non-compliance with statutory data protection legislation.

Regulatory decisions and changes in the legal and regulatory environment could increase the company's costs and liabilities or limit its business activities

The company's operations are subject to extensive regulatory requirements, which include those in respect of production, product liability, distribution, marketing, promotion, labelling, advertising, labour, pensions, excise tax and environmental issues. Changes in laws, regulations or governmental policy could cause the company to incur material additional costs or liabilities that could adversely affect its business.

Changes in tax law (including tax rates), accounting policies and accounting standards could materially reduce the company's reported after tax income.

Breach of data privacy laws or regulations could harm the trust and/or reputation of the company, its brands or people and could significantly restrict the company's ability to deliver its digital productivity and growth plans.

Financial risk management

The company's funding, liquidity and exposure to foreign exchange rate risk are similar to those facing the Diageo group as a whole and are managed by the group's treasury department. The treasury department uses a range of financial instruments to manage these underlying risks.

Currency risk

The company publishes its financial statements in sterling and conducts some of its business in foreign currencies. As a result, it is subject to foreign currency risk due to exchange rate movements, which will affect the company's transactions. To manage the currency risk the company uses certain financial instruments. Where hedge accounting is applied, hedges are documented and tested for effectiveness on an ongoing basis.

Strategic report (continued)

Business review (continued)

Financial risk management (continued)

Liquidity risk

In order to maintain liquidity to ensure that sufficient funds are available for ongoing operation and futre developments, the company has access to group funding.

Credit risk

The company's credit risk is primarily attributable to fellow subsidiary undertakings. The amounts presented in the balance sheet are net of allowances for doubtful receivables. The company sets credit limits for, and monitors its credit exposure to its counterparties via their credit ratings (where applicable).

By order of the board

G Zeisler
Director
Edinburgh Park
5 Lochside Way
Edinburgh
EH12 9DT

18 December 2018

Directors' report

The directors are pleased to submit their annual report, together with the audited financial statements for the year ended 30 June 2018.
The company is incorporated and domiciled as a private limited company in the United Kingdom.
The registered address of the company is Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT.

Going concern

The company's business activities, together with the factors likely to affect its future development and position, are set out in the business review section of the strategic report on pages 2 to 6. The company is expected to continue to generate profit for its own account and to remain in a positive net asset position for the foreseeable future. The company participates in the group's centralised treasury arrangements. The company is not reliant on external third party financing. The directors have no reason to believe that a material uncertainty exists that may cast significant doubt about the ability of the company to continue as a going concern. On the basis of their assessment, the company's directors have a reasonable expectation that the company will be able to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Financial

The result for the year ended 30 June 2018 is shown on page 14.

The profit for the year transferred to reserves was £141 million (2017 - £243 million) and other comprehensive expense for the year was £3 million (2017 - £1 million comprehensive income).

Dividends paid during the year ended 30 June 2018 were £100 million (2017 - £100 million).

Proposed dividend

The directors have proposed a final ordinary dividend in respect of the year ended 30 June 2018 of £100 million. This has not been included as a liability as it was not approved before the balance sheet date.

Directors

The directors who held office during the year and were as follows:

G Zeisler
G P Crickmore
K J Miller
D Nayager
J M C Edmunds (appointed 8 March 2018)
J J Nicholls (resigned 9 March 2018)

The following directors were appointed after the year end:
S L Fennessy (appointed 28 September 2018)
Y Elliott (appointed 28 September 2018)
H Patel (appointed 28 September 2018)

Directors' report (continued)

Directors (continued)

The following directors resigned after the year end:
S J Bolton (resigned 28 September 2018)
D F Harlock (resigned 1 August 2018)
K L Haynes (resigned 10 September 2018)

The following director was both appointed and resigned after the year end:
K E Major (appointed 1 August 2018 and resigned 28 September 2018)

Directors' remuneration

Details of the directors' remuneration are shown in note 4 of the financial statements.

Employee involvement

The company's goal is to offer an energising work environment, personal growth and recognition and attractive rewards for the performance contribution its people make to the company. Its employee policies are designed to support these goals and to do so in a manner that is fair and equitable to all employees. These policies take account of external legislation, internal codes of conduct, as well as the company's values as an organisation.

Employee engagement is a key element of the company's people strategy. Diageo's values are embedded in the business and guide how all employees operate and behave. A values survey, which includes a measure of employee engagement, is conducted with employees every year. This survey provides an annual insight into what employees are thinking and feeling about the business. The employee values survey allows the company to assess how the business is tracking against the long-term goals of engaging employees and consistently bringing Diageo's values to life.

The company is a multi-cultural community operating in an increasingly diverse business world and is committed to active equality and diversity practices. The company offers people with disability the same opportunities for employment, training and career progression as other employees. Employees who become disabled and unable to continue in their existing jobs are given the opportunity to be retrained for suitable alternative employment. It is also committed to attracting and retaining talented people. The company invests in the growth and development of its people, which contributes directly to the performance and results of the business. Where practical, the company encourages flexible ways of working to enable employees to take some control over the balance between work and home life. The company's reward systems recognise the contribution employees make to the success and reflect the value of the role they are performing.

The company is committed to the safety and wellbeing of employees at work. It promotes responsible drinking behaviours among all its people. The company is committed to open and continuous dialogue with its employees as a way to inform and engage them in the company's strategy and business goals as well as harnessing the ideas employees will have on improving broad areas of business performance.

Each senior manager is responsible for supporting the Diageo Executive and senior leadership community in delivering against these communication and employee engagement goals. Diageo has an intranet web site from which employees with access to a computer can obtain timely and accurate news and information.

Directors' report (continued)

Secretary

On 5 January 2018, C E Matthews resigned as secretary of the company.

On 5 January 2018, J M Guttridge was appointed, and on 20 April 2018, resigned as secretary of the company.

Directors' indemnity

The Articles of Association permit qualifying third-party indemnities for the directors as defined by Section 234 of the Companies Act 2006. No such indemnity was in force during the last financial year, nor is any currently in force.

Post balance sheet events

High Court ruling on gender equalisation of pension benefit schemes
The method of calculation for guaranteed minimum pensions in the Diageo Pension Scheme in the United Kingdom, where members opted out of the state pension scheme, was different for males and females which resulted in a potential equality issue. In October 2018 the High Court determined that all companies with a UK defined benefit pension plan that existed before 1997 should amend these schemes to equalise the pension benefits for males and females for guaranteed minimum pensions. At the time of signing these accounts the impact of this ruling is being assessed and it is not possible to provide an estimate of the impact on the net liabilities of the scheme.

