Diageo Capital plc

Financial statements
30 June 2016

Registered number: SC040795

Diageo Capital plc
Registered number: SC040795
Year ended 30 June 2016

CONTENTS **PAGES**

STRATEGIC REPORT

The directors present their strategic report for the year ended 30 June 2016.

Activities

The company is engaged in the provision of treasury risk and cash management for Diageo plc and its subsidiary undertakings. Diageo Capital plc's principal activity is to raise external funds, principally using the London and New York financial markets. The company finances other companies of the Group via intra-group loans and deposits. Foreign exchange translation hedging, interest rate risk management and cash management are performed by the company.

The company's operations are based in the United Kingdom. The directors foresee no changes in the company's activities.

Business review

Development and performance of the business of the company during the financial year and position of the company as at 30 June 2016
The results of the company and the development of its business are influenced to a considerable extent by group financing requirements. Further information on the risk management policies of the Diageo group is included in the annual report of Diageo plc (see note 15 of the Diageo plc consolidated financial statements).

Net finance income has decreased by £10 million in the year ended 30 June 2016 from a net finance income of £8 million in the year ended 30 June 2015.The main driver of the decrease is the other volatility caused by the USD Libor curve and the GBP/USD rate changes on those interest rate instruments which are not in a hedge relationship.

External borrowings increased by £239 million in the year ended 30 June 2016 to £5,160 million from £4,921 million in the year ended 30 June 2015, which was mainly due to £477 million bond and £81 million commercial paper repayment, offset by the increase due to weakening of the GBP versus USD.

STRATEGIC REPORT (continued)

Financial and other key performance indicators
As the company forms part of the group's treasury operations, the principal key performance indicator used by management to analyse the development, performance and position of the company's business is net interest income in respect of intra-group lending and bonds issued on external financial markets.

The company receives management fee income from Diageo plc to reimburse the expenses incurred in relation to treasury services provided to the group.

Principal risks and uncertainties facing the company as at 30 June 2016
The company forms part of the Diageo group's treasury operations, which manage the Diageo group's funding, liquidity, interest rate and foreign exchange risks. (See detailed description under note 9. Financial instruments and risk management.) The principal risks and uncertainties facing the company are foreign currency risk associated with certain foreign currency denominated bonds and interest rate risk arising principally on changes in US dollar and sterling interest rates. The company uses derivative financial instruments to hedge its exposures to fluctuations in interest and exchange rates. Cash flow hedges are carried out to hedge the currency risk of highly probable future foreign currency cash flows, as well as the cash flow risk from changes in interest rates.

By order of the board

M Pais
Director
Edinburgh Park
5 Lochside Way
Edinburgh
EH12 9DT

12 December 2016

DIRECTORS' REPORT

The directors have pleasure in submitting their annual report, together with the audited financial statements for the year ended 30 June 2016.

Going concern

The company is expected to continue to generate profit for its own account and to remain in positive net asset position for the foreseeable future. The directors have no reason to believe that a material uncertainty exists that may cast significant doubt about the ability of the Diageo group 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 results for the year ended 30 June 2016 are shown on page 9.

The profit for the year transferred to reserves is £10 million (2015 - £16 million) and the other comprehensive income for the year is £36 million (2015 - £38 million expense).

No dividend was paid during the year (2015 - £nil) and there is no dividend proposed to be distributed to the shareholder in regards to the financial year (2015 - £nil).

The transition to FRS 101 did not change the reported figures as at 30 June 2016 nor for the year ended 30 June 2015.

Directors

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

S L Fennessy
D Harlock (appointed 26 May 2016)
E McShane
J J Nicholls
M Pais
P D Tunnacliffe (resigned 30 June 2016)

Directors' remuneration

None of the directors received any remuneration during the year in respect of their services as directors of the company (2015 - £nil).

Secretary

On 5 November 2015, V Cooper was appointed as joint Company Secretary.

Internal control and risk management over financial reporting

The company operates under the financial reporting processes and controls of the Diageo group. The internal control and risk management systems over the financial reporting process of Diageo plc, which include those of the company, are discussed in the Group's Annual Report 2016 on pages 60 to 61 at www.diageo.com, which does not form part of this report.