Capital reduction and dividend declaration of subsidiary undertaking
On 15 November 2018 Diageo Distilling Limited, a fully owned subsidiary, reduced its share capital to 2 ordinary shares of £1 each, and declared a dividend of £454 million. As a result, the company will write down its investment in Diageo Distilling Limited from £217 million to £2. The dividend receivable will be recognised in the year ending 30 June 2019 resulting in a net gain of £237 million.

Internal control and risk management over financial reporting

The company operates under the financial reporting processes and controls of the Diageo group. Diageo plc's internal control and risk management systems, including its financial reporting process, which include those of the company, are discussed in the Group's Annual Report 2018 on pages 66 to 67 at www.diageo.com, which does not form part of this report.

Auditors

Pursuant to Section 487 of the Companies Act 2006, the auditors, PricewaterhouseCoopers LLP, have been reappointed and will continue in office as auditors of the company.

Directors' report (continued)

Disclosure of information to the auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

By order of the board

G Zeisler
Director
Edinburgh Park
5 Lochside Way
Edinburgh
EH12 9DT

18 December 2018

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the members of Diageo Scotland Limited

Report on the audit of the financial statements

Opinion

In our opinion, Diageo Scotland Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 30 June 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 30 June 2018; the income statement, the statement of comprehensive income, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which ISAs (UK) require us to report to you when:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 30 June 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities in respect of the financial statements set out on page 11, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Kenneth Wilson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Glasgow
19 December 2018

Income statement

	Notes	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Turnover	2	**1,599**	1,132
Cost of sales	3	**(989)**	(678)
Gross profit		**610**	454
Marketing expenses	3	**(106)**	(65)
Other operating expenses	3-5	**(80)**	(43)
Operating profit		**424**	346
Gain on sale of property, plant and equipment		**-**	6
Income from shares in group undertakings	6	**-**	2
Net finance charges	7	**(58)**	(77)
Profit before taxation		**366**	277
Taxation	8	**(225)**	(34)
Profit for the year		**141**	243

The accompanying notes are an integral part of these financial statements.

Statement of comprehensive income

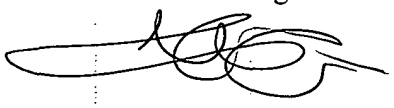
	Note	**Year ended 30 June 2018 £ million**	Year ended 30 June 2017 £ million
Profit for the year		**141**	243
Other comprehensive (expense) / income			
Items that may be recycled subsequently to the income statement			
Effective portion of changes in fair value of cash flow hedges	*19*		
- losses taken to other comprehensive (expense) / income		(4)	-
- recycled to income statement		-	1
Tax credit on effective portion of changes in fair value of cash flow hedges		1	-
Other comprehensive (expense) / income for the year, net of tax		(3)	1
Total comprehensive income for the year		**138**	244

The accompanying notes are an integral part of these financial statements.

Balance sheet

	Notes	30 June 2018	30 June 2017
		£ million	£ million
Non-current assets			
Intangible assets	*9*	**98**	99
Property, plant and equipment	*10*	**1,324**	1,289
Investments	*11*	**235**	235
		1,657	1,623
Current assets:			
Inventories	*12*	**3,045**	2,906
Trade and other receivables	*13*	**375**	307
Cash and cash equivalents		**-**	-
		3,420	3,213
Total assets		**5,077**	4,836
Current liabilities			
Trade and other payables	*16*	**(2,368)**	(2,307)
Provisions	*17*	**(6)**	(12)
Corporate tax payable		**(49)**	(9)
Other financial liabilities	*14*	**(18)**	(12)
		(2,441)	(2,340)
Non-current liabilities			
Trade and other payables	*16*	**(323)**	(266)
Deferred tax liabilities	*18*	**(103)**	(46)
Other financial liabilities	*14*	**(88)**	(102)
		(514)	(414)
Total liabilities		**(2,955)**	(2,754)
Net assets		**2,122**	2,082
Equity			
Called up share capital	*19*	**182**	182
Other reserves		**(3)**	-
Retained earnings		**1,943**	1,900
Total equity		**2,122**	2,082

The accompanying notes are an integral part of these financial statements.
The accounting policies and other notes on pages 18 to 47 form part of the financial statements.
These financial statements on pages 14 to 47 were approved by the board of directors on 18 December 2018 and were signed on its behalf by:



G Zeisler
Director

Statement of changes in equity

Attributable to shareholders of the company

	Called up share capital £million	Hedging reserve £million	Retained earnings £million	Total equity £million
At 30 June 2016	182	3	1,752	1,937
Profit for the year	-	-	243	243
Other comprehensive income	-	1	-	1
Tax on share - based incentive plans	-	-	1	1
Transfer	-	(4)	4	-
Dividends	-	-	(100)	(100)
At 30 June 2017	182	-	1,900	2,082
Profit for the year	-	-	141	141
Other comprehensive expense	-	(3)	-	(3)
Tax on share - based incentive plans	-	-	2	2
Dividends	-	-	(100)	(100)
At 30 June 2018	**182**	**(3)**	**1,943**	**2,122**

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements

1. Accounting policies

Basis of preparation

These financial statements are prepared in accordance with Financial Reporting Standard 101 *Reduced Disclosure Framework* (FRS 101).

In preparing these financial statements, the company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU (IFRS), but makes amendments where necessary in order to comply with Companies Act 2006 and sets out below where the FRS 101 disclosure exemptions have been taken.

These financial statements are prepared on a going concern basis under the historical cost convention, except that certain financial instruments are stated at their fair value.

The company is a wholly owned subsidiary of Diageo plc and is included in the consolidated financial statements of Diageo plc which are publicly available.

The company has taken advantage of the following exemptions from the requirements of IFRS in the preparation of these financial statements, in accordance with FRS 101:

- a cash flow statement and related notes;
- comparative period reconciliations for share capital, property, plant and equipment, intangible assets and investments;
- disclosures in respect of transactions with wholly owned subsidiaries;
- disclosures in respect of capital management;
- the effects of new but not yet effective IFRSs;
- disclosures in respect of the compensation of key management personnel.

As the consolidated financial statements of Diageo plc include equivalent disclosures, the company has also utilised exemptions available under FRS 101 in respect of the following disclosures:

- IFRS 2 Share-based Payments in respect of group settled share-based payments;
- The disclosures required by IFRS 7 Financial Instruments Disclosures;
- Certain disclosures required by IAS 36 Impairment of Assets in respect of the impairment of goodwill and indefinite life intangible assets.

The company has taken advantage of the exemption under IAS 27, 'Consolidated and separate financial statements', from the requirement to prepare consolidated financial statements as it and its subsidiaries are included in the consolidated financial statements of its ultimate parent, Diageo plc.

These financial statements are separate financial statements.

Notes to the financial statements (continued)

1. Accounting policies (continued)

New accounting policies

The following standards, issued by the IASB and endorsed by the EU, have been early adopted by the company from 1 July 2017:

- ***IFRS 9 – Financial instruments replaces IAS 39*** (Financial instruments - Recognition and measurement) and addresses the classification and measurement of financial instruments, introduces new principles for hedge accounting and a new forward-looking impairment model for financial assets. The adoption of IFRS 9 hedge accounting principles did not result in a restatement of the company's results and the impact on the year ended 30 June 2018 is not material. All classes of financial assets and financial liabilities had as at 1 July 2017 the same carrying values under IFRS 9 as they had under IAS 39. The new impairment model under IFRS 9 requires the recognition of allowances for doubtful debt based on expected credit losses (ECL), rather than incurred credit losses as under IAS 39. The adoption of the ECL approach did not result in any additional impairment loss for trade and other receivables as at 1 July 2017.

- ***IFRS 15 – Revenue from contracts with customers*** provides enhanced detail on the principle of recognising revenue to reflect the concept that revenue should be recognised when the control of goods or services is transferred to the customer at a value that the company is expected to receive. It replaces the separate models for goods, services and construction contracts under previous IFRS (IAS 11, IAS 18 and related interpretations) which was based on the concept of the transfer of risks and rewards. It also provides further guidance on the initial measurement of sales on contracts which have discounts, rebates and consignment inventories by identifying separate performance obligations that may apply. This review in particular examined promotional and marketing support payments made to customers post the initial sale of product, the timing of the recognition of sales made where a third party manufactures or modifies a product on behalf of the company and consignment inventories. On application of IFRS 15 some changes in accounting policy resulted, principally in respect of variable consideration receivable where the criteria applied for deducting future promotional payments from the initial revenue recognition was more stringent than under the former accounting policy. The revised accounting policy establishes that revenue is recognised to the extent that it is highly probable that a reversal in the amount of revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently settled. This means that the company, under the revised accounting policy, deducts from the initial revenue recognised any future promotional payments to direct and indirect customers unless it is highly probable that they will not be incurred.
  The adoption of IFRS 15 did not result in any adjustment to the retained earnings as at 30 June 2017.

Functional and presentational currency

These financial statements are presented in sterling (£), which is the company's functional currency. All financial information presented in sterling has been rounded to the nearest million unless otherwise stated.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Turnover

Turnover comprises revenue from the sale of goods, the provision of manufacturing services and royalties receivable and rents receivable. Revenue from the sale of goods includes excise and other duties which the company pays as principal but excludes duties and taxes collected on behalf of third parties, such as value added tax. Sales are recognised as or when performance obligations are satisfied by transferring control of a good or service to the customer. Generally the transfer of control of goods occurs at the time of despatch but for in case of wholesale customers may be on delivery to customers. The company includes in sales the net consideration to which it expects to be entitled. Sales are recognised to the extent that it is highly probable that a significant reversal will not occur. Therefore, sales are stated net of expected price discounts, allowances for customer loyalty and certain promotional activities and similar items. Generally, payment of the transaction price is due within credit terms that are consistent with industry practices, with no element of financing. Royalties are accrued as earned.

Advertising

Advertising expenditure, such as advertising costs, points of sale materials and sponsorship payments, are charged to the income statement when the company has the right of access to the goods or services acquired.

Research and development

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

Share based payments

The ultimate parent, Diageo plc, operates a number of share-based incentive schemes (awards of shares and options) and grants rights to its equity instruments to the company's employees. The company accounts for these share-based payments as cash-settled instruments. Amounts recharged by the parent in respect of the cost of providing the benefit are measured at the fair value of the share or share option at the date of grant, and is recognised on a straight-line basis over the vesting period of the award. The fair value is measured on the binomial or Monte Carlo models, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to share prices not achieving the threshold for vesting.

Pensions and other post-employment benefits

The employees of the company are members of the Diageo UK pension plans, which are defined benefit schemes.

It is not possible to allocate the assets and liabilities of the pension plans on a consistent and reasonable basis between individual companies and therefore the company accounts for the plans as defined contribution schemes. Contributions payable in respect of the pension plans in respect of current and former employees are charged to operating profit as incurred. The assets and liabilities of the pension plans are reported by the sponsoring employer, Diageo plc.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction.

If hedged forward, the impact of hedging is recognised, where permitted, under hedge accounting (refer to accounting policy for derivative financial instruments). Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the financial year end exchange rates and these foreign exchange differences are recognised in the income statement.

Intangible assets

Intangible assets that are regarded as having limited useful economic lives are amortised on a straight-line basis over those lives and reviewed for impairment whenever events or circumstances indicate that carrying amount may not be recoverable. These assets are reviewed for impairment at least annually or when there is an indication that the assets may be impaired.

To ensure that assets are not carried at above their recoverable amounts, the impairment reviews compare the net carrying value with the recoverable amount, where the recoverable amount is the higher of value in use or fair value less cost to sell. Amortisation and any impairment write downs are charged to other operating expenses in the income statement.

Computer software is amortised on a straight-line basis to estimated residual value over its expected useful life. Residual values and useful lives are reviewed each year. Subject to these reviews, the estimated useful lives are up to 15 years.

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation.

Freehold land is not depreciated. Leaseholds are depreciated over the unexpired period of the lease. Other property, plant and equipment are depreciated on a straight-line basis to estimated residual values over their expected useful lives, and these values and lives are reviewed each year. Subject to these reviews, the estimated useful lives fall within the following ranges:

Buildings	10 to 70 years
Plant and equipment	5 to 50 years
Casks and containers	10 to 50 years

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

Profit or loss on the sale of a property is the difference between the disposal proceeds and the net book value.

Investment in subsidiaries and associates

Investments in subsidiaries and associates are stated at historical cost less impairment provisions for any permanent decrease in value. The carrying amounts of the company's investments are reviewed at each reporting date to determine whether there is an indication of impairment. If such an indication exists, then the asset's recoverable amount is estimated. Losses are recognised in the income statement and reflected in an allowance against the carrying value. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through the income statement.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost includes raw materials, direct labour and expenses, and an appropriate proportion of production and other overheads, but not borrowing costs. Cost is calculated at the weighted average cost incurred in acquiring inventories. Maturing inventories which are retained for more than one year are classified as current assets, as they are expected to be realised in the normal operating cycle.

Financial assets and liabilities

Financial assets and liabilities are initially recorded at fair value including, where permitted by IFRS 9, any directly attributable transaction costs. For those financial assets that are not subsequently held at fair value, the company assesses whether there is evidence of impairment at each balance sheet date. The company classifies its financial assets and liabilities into the following categories: financial assets and liabilities at amortised cost, financial assets and liabilities at fair value through profit and loss and financial assets at fair value through other comprehensive income. Where financial assets or liabilities are eligible to be carried at either amortised cost or fair value the company does not apply the fair value option.