DIRECTORS' REPORT (continued)

Auditors

Following an audit tender conducted during last year, PricewaterhouseCoopers LLP were selected as auditors for the Diageo group. Accordingly, PricewaterhouseCoopers LLP were appointed to replace KPMG LLP as auditors for the year ended 30 June 2016.

Disclosure of information to auditor

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

M Pais
Director
Edinburgh Park
5 Lochside Way
Edinburgh
EH12 9DT

12 December 2016

Statement of directors' responsibilities in respect of the strategic report, the directors' report and the financial statements

The directors are responsible for preparing the strategic report, the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 101 - Reduced Disclosure Framework (FRS 101).

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 these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- notify its shareholder in writing about the use of disclosure exemptions, if any, of FRS 101 used in the preparation of financial statements; 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. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DIAGEO CAPITAL PLC

Report on the financial statements

Our opinion

In our opinion, Diageo Capital Plc's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 30 June 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

What we have audited

The financial statements, included within the Financial Statements (the "Annual Report"), comprise:

- the Balance Sheet as at 30 June 2016;
- the Income Statement and Statement of Comprehensive Income for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law (United Kingdom Generally Accepted Accounting Practice).

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of directors' responsibilities in respect of the strategic report, the directors' report and the financial statements set out on page 6, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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.

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;

the reasonableness of significant accounting estimates made by the directors; and

the overall presentation of the financial statements.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.

CRichmond

Christopher Richmond (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
12 December 2016

INCOME STATEMENT

	Notes	**Year ended 30 June 2016 £'million**	**Year ended 30 June 2015 £'million**
Other operating income	*2*	**12**	8
Finance income	*4*	**455**	384
Finance charges	*4*	**(457)**	(376)
Operating profit		**10**	16
Profit before taxation on ordinary activities		**10**	16
Taxation on profit on ordinary activities	*5*	**-**	-
Profit for the financial year		**10**	16

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

STATEMENT OF COMPREHENSIVE INCOME

	Notes	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Other comprehensive income/(expense)			
Items that may be recycled subsequently to the income statement			
Effective portion of changes in fair value of cash flow hedges			
- gains taken to other comprehensive income		**231**	34
- recycled to income statement		**(195)**	(72)
Other comprehensive income/(expense) for the year	*11*	**36**	(38)
Profit for the financial year	*11*	**10**	16
Total comprehensive income/(expense) for the year		**46**	(22)

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

Diageo Capital plc
Registered number: SC040795
Year ended 30 June 2016

BALANCE SHEET

	Notes	30 June 2016 £'million	30 June 2015 £'million
Current assets: due after one year			
Other financial assets	6	**419**	289
Current assets: due within one year			
Other financial assets	6	**130**	-
Trade and other receivables	7	**7,546**	6,460
		8,095	6,749
Creditors: amounts falling due within one year			
Borrowings and bank overdrafts	8	**(1,204)**	(558)
Trade and other creditors	10	**(2,703)**	(1,664)
		(3,907)	(2,222)
Net current assets		**4,188**	4,527
Creditors: amounts falling due after more than one year			
Borrowings	8	**(3,956)**	(4,363)
Other financial liabilities	6	**(145)**	(123)
		(4,101)	(4,486)
Net assets		**87**	41
Equity			
Called up share capital	11	**-**	-
Share premium		**250**	250
Fair value and hedging reserve	11	**55**	19
Other reserves		**70**	70
Retained deficit		**(288)**	(298)
Total equity		**87**	41

The accounting policies and other notes on pages 13 to 30 form part of the financial statements.

These financial statements on pages 9 to 30 were approved by the board of directors on 12 December 2016 and were signed on its behalf by:

M Pais
Director

STATEMENT OF CHANGES IN EQUITY

ATTRIBUTABLE TO SHAREHOLDER OF THE COMPANY

	Share premium	Fair value and hedging reserve	Other reserves	Subtotal Other reserves	Retained deficit	Total equity
	£'million	£'million	£'million	£'million	£'million	£'million
Balance at 30 June 2014	250	57	70	127	(314)	63
Other comprehensive expense	-	(38)	-	(38)	-	(38)
Profit for the financial year	-	-	-	-	16	16
Balance at 30 June 2015	**250**	**19**	**70**	**89**	**(298)**	**41**
Other comprehensive income	**-**	**36**	**-**	**36**	**-**	**36**
Profit for the financial year	**-**	**-**	**-**	**-**	**10**	**10**
Balance at 30 June 2016	**250**	**55**	**70**	**125**	**(288)**	**87**

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.

Transition to FRS 101

The company has applied FRS 101 for the first time for the year ended 30 June 2016 with comparative information for the year ended 30 June 2015 also prepared under FRS 101. The accounting policies applicable to the company from 1 July 2014 are set out below. This involved preparation of an opening FRS 101 balance sheet as at 1 July 2014, which is the company's date of transition to FRS 101 reporting.

The transition to FRS 101 did not change the reported figures as at 30 June 2016 nor for the year ended 30 June 2015.

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;
- Disclosures in respect of transactions with wholly owned subsidiaries;
- The effects of new but not yet effective IFRSs;
- Disclosures in respect of the compensation of Key Management Personnel.

These financial statements are separate financial statements.

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.

Finance costs

Borrowing costs which are not capitalised are recognised in the income statement based on the effective interest method.

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. 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.

Financial assets

Trade and other receivables Amounts owed by other group companies are initially measured at fair value and are subsequently reported at amortised cost.

Financial liabilities

Borrowings Borrowings are initially measured at fair value net of transaction costs and are subsequently reported at amortised cost. Certain bonds are designated as being part of a fair value hedge relationship. In these cases, the amortised cost is adjusted for the fair value of the risk being hedged, with changes in value recognised in the income statement. The fair value adjustment is calculated using a discounted cash flow technique based on unadjusted market data.
Trade creditors Amounts owed to other group companies are initially measured at fair value and are subsequently reported at amortised cost.

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 derivatives 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 changes in fair value of recognised assets and liabilities (fair value hedges) and the cash flow risk from a change in exchange or interest rates (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.
Fair value hedges are used to manage the currency and/or interest rate risks to which the fair value of certain assets and liabilities are exposed. Changes in fair value of the derivatives are recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.
If such a hedge relationship is de-designated, fair value movements on the derivative continue to be taken to the income statement while any fair value adjustments made to the underlying hedged item to that date are amortised through the income statement over its remaining life using the effective interest rate method.
Cash flow hedges are used to hedge the cash flow risk from changes in exchange or interest rates. 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 or interest exposure 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.

NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (continued)

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. Interests 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 and is based on the expected manner of recovery 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.

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 the policies in relation to fair valuation of derivatives (see detailed description under note 9. Financial instruments and risk management (f) Fair value measurements).

NOTES TO THE FINANCIAL STATEMENTS (continued)

2. OTHER OPERATING INCOME

	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Intercompany management income	**11**	10
Foreign exchange gain/(loss) on operations	**1**	(2)
	12	8

Fees in respect of audit services provided by the auditors are: £9,000 (2015 - £57,000). There were no fees payable to the auditors in respect of non-audit services (2015 - £nil).

3. EMPLOYEES

The company did not employ any staff during either the current or prior year.

None of the directors received any remuneration during the financial year in respect of their services as directors of the company (2015 - £nil).