Trade and other receivables Amounts owed by other group companies are initially measured at fair value and are subsequently reported at amortised cost. Non-interest bearing trade receivables are stated at their nominal value as they are due on demand. Allowance for expected credit losses are made based on the risk of non-payment taking into account ageing, previous experience, economic conditions and forward looking data. Such allowance are measured as either 12-months expected credit losses or lifetime expected credit losses depending on changes in the credit quality of the counterparty.

Cash and cash equivalents Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less at acquisition, including money market deposits, commercial paper and investments.

Trade and other payables Amounts owed to other group companies are initially measured at fair value and are subsequently reported at amortised cost. Non-interest bearing trade payables are stated at their nominal value as they are due on demand.

Derivative financial instruments

Derivative financial instruments are carried at fair value using a discounted cash flow technique based on market data applied consistently for similar type of instruments. Gains and losses on derivative that do not qualify for hedge accounting treatment are taken to the income statement as they arise.

The company designates and documents certain derivatives as hedging instruments against highly probable forecast transactions (cash flow hedges). The effectiveness of such hedges is assessed at inception and at least on a quarterly basis, using prospective and retrospective testing. Methods used for testing effectiveness include dollar offset, critical terms, regression analysis and hypothetical derivative method.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Derivative financial instruments (continued)

Cash flow hedges are used to hedge the foreign currency risk of highly probable future foreign currency cash flows, as well as the cash flow risk from changes in exchange. The effective portion of the gain or loss on the hedges is recognised in the other comprehensive income, while any ineffective part is recognised in the income statement. Amounts recorded in the other comprehensive income are recycled to the income statement in the same period in which the underlying foreign currency affects the income statement.

Derivative financial instruments are presented in the financial statements as 'Intra-group derivative assets/ (liabilities)'as these transactions are entered into by Diageo Finance plc, a fellow group undertaking, and subsequently passed to the company.

Provisions
Provisions are liabilities of uncertain timing or amount. A provision is recognised if, as a result of a past event, the company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are calculated on a discounted basis, where the effect is material to the original undiscounted provision.
The carrying amounts of provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

Taxation
Current tax is based on taxable profit for the year. Taxable profit is different from accounting profit due to temporary differences between accounting and tax treatments, and due to items that are never taxable or tax deductible. Tax benefits are not recognised unless it is probable that the tax positions are sustainable. Once considered to be probable, tax benefits are reviewed each year to assess whether a provision should be taken against full recognition of the benefit on the basis of potential settlement through negotiation and/or litigation. Tax provisions are included in current liabilities. Interest and penalties on tax liabilities are provided in the tax charge.
Full provision for deferred tax is made for temporary differences between the carrying value of assets and liabilities for financial reporting purposes and their value for tax purposes. The amount of deferred tax reflects the expected recoverable amount and is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using the basis of taxation enacted or substantively enacted by the balance sheet date. Deferred tax assets are not recognised where it is more likely than not that the asset will not be realised in the future.

Dividends paid and received
The interim dividend is included in the financial statements in the year in which it is approved by the directors, and the final dividend in the year in which it is approved by shareholders. Dividends received are included in the financial statements in the year in which they are receivable.

Notes to the financial statements (continued)

1. Accounting policies (continued)

Judgements in applying accounting policies and key sources of estimation uncertainty
The directors make estimates and assumptions concerning the future of the company. The resulting accounting estimates will, by definition, seldom equate to actual results. The company's directors are of the opinion that there are no estimates and assumptions that have a significant risk of casting material adjustment to the carrying value of the assets and liabilities for the company within the next financial year due to the nature of the business.

The critical accounting policies, which the directors consider are of greater complexity and/or particularly subject to the exercise of judgements, are set out in detail in the relevant accounting policies:

- Intangible assets: Assessment of the recoverable amount of an intangible asset, the useful economic life of an asset, or that an asset has an indefinite life, requires management estimate and judgement. Impairment review is carried out to ensure that the distribution right is not carried at above its recoverable amount. The tests are dependent on management's estimates and judgements, in particular in relation to the forecasting of future cash flows, the discount rates applied to those cash flows and the expected long term growth rates. Such estimates and judgements are subject to change as a result of changing economic conditions and actual cash flows may differ from forecasts.
- Investment in subsidiaries and associates: The carrying value of the investments was assessed to ensure that the investments are worth at least the amount at which they are stated in the financial statements. The impairment review involves management judgement and estimates.
- Taxation: The evaluation of deferred tax assets recoverability requires judgements to be made regarding the availability of future taxable income. The directors believe that the company will generate sufficient future taxable income to justify recognition of the deferred tax assets.

Notes to the financial statements (continued)

2. Turnover

The turnover and profit on ordinary activities before taxation are attributable to the production, maturation and marketing of Scotch whisky and other spirits, and their onward sale to fellow group undertakings and third parties (including global travel distributors). Additionally, the company operates 12 malt whisky distillery visitor centres.

Geographical analysis of turnover

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
United Kingdom	**207**	213
Europe	**856**	712
North America	**178**	119
Asia Pacific	**293**	69
Rest of world	**65**	19
	1,599	1,132

Analysis of turnover by class of business

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Production and maturation of Scotch whisky and other spirits	**764**	757
Marketing and selling of spirits	**815**	361
Royalties	**6**	3
Visitor centres	**14**	11
	1,599	1,132

Segmental information is provided in the consolidated financial statements of the ultimate parent company, Diageo plc.

Sales to fellow group undertakings included in turnover amounted to £1,092 million (2017 - £1,028 million).

Notes to the financial statements (continued)

3. Operating costs

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Cost of sales	**989**	678
Marketing expenses	**106**	65
Other operating expenses	**80**	43
	1,175	786
Comprising:		
Increase in inventories of finished goods and work in progress	**(138)**	(85)
Raw materials and consumables	**757**	392
Marketing expenses	**106**	65
Other external charges (a)	**173**	165
Staff costs (see note 4)	**194**	193
Depreciation, amortisation and impairment	**78**	77
Net foreign exchange loss / (gain)	**4**	(14)
Other operating expense / (income)	**1**	(7)
	1,175	786

(a) Other external charges include facilities costs of £32 million (2017 - £27 million), maintenance and repairs of £29 million (2017 - £27 million), procurement costs recharged by a fellow group undertaking of £8 million (2017 - £10 million), temporary and contract staff costs of £12 million (2017 - £11 million), computer system costs of £12 million (2017 - £10 million), operating lease rentals for land and buildings of £1 million (2017 - £1 million) and other lease rentals of £3 million (2017 - £3 million).

(b) Fees in respect of services provided by the auditors were: audit services £94,845 (2017 - £85,500); other non-audit work £251,340 (2017 - £200,000).

Notes to the financial statements (continued)

4. Employees

The average number of employees on a full-time basis, including directors, during the year was:

	Year ended 30 June 2018	Year ended 30 June 2017
Production	**2,895**	2,925
Corporate and administration	**211**	224
Selling and distribution	**130**	-
	3,236	3,149

The average number of employees of the company, including part time employees, for the year was 3,319 (2017 – 3,258).

	Year ended 30 June 2018 £million	Year ended 30 June 2017 £million
Aggregate remuneration		
Wages and salaries	**134**	126
Employer's social security costs	**15**	14
Employer's pension costs	**38**	42
Share based payments	**2**	1
Redundancy payments	**2**	7
Other employment costs	**3**	3
	194	193

Retirement benefits

The employees of the company are members of the Diageo UK pension plans, which are defined benefit schemes.

It is not possible to allocate the assets and liabilities of the pension plans on a consistent and reasonable basis between individual companies and therefore the company accounts for the plans as defined contribution schemes. Contributions payable in respect of defined contribution plans in respect of current and former employees are charged to operating profit as incurred. The company made cash contributions of £38 million to the schemes in respect of its employees in the year ended 30 June 2018 (2017 - £42 million). As there is no contractual agreement for allocating the surplus or deficit of the pension funds to participating entities, it is recognised fully by the sponsoring employer, Diageo plc.

Notes to the financial statements (continued)

4. Employees (continued)

Directors' remuneration

	Year ended 30 June 2018 £'000	Year ended 30 June 2017 £'000
Directors' remuneration (excluding pension contributions)	**468**	457
Amounts receivable under long term incentive schemes	**24**	6
	492	463

The aggregate remuneration of the highest paid director was £259,653 (2017 - £234,306). The amount that the highest paid director has accrued on the Diageo Lifestyle Plan at 30 June 2018 was £38,507 (2017 - £40,267).

Some of the directors were paid by fellow group undertakings. All of the directors paid by the company are members of the Diageo UK pension plans and are entitled to receive share-based payments from Diageo plc.

	Year ended 30 June 2018	Year ended 30 June 2017
The number of directors who exercised share options was	**1**	1
The number of directors in respect of whose services shares were received or receivable under long term incentive schemes was	**2**	2
The number of directors in respect of whose retirement benefits were accrued for under defined benefit pension schemes	**2**	2

5. Employee share compensation

A number of the employees of the company participate in a number of equity settled and cash settled share plans, all of which are operated by the group, to grant options and share awards to its directors and employees.

Executive share awards are made under the Diageo 2014 Long Term Incentive plan (DLTIP) from September 2014 onwards. Prior to that, awards were made under the Diageo plc 2009 Executive Long Term Incentive Plan (DELTIP), the 2008 Performance Share Plan (PSP), the 2008 Senior Executive Share Option Plan (SESOP) and the 2009 Discretionary Incentive Plan (DIP).
Share awards normally vest and are released on the third anniversary of the grant date. Participants do not make a payment to receive the award at grant. Executive Directors are required to hold any vested shares awarded from 2014 for a further two-year period. Share options may normally be exercised between three and ten years after the grant date.

Notes to the financial statements (continued)

5. Employee share compensation (continued)

Performance shares under the DLTIP (previously PSP) are subject to the achievement of three equally weighted performance tests: 1) compound annual growth in profit before exceptional items over three years; 2) compound annual growth in organic net sales over three years; 3) cumulative free cash flow over a three-year period, measured at constant exchange rates. Performance share options under the DLTIP (previously SESOP) are subject to the achievement of two equally weighted performance tests: 1) a comparison of Diageo's three-year TSR with a peer group; 2) compound annual growth in profit before exceptional items over three years. Performance measures and targets are set annually by the Remuneration Committee. The vesting range is 20% or 25% (for Executive Directors and for other participants respectively) for achieving minimum performance targets, up to 100% for achieving the maximum target level. Retesting of the performance condition is not permitted.
For performance shares under the DLTIP (previously PSP) dividends are accrued on awards and are given to participants to the extent that the awards actually vest at the end of the performance period. Dividends are normally paid out in the form of shares. For the two years ended 30 June 2018, the calculation of the fair value of each share award used the Monte Carlo pricing model.

Further details of the assumptions used for the valuation and the accounting for share options schemes are disclosed in Diageo plc's Annual Report for the year ended 30 June 2018 (see note 17 of Diageo plc's 2018 Annual Report).

The company recognised share based payment expense for the year ended 30 June 2018 of £2 million (2017 - £ 1 million)

6. Income from shares in group undertakings

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Dividend income from shares in group undertakings:		
Diageo Suisse S.A.	-	1
Zepf Technologies UK Limited	-	1
	-	2

7. Net finance charges

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Interest charge to fellow group undertaking	**52**	71
Interest charge on finance leases	**6**	6
	58	77

Interest charge to fellow group undertaking includes £50 million (2017 - £71 million) in respect of the option premium paid to Lakeside (see note 12).

Notes to the financial statements (continued)

8. Taxation

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
(a) Analysis of taxation charge for the year		
Current tax		
UK corporation tax	**(99)**	(21)
Overseas corporation tax	**(1)**	-
Adjustments in respect of prior years	**(67)**	-
Total current tax	**(167)**	(21)
Deferred tax		
Origination and reversal of timing differences	**(14)**	(21)
Adjustments in respect of prior years	**(45)**	-
Effect of changes in tax rate	**1**	8
Taxation on profit on ordinary activities	**(225)**	(34)
(b) Tax credit included in equity		
Current tax	**2**	1
(c) Tax credit included in other comprehensive expense		
Deferred tax	**1**	-

Notes to the financial statements (continued)

8. Taxation (continued)

(d) Factors affecting total tax charge for the year

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Profit before taxation	**366**	277
Taxation on profit at the UK corporation tax rate of 19% (2017 – 19.75%)	**(69)**	(55)
Adjustments in respect of prior years	**(112)**	-
Changes in tax rates	**1**	8
Transfer pricing adjustments	**(40)**	6
Expenses not deductible for tax purposes	**-**	(4)
Group relief received for nil consideration	**-**	9
Income not taxable	**-**	1
Overseas taxes suffered	**(1)**	-
Share options	**(1)**	2
Other	**(3)**	(1)
Total tax charge for the year	**(225)**	(34)

In its annual report for the year ended 30 June 2017, Diageo plc, the ultimate parent of the company, reported that discussions were being held with the tax authorities to seek clarity on Diageo's transfer pricing and related issues, and that a preliminary assessment for diverted profits tax had been issued. Diageo agreed in June 2018 with the tax authorities that diverted profits tax does not apply and at the same time has reached resolution on the transfer pricing issues being discussed. The agreement in respect of transfer pricing covers the period from 1 July 2014 to 30 June 2017 and the impact of this charge on the company has been reflected in the adjustment in respect of prior years included in the tables.