4. FINANCE INCOME AND CHARGES

	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Net interest		
Interest income from fellow group undertakings	**365**	337
Other interest income	**1**	1
Fair value gain on external derivative financial instruments	**2**	1
Fair value gain on intra-group derivative financial instruments	**65**	24
Amortisation of bonds	**22**	21
Total interest income	**455**	384
Interest charge to fellow group undertakings	**(180)**	(161)
Interest charge on all other borrowings	**(186)**	(175)
Fair value loss on intra-group derivative financial instruments	**(60)**	(21)
Fair value adjustment on borrowings	**(20)**	(8)
Amortisation of bonds	**(1)**	(1)
Discount and fee amortisation	**(10)**	(10)
Total interest charges	**(457)**	(376)
Net finance (charges)/income	**(2)**	**8**

NOTES TO THE FINANCIAL STATEMENTS (continued)

5. TAXATION

(i) Analysis of taxation charge for the year	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Current tax	-	-
Deferred tax	-	-
Taxation on profit on ordinary activities	-	-

(ii) Factors affecting total tax charge for the year	Year ended 30 June 2016 £'million	Year ended 30 June 2015 £'million
Profit on ordinary activities before taxation	10	16
Taxation on profit on ordinary activities at UK corporation tax rate of 20% (2015 - 20.75%)	(2)	(3)
Group relief received for nil consideration	2	3
Total tax charge for the year	-	-

NOTES TO THE FINANCIAL STATEMENTS (continued)

6. OTHER FINANCIAL ASSETS AND LIABILITIES

	Assets due after one year £'million	Assets due within one year £'million	Liabilities due within one year £'million	Liabilities due after one year £'million
2016				
External derivative assets				
Designated in cash flow hedge	-	23	-	-
	-	23	-	-
Intra-group derivative assets/(liabilities)				
Designated in cash flow hedge	232	107	-	-
Designated in fair value hedge	25	-	-	-
Not designated in a hedge relationship	162	-	-	(145)
	419	107	-	(145)
Total derivative assets/(liabilities)	419	130	-	(145)

Diageo Finance plc entered into external cross currency interest rate swaps on behalf of Diageo Capital plc, market value of which amounted to £339 million at the balance sheet date (2015 - £118 million). The external deals are mirrored through Diageo plc to Diageo Capital plc, the ultimate beneficiary. Market value of intra-group cross currency interest rate swaps amounts to a net asset of £339 million (2015 - £118 million).

NOTES TO THE FINANCIAL STATEMENTS (continued)

6. OTHER FINANCIAL ASSETS AND LIABILITIES (continued)

	Assets due after one year £'million	Assets due within one year £'million	Liabilities due within one year £'million	Liabilities due after one year £'million
2015				
External derivative assets				
Designated in cash flow hedge	12	-	-	-
	12	-	-	-
Intra-group derivative assets/(liabilities)				
Designated in cash flow hedge	137	-	-	(19)
Designated in fair value hedge	14	-	-	-
Not designated in a hedge relationship	126	-	-	(104)
	277	-	-	(123)
Total derivative assets/(liabilities)	289	-	-	(123)

7. TRADE AND OTHER RECEIVABLES

	30 June 2016 £'million	30 June 2015 £'million
Amounts owed by fellow group undertakings	**7,546**	6,460
	7,546	6,460

Amounts owed by fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2016 and at 30 June 2015. These balances are repayable on demand and bear interest at fixed and variable rates from 0.19% to 8.11% for the year ended 30 June 2016 (2015 - from 0.15% to 8.11%).

Amounts owed by fellow group undertakings represent transactions with companies in the Diageo group with which the company has a long term financing relationship. These financing relationships are expected to continue for the foreseeable future. Amounts owed by group undertakings are considered to have a fair value which is not materially different to the book value.

NOTES TO THE FINANCIAL STATEMENTS (continued)

8. BORROWINGS AND BANK OVERDRAFTS

	30 June 2016 £'million	30 June 2015 £'million
Bank overdrafts	**1**	-
Commercial paper	-	81
US$ 750 million 0.625% Bonds due 2016	-	477
US$ 600 million 5.5% Bonds due 2016	**451**	-
US$ 1,000 million 1.5% Bonds due 2017	**751**	-
Fair value adjustment to borrowings	**1**	-
Borrowings due within one year and bank overdrafts	**1,204**	558
US$ 600 million 5.5% bonds due 2016	-	382
US$ 1,000 million 1.5% bonds due 2017	-	635
US$ 1,250 million 5.75% bonds due 2017	**939**	795
US$ 650 million 1.125% bonds due 2018	**487**	412
US$ 696 million 4.828% bonds due 2020	**488**	399
US$ 1,350 million 2.625% bonds due 2023	**1,011**	855
US$ 600 million 5.875% bonds due 2036	**446**	378
US$ 500 million 3.875% bonds due 2043	**369**	312
US$ 200 million 4.85% medium term notes due 2018	**150**	127
Fair value adjustment to borrowings	**66**	68
Borrowings due after one year	**3,956**	4,363
Total external borrowings	**5,160**	4,921

The interest rates of external borrowings shown in the table above are those contracted on the underlying borrowings before taking into account any interest rate hedges. Bonds are stated net of unamortised finance costs of £56 million (2015 - £66 million). Bonds are reported at amortised cost with a fair value adjustment shown separately. All bonds, medium term notes and commercial paper issued by the company are fully and unconditionally guaranteed by Diageo plc.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The company's funding, liquidity and exposure to foreign currency and interest rate risks are managed by the group's treasury department.

The treasury department uses a range of financial instruments to manage these underlying risks. Treasury operations are conducted within a framework of board-approved policies and guidelines, which are recommended and monitored by the finance committee, chaired by the chief financial officer. The policies and guidelines include benchmark exposure and/or hedge cover levels for key areas of treasury risk which are periodically reviewed by the board following, for example, significant business, strategic or accounting changes. The framework provides for limited defined levels of flexibility in execution to allow for the optimal application of the board-approved strategies. Transactions arising from the application of this flexibility may give rise to exposures different from the defined benchmark levels that are separately monitored on a daily basis using Value at Risk analysis. These transactions are carried at fair value and gains or losses are taken to the income statement as they arise. In the year ended 30 June 2016 and 30 June 2015 gains and losses on these transactions were not material. The company does not use derivatives for speculative purposes. All transactions in derivative financial instruments are initially undertaken to manage the risks arising from underlying business activities.

The finance committee receives monthly reports on the activities of the treasury department, including any exposures different from the defined benchmarks.

(a) Currency risk
The company presents its financial statements in sterling (which is the functional currency of the entity) 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. The company expects hedges entered into to continue to be effective and therefore does not expect the impact of ineffectiveness on the income statement to be material.

Hedge of foreign currency debt
The company uses cross currency interest rate swaps to hedge the foreign currency risk associated with certain foreign currency denominated borrowings.

(b) Interest rate risk
The company has an exposure to interest rate risk, arising principally on changes in US dollar and sterling interest rates. To manage interest rate risk, the company manages its proportion of fixed to floating rate borrowings within limits approved by the board, primarily through issuing fixed and floating rate borrowings and commercial paper, and by utilising interest rate derivatives. These practices aim to minimise the company's net finance charges with acceptable year on year volatility. To facilitate operational efficiency and effective hedge accounting, the group's policy is to maintain fixed rate borrowings within a band of 40% to 60% of forecast net borrowings. For these calculations, net borrowings exclude interest rate related fair value adjustments. The majority of the company's existing interest rate derivatives are designated as hedges and are expected to be effective. Fair value of these derivatives is recognised in the income statement, along with any changes in the relevant fair value of the underlying hedged asset or liability.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(c) Market risk sensitivity analysis

The company uses a sensitivity analysis that estimates the impacts on the income statement and other comprehensive income of either an instantaneous increase or decrease of 0.5% in market interest rates or a 10% strengthening or weakening in sterling against all other currencies, from the rates applicable at 30 June 2016 and 30 June 2015, for each class of financial instruments with all other variables remaining constant. The sensitivity analysis excludes the impact of market risks on the corporate tax payable. This analysis is for illustrative purposes only, as in practice interest and foreign exchange rates rarely change in isolation. The sensitivity analysis estimates the impact of changes in interest and foreign exchange rates. All hedges are expected to be highly effective for this analysis and it considers the impact of all financial instruments including financial derivatives, cash and cash equivalents, borrowings and other financial assets and liabilities. The results of the sensitivity analysis should not be considered as projections of likely future events, gains or losses as actual results in the future may differ materially due to developments in the global financial markets which may cause fluctuations in interest and exchange rates to vary from the hypothetical amounts disclosed in the table below.