In the year ended 30 June 2018, an additional tax charge of £47 million has been recognised within transfer pricing adjustments in the above tax note, which is based on the approach agreed with HMRC.

The UK tax rate is 19% effective from 1 April 2017 which is applied for year ended 30 June 2018. A further reduction to 17% (effective from 1 April 2020) was enacted in September 2016. Deferred taxes at 30 June 2018 have been measured using these enacted tax rates (17%) and reflected in these financial statements.

Notes to the financial statements (continued)

9. Intangible assets

	Distribution rights £ million	Computer software £ million	Under construction £ million	Total £ million
Cost				
At 30 June 2017	95	9	2	106
Transfers	-	2	(2)	-
At 30 June 2018	**95**	**11**	**-**	**106**
Amortisation				
At 30 June 2017	-	(7)	-	(7)
Amortisation	-	(1)	-	(1)
At 30 June 2018	**-**	**(8)**	**-**	**(8)**
Net book value				
At 30 June 2018	**95**	**3**	**-**	**98**
At 30 June 2017	95	2	2	99

Distribution rights comprise the cost of the worldwide distribution rights to the Captain Morgan brand (excluding Canada and the United States of America). There are not believed to be any legal, regulatory or contractual provisions that limit the useful life of this distribution right. Accordingly, the directors believe that it is appropriate that the intangible asset is treated as having an indefinite life for accounting purposes.

Notes to the financial statements (continued)

9. Intangible assets (continued)

Impairment testing

To ensure that the distribution rights with indefinite useful life are not carried at above the recoverable amount, impairment reviews are performed comparing the net carrying value with the recoverable amount using value in use calculations. This calculation is performed annually. The value in use calculations are based on terminal values calculated on the assumption that the cash flows continue in perpetuity at the long-term growth rate.

The discount rate used for the value in use calculations is the group's weighted average cost of capital. The long-term growth rates applied at the end of the forecast period are taken as the real gross domestic product (GDP) growth rate of the region plus its inflation rate, based on a five-year average.

The pre-tax discount rates and long-term growth rates for the principal market of the Captain Morgan brand used for impairment testing are as follows:

2018		2017	
Pre-tax discount rate	**Long term growth rate**	Pre-tax discount rate	Long term growth rate
%	**%**	%	%
7	**2**	7	2

Sensitivity to change in key assumptions

Impairment testing is dependent on estimates and judgements; in particular in relation to the forecasting of future cash flows, the discount rates applied to those cash flows and the expected long-term growth rates.

For the Captain Morgan distribution right it has been concluded that no reasonable possible change in the key assumptions on which it has determined the recoverable amount would cause its carrying value to exceed its recoverable amount.

Notes to the financial statements (continued)

10. Property, plant and equipment

	Land and buildings £ million	Plant and equipment £ million	Casks and containers £ million	Assets in course of construction £ million	Total £ million
Cost					
At 30 June 2017	493	837	498	41	1,869
Additions	10	14	32	57	113
Disposals	-	(1)	-	-	(1)
Written off	(1)	(4)	-	-	(5)
Transfers	11	42	2	(55)	-
At 30 June 2018	**513**	**888**	**532**	**43**	**1,976**
Depreciation					
At 30 June 2017	(111)	(315)	(154)	-	(580)
Depreciation charge	(14)	(50)	(13)	-	(77)
Disposals	-	1	-	-	1
Written off	-	4	-	-	4
At 30 June 2018	**(125)**	**(360)**	**(167)**	**-**	**(652)**
Net book value					
At 30 June 2018	**389**	**523**	**369**	**43**	**1,324**
At 30 June 2017	382	522	344	41	1,289

(a) The net book value of land and buildings comprises freeholds of £388 million (2017 – £381 million) and long leaseholds of £1 million (2017 – £1 million). Depreciation was not charged on £16 million (2017 – £16 million) of land.

(b) Included in the total net book value of property plant and equipment is £109 million (2017 - £115 million) within plant and machinery and £32 million (2017 - £33 million) within casks and containers and vehicles in respect of assets held under finance leases. Depreciation for the year on those assets within plant and machinery was £6 million (2017 - £6 million) and for casks and containers and vehicles was £1 million (2017 - £1 million).

Notes to the financial statements (continued)

11. Investments

Shares in subsidiary and associate undertakings

	Subsidiaries and associates £ million
Cost	
At 30 June 2017 and 30 June 2018	**245**
Provisions	
At 30 June 2017 and 30 June 2018	**(10)**
Net book value	
At 30 June 2017 and 30 June 2018	**235**

Details of the investments in which the company holds 20% or more of the nominal value of any class of share capital are as follows. Unless otherwise stated the percentage of shares held are in respect of ordinary share capital.

	Notes	Registered office address	Proportion of ownership interest
Direct holdings			
Subsidiary undertakings			
D.C.L. (Holdings) Australia Proprietary Limited	(i), (ii)	Level 1, 162 Blues Point Road, McMahons Point, NSW 2060, Australia	100%
Diageo Distilling Limited	(i)	Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT, United Kingdom	100%
Diageo New Zealand Limited	(ii)	123 Carlton Gore Road, Level 2, Newmarket, 1023, Auckland, New Zealand	100%
Diageo Scotland Investment Limited		Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%

Notes to the financial statements (continued)

11. Investments (continued)

	Notes	Registered office address	Percentage of shares owned
James Buchanan & Company Limited	(i)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%
John Haig & Company Limited		Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT, United Kingdom	100%
John Walker and Sons Limited	(i)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%
The Distillers Company (Biochemicals) Limited	(i)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%
United Distillers & Vintners Philippines Inc	(i)	15th Floor, W-fifth Building, 5th Avenue, Bonifacio Global City, Taguig City, Philippines	100%
United Distillers France Limited	(i)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%
United Distillers Investments Limited	(i)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%
United Distillers UK plc	(i)	Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT, United Kingdom	100%
William Sanderson and Son Limited	(i)	Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT, United Kingdom	100%
Winchester House Property Company Limited	(iv)	Lakeside Drive, Park Royal, London, NW10 7HQ, United Kingdom	100%

Notes to the financial statements (continued)

11. Investments (continued)

	Notes	Registered office address	Percentage of shares owned
Zepf Techonolgies UK Limited		Edinburgh Park, 5 Lochside Way, Edinburgh, EH12 9DT, United Kingdom	100%
Direct holdings			
Associate undertakings			
Diageo Suisse SA		Rue du Grand-Pre 2 b CH-1007 Lausanne, Switzerland	45.13%
The Scotch Whisky Heritage Centre Limited	(iii)	354 Castlehill, The Royal Mile, Edinburgh, EH1 2NE, United Kingdom	22.38%
Indirect holdings			
Subsidiary undertaking			
United Distillers France SAS		73, Rue de Provence 75009 Paris, France	100%
Associate undertaking			
Ballindalloch Distillery LLP		Ballindalloch Castle, Ballindalloch, Banffshire AB37 9AX, United Kingdom	33%
Diageo Southern Africa Markets (Pty) Ltd		Building 3, Maxwell Office Park, Magwa Crescent West, Waterfall City, Midrand, 2090, South Africa	50%

(i) Dormant company.
(ii) Ownership held in class of A shares.
(iii) Ownership held in preference shares.
(iv) In process of being struck off.

The investments in subsidiaries, associates and jointly controlled entities are held at cost less, where appropriate, provision for impairment in value.

In the opinion of the directors, the investment in and amounts due from the company's subsidiary undertakings are worth at least the amount at which they are stated in the financial statements.

Notes to the financial statements (continued)

12. Inventories

	30 June 2018 £ million	30 June 2017 £ million
Raw materials and consumables	**34**	33
Work in progress	**4**	4
Maturing inventories	**2,991**	2,851
Finished goods and goods for resale	**16**	18
	3,045	2,906

Maturing inventories include whisky. £2,699 million (2017 - £2,585 million) of inventories are expected to be utilised after more than one year:

Inventories are disclosed net of provisions of £6 million (2017 - £8 million) for obsolescence.

In June 2010, the Diageo group established a Pension Funding Partnership in which the UK Scheme acquired a limited interest and as a partner, is entitled to a distribution of the profits of the Pension Funding Partnership each year for 14 years.

The company entered into an agreement with Lakeside, a fellow subsidiary undertaking, and sold an amount of maturing spirit aged up to three years to Lakeside at cost and additionally charges inventory holding costs to Lakeside. The company was granted a call option to enable it to repurchase the maturing spirit at any time from Lakeside at original sale price plus inventory holding cost and a put option to require Lakeside to purchase inventory from the company. As consideration for these options the company pays an annual premium. As at 30 June 2018, Lakeside owned the legal title over £647 million (2017 - £520 million) of maturing spirit while the beneficial title remains with the company. As the risks and rewards of ownership of the inventory remained with the company, the maturing spirit continues to be shown in its financial statements. For accounting purposes the amount the company received for the inventory is recognised as liability to a fellow group undertaking on the balance sheet (see note 16) and the premium it pays for the options provided is presented as an interest charge within net finance charges (see note 7).

Notes to the financial statements (continued)

13. Trade and other receivables

	30 June 2018 £ million	30 June 2017 £ million
Trade receivables	74	6
Amounts owed by fellow group undertakings	240	235
Other receivables	19	28
Prepayments and accrued income	42	38
	375	307

Amounts owed by fellow group undertakings are unsecured, interest-free and repayable on demand.

All trade and other receivable balances fall due within one year.

14. Other financial liabilities

	Current liabilities £ million	Non-current liabilities £ million
2018		
Intra-group derivative liabilities		
Designated in cash flow hedge	(2)	(2)
Non-derivative liabilities		
Finance lease liabilities	(16)	(86)
	(18)	(88)

	Current liabilities £ million	Non-current liabilities £ million
2017		
Non-derivative liabilities		
Finance lease liabilities	(12)	(102)

Notes to the financial statements (continued)

14. Other financial liabilities (continued)

Finance lease liabilities are payable as follows:

	30 June 2018			30 June 2017		
	Future minimum lease payments £ million	**Future finance charges £ million**	**Present value of minimum lease payments £ million**	Future minimum lease payments £ million	Future finance charges £ million	Present value of minimum lease payments £ million
Less than one year	**21**	**(5)**	**16**	18	(6)	12
Between one and five years	**73**	**(12)**	**61**	75	(15)	60
More than five years	**26**	**(1)**	**25**	45	(3)	42
	120	**(18)**	**102**	138	(24)	114

Finance lease liabilities of £102 million (2017 - £114 million) include an obligation of £49 million (2017 - £51 million) in respect of the bio-energy plant at Cameronbridge.

15. Financial instruments and risk management

(a) Currency risk

The company presents its financial statements in sterling and conducts business in many currencies. As a result, it is subject to foreign currency risk due to exchange rate movements, which will affect the company's transactions. To manage the currency risk the company uses certain financial instruments. Where hedge accounting is applied, hedges are documented and tested for effectiveness on an ongoing basis.

Transaction exposure hedging

The group's policy is to hedge up to 24 months forecast transactional foreign currency risk on the net US dollar exposure of the group targeting 75% coverage for the current financial year and up to 18 months for other currency pairs.

Notes to the financial statements (continued)

15. Financial instruments and risk management (continued)

(b) Commodity price risk

The company is exposed to commodity price risk. Commodity price risk is managed in line with the principles approved by the Board either through long term purchase contracts with suppliers or, where appropriate, derivative contracts. Where derivative contracts are used the commodity price risk exposure is hedged up to 24 months forecasted volume usage with up to 80% coverage. Where derivative contracts are used the company manages exposures principally through exchange-traded futures, forwards, swaps and options.

(c) Fair value measurements

Fair value measurements of financial instruments are presented through the use of a three-level fair value hierarchy that prioritises the valuation techniques used in fair value calculations.

The group maintains policies and procedures to value instruments using the most relevant data available. If multiple inputs that fall into different levels of the hierarchy are used in the valuation of an instrument, the instrument is categorised on the basis of the most subjective input.

Foreign currency forwards are valued using discounted cash flow techniques. These techniques incorporate inputs at levels 1 and 2, such as foreign exchange rates and interest rates. These market inputs are used in the discounted cash flow calculation incorporating the instrument's term, notional amount and discount rate, and taking credit risk into account. As significant inputs to the valuation are observable in active markets, these instruments are categorised as level 2 in the hierarchy.

The company's financial assets and liabilities measured at fair value are categorised as follows:

	30 June 2018 £ million	30 June 2017 £ million
Derivative assets	-	-
Derivative liabilities	(4)	-
Valuation techniques based on observable market input (Level 2)	(4)	-

There were no transfers between levels during the two years ended 30 June 2018 and 30 June 2017.

(d) Results of hedging instruments

No gain or loss has been transferred out from other comprehensive income to other operating income (2017 – a gain of £1 million transferred to operating income).

For cash flow hedges the forecast transactions at 30 June 2018, based on year end interest and foreign exchange rates, there is expected to be a loss of £2 million in 2019 and a loss of £2 million in 2020.