30 June 2016	**0.5 % decrease in interest rates £'million**	**0.5 % increase in interest rates £'million**	**10 % weakening of sterling £'million**	**10 % strengthening of sterling £'million**
Impact on income statement - gain/(loss)	**(32)**	**32**	**9**	**(8)**
Impact on other comprehensive income-gain/(loss)	**(16)**	**18**	**(21)**	**30**
30 June 2015				
Impact on income statement - gain/(loss)	(33)	33	12	(11)
Impact on other comprehensive income-gain/(loss)	(30)	30	25	(22)

Impact on the statement of comprehensive income includes the impact on the income statement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(d) Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the company. Credit risk arises on cash balances (including bank deposits and cash and cash equivalents), derivative financial instruments and credit exposures to customers, including outstanding loans, trade and other receivables, financial guarantees and committed transactions.

The carrying amount of financial assets represents the company's exposure to credit risk at the balance sheet date as disclosed in section (h), excluding the impact of any collateral held or other credit enhancements.

Credit risk is managed separately for financial and business related credit exposures.

Financial credit risk

Diageo aims to minimise its financial credit risk through the application of risk management policies approved and monitored by the Board. Counterparties are limited to major banks and financial institutions, primarily with a long term credit rating within the A band or better, and the policy restricts the exposure to any one counterparty by setting credit limits taking into account the credit quality of the counterparty. The group's policy is designed to ensure that individual counterparty limits are adhered to and that there are no significant concentrations of credit risk. The Board also defines the types of financial instruments which may be transacted. The credit risk arising through the use of financial instruments for currency and interest rate risk management is estimated with reference to the fair value of contracts with a positive value, rather than the notional amount of the instruments themselves.

When derivative transactions are undertaken with bank counterparties, the group may, where appropriate, enter into certain agreements with such bank counterparties whereby the parties agree to post cash collateral for the benefit of the other if the net valuations of the derivatives are above a predetermined threshold. At 30 June 2016, the collateral held under these agreements amounted to $104 million (£78 million) and €73 million (£61 million) (2015– $82 million (£52 million) and €34 million (£24 million)).

Diageo annually reviews the credit limits applied and regularly monitors the counterparties' credit quality reflecting market credit conditions.

Business related credit risk

Since trade and other receivables principally include balances with fellow group undertakings, the risk of non-performance is considered remote.

(e) Liquidity risk

Liquidity risk is the risk that Diageo may encounter difficulties in meeting its obligations associated with financial liabilities that are settled by delivering cash or other financial assets. The company uses short term commercial paper to finance its day-to-day operations. The group's policy with regard to the expected maturity profile of borrowings is to limit the amount of such borrowings maturing within 12 months to 50% of gross borrowings less money market demand deposits, and the level of commercial paper to 30% of gross borrowings less money market demand deposits. In addition, the group's policy is to maintain backstop facilities with relationship banks to support commercial paper obligations. The following tables provide an analysis of the anticipated contractual cash flows including interest payable for the company financial liabilities and derivative instruments on an undiscounted basis. Where interest payments are on a floating rate basis, rates of each cash flow until maturity of the instruments are calculated based on the forward yield curve prevailing at 30 June 2016 and 30 June 2015. The gross cash flows of derivative contracts are presented for the purposes of this table, although in practice, the group uses netting arrangements to reduce its liquidity requirements on these instruments.