Notes to the financial statements (continued)

16. Trade and other payables

	30 June 2018		30 June 2017	
	Amounts falling due within one year	**Amounts falling due after one year**	Amounts falling due within one year	Amounts falling due after one year
	£ million	**£ million**	£ million	£ million
Trade payables	**278**	-	249	-
Amounts owed to fellow group undertakings	**1,656**	-	1,735	-
Tax and social security excluding income tax	**8**	-	7	-
Loan payable to fellow group undertakings	**324**	**323**	254	266
Other payables	**2**	-	5	-
Accruals and deferred income	**100**	-	57	-
	2,368	**323**	2,307	266

Amounts owed to fellow group undertakings are unsecured, interest-free and repayable on demand.

Loan payable to fellow group undertaking represents the amount the company received for the inventory sold to Lakeside, but the inventory has not been derecognised as the risks and rewards of ownership have not been transferred from the company. Amounts due within one year of £324 million (2017 - £254 million) reflect the directors' expectation, based on historical experience of how much of the maturing whisky inventory subject to the call option will be exercised by the company within one year.

17. Provisions

	Restructuring £ million	**Other £ million**	**Total £ million**
At 30 June 2017	7	5	12
Provided during the year	5	1	6
Utilised during the year	(10)	(2)	(12)
At 30 June 2018	**2**	**4**	**6**

All provisions are expected to be utilised by 30 June 2019. Other provisions are principally in respect of a subcontractor claim and redevelopment obligations.

Notes to the financial statements (continued)

18. Deferred tax assets and liabilities

The amounts of deferred tax accounted for in the balance sheet comprises the following net deferred tax liabilities:

	Property, plant and equipment £ million	Other temporary differences £ million	Total £ million
At 30 June 2016	(7)	(27)	(34)
Recognised in income statement	(10)	(3)	(13)
Recognised in equity	-	1	1
At 30 June 2017	(17)	(29)	(46)
Recognised in income statement	(55)	(3)	(58)
Recognised in other comprehensive expense	-	1	1
At 30 June 2018	**(72)**	**(31)**	**(103)**

Other temporary differences are in respect of costs capitalised in maturing inventories.

Unrecognised deferred tax assets
Deferred tax assets have been recognised to the extent that it is considered more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Where this is not the case, deferred tax assets have not been recognised. The total value of unrecognised deferred tax assets as at 30 June 2018 is £348,000 (2017 - £275,000).

19. Called up share capital and reserves

(a) Called up share capital

	30 June 2018 £ million
Allotted, called up and fully paid:	
363,169,546 ordinary shares of 50p each	182

(b) Hedging reserves

	Hedging reserves £ million
At 30 June 2017	-
Effective portion of changes in fair value of cash flow hedges	
- losses taken to other comprehensive (expense) / income	(3)
- transferred to income statement	-
At 30 June 2018	(3)

Notes to the financial statements (continued)

20. Commitments

Capital commitments

Commitments for expenditure on property, plant and equipment not provided for in these financial statements are estimated at £32 million (2017 - £23 million).

Operating lease commitments

The minimum lease rentals to be paid under non-cancellable leases are as follows:

	Land and buildings £ million	Plant and machinery £ million	Other £ million	Total £ million
Payments falling due:				
Within one year	1	1	1	3
Between one and two years	-	-	1	1
Between two and three years	-	-	-	-
Between three and four years	-	-	-	-
Between four and five years	-	-	-	-
After five years	1	-	-	1
As at 30 June 2018	**2**	**1**	**2**	**5**

	Land and buildings £ million	Plant and machinery £ million	Other £ million	Total £ million
Payments falling due:				
Within one year	1	1	1	3
Between one and two years	1	-	1	2
Between two and three years	-	-	-	-
Between three and four years	-	-	-	-
Between four and five years	-	-	-	-
After five years	1	-	-	1
As at 30 June 2017	3	1	2	6

Other purchase commitments

At 30 June 2018 the company had purchase commitments totalling £428 million (2017 - £661 million), the majority of which were in respect of dry goods and raw material purchases.

Notes to the financial statements (continued)

21. Related party transactions

Transactions between the company and its related parties are made on terms equivalent to those that prevail in arm's length transactions.

The company provides services to and act as an agent for a number of not wholly owned fellow group undertakings. The costs and income (excluding agents' fees) in respect of agency activities are not disclosed separately in the company's income statement.

The following transactions were carried out with related parties:

(a) Sales of goods and services

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Subsidiaries not wholly owned by the Diageo group	**5**	5
Joint operations	**-**	4
	5	9

(b) Purchases of goods and services

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Subsidiaries not wholly owned by the Diageo group	**1**	6
Associates	**5**	-
Joint ventures	**24**	26
Joint operations	**1**	7
	31	39

At 30 June 2018, inventories include purchases £26 million from group undertakings not wholly owned by the Diageo group (2017 - £27 million).

Notes to the financial statements (continued)

21. Related party transactions (continued)

(c) Year-end balances arising from sales/purchases of goods and services

	Year ended 30 June 2018 £ million	Year ended 30 June 2017 £ million
Trade receivables due from related parties:		
Subsidiaries not wholly owned by the Diageo group	1	-
Joint operations	-	3
	1	3
Trade payables due to related parties:		
Associates	1	-
Joint ventures	-	2
Joint operations	1	8
	2	10

(d) Loans from related parties

At 30 June 2018, other payables included a secured loan owed to a fellow group undertaking of £647 million (2017 - £520 million) in respect of a loan payable to Lakeside.

22. Post balances sheet events

High Court ruling on gender equalisation of pension benefit schemes
The method of calculation for guaranteed minimum pensions in the Diageo Pension Scheme in the United Kingdom, where members opted out of the state pension scheme, was different for males and females which resulted in a potential equality issue. In October 2018 the High Court determined that all companies with a UK defined benefit pension plan that existed before 1997 should amend these schemes to equalise the pension benefits for males and females for guaranteed minimum pensions. At the time of signing these accounts the impact of this ruling is being assessed and it is not possible to provide an estimate of the impact on the net liabilities of the scheme.

Capital reduction and dividend declaration of subsidiary undertaking
On 15 November 2018 Diageo Distilling Limited, a fully owned subsidiary, reduced its share capital to 2 ordinary shares of £1 each, and declared a dividend of £454 million. As a result, the company will write down its investment in Diageo Distilling Limited from £217 million to £2. The dividend receivable will be recognised in the year ending 30 June 2019 resulting in a net gain of £237 million.

Notes to the financial statements (continued)

23. Immediate and ultimate parent undertaking

The immediate parent undertaking of the company is Diageo Great Britain Limited, a company incorporated and registered in England.

The ultimate parent undertaking of the company is Diageo plc which is the ultimate controlling party of the Diageo group. Diageo plc is incorporated and registered in England. The consolidated financial statements of Diageo plc can be obtained from the registered office at Diageo, Lakeside Drive, Park Royal, London, NW10 7HQ.