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Contractual cash flows

	Due within 1 year £ million	Due between 1 and 3 years £ million	Due between 3 and 5 years £ million	Due after 5 years £ million	Total £ million	Carrying amount at balance sheet date £ million
2016						
Borrowings	(1,204)	(1,579)	(523)	(1,843)	(5,149)	(5,160)
Interest on borrowings	(203)	(250)	(192)	(855)	(1,500)	(45)
Trade and other financial liabilities	(2,703)	-	-	-	(2,703)	(2,703)
Non-derivative financial liabilities	(4,110)	(1,829)	(715)	(2,698)	(9,352)	(7,908)
Gross amount receivable from derivatives	1,428	286	135	2,378	4,227	-
Gross amount payable from derivatives	(1,225)	(218)	(106)	(1,952)	(3,501)	-
Derivative instruments	203	68	29	426	726	404
2015						
Borrowings	(558)	(2,357)	-	(2,004)	(4,919)	(4,921)
Interest on borrowings	(201)	(298)	(175)	(803)	(1,477)	(38)
Trade and other financial liabilities	(1,664)	-	-	-	(1,664)	(1,664)
Non-derivative financial liabilities	(2,423)	(2,655)	(175)	(2,807)	(8,060)	(6,623)
Gross amount receivable from derivatives	186	1,478	170	2,046	3,880	-
Gross amount payable from derivatives	(140)	(1,216)	(147)	(1,974)	(3,477)	-
Derivative instruments	46	262	23	72	403	166

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

The company had, along with other financing companies in the Diageo group, available undrawn committed bank facilities as follows:

	30 June 2016 £ million	30 June 2015 £ million
Expiring within one year	**-**	688
Expiring between one and two years	**470**	-
Expiring after two years	**2,072**	1,541
	2,542	2,229

The facilities can be used for general corporate purposes and, together with cash and cash equivalents, support the group's commercial paper programmes. There are no financial covenants on the group's material short and long term borrowings. Certain of these borrowings contain cross default provisions and negative pledges. The committed bank facilities are subject to a single financial covenant, being minimum interest cover ratio of two times (defined as the ratio of operating profit before exceptional items, aggregated with share of after tax results of associates and joint ventures, to net interest). They are also subject to pari passu ranking and negative pledge covenants. Any non-compliance with covenants underlying Diageo's financing arrangements could, if not waived, constitute an event of default with respect to any such arrangements, and any noncompliance with covenants may, in particular circumstances, lead to an acceleration of maturity on certain borrowings and the inability to access committed facilities. Diageo was in full compliance with its financial, pari passu ranking and negative pledge covenants in respect of its material short and long term borrowings throughout each of the years presented.

(f) 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 and swaps, cross currency swaps and interest rate swaps 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 2016 £ million	30 June 2015 £ million
Derivative assets	**549**	289
Derivative liabilities	**(145)**	(123)
Valuation techniques based on observable market input (Level 2)	**404**	166

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(g) Results of hedging instruments

In respect of cash flow hedging instruments, a gain of £36 million (2015 – £38 million loss) has been recognised in other comprehensive income due to changes in fair value. A gain of £195 million has been transferred out of other comprehensive income to other finance income/charges (2015 – a gain of £72 million).

With respect to hedges of the cash flow risk from a change in forward foreign exchange rates using cross currency interest rate swaps, the retranslation of the related bond principal to closing foreign exchange rates and recognition of interest on the related bonds will affect the income statement in each year until the related bonds mature in 2016, 2036 and 2043. Foreign exchange retranslation and the interest on the hedged bonds in the income statement are expected to offset those on the cross currency swaps in each of the years.

The gain on fair value hedging instruments for the year was £11 million (2015 – £8 million gain) and the loss on the hedged items attributable to the hedged risks was £20 million (2015 – £8 million loss).

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(h) Reconciliation of financial instruments

The table below sets out the company's accounting classification of each class of financial assets and liabilities.

2016	Fair value through income statement £ million	Loans and receivables and liabilities at amortised cost £ million	Total £ million	Current £ million	Non-current £ million
Trade and other receivables	-	7,546	7,546	7,546	-
External derivatives in cash flow hedge	23	-	23	23	-
Intra-group derivatives in fair value hedge	25	-	25	25	-
Intra-group derivatives in cash flow hedge	339	-	339	107	232
Intra-group derivatives not designated in a hedge relationship	162	-	162	162	-
Total financial assets	549	7,546	8,095	7,863	232
Borrowings	-	(5,160)	(5,160)	(1,204)	(3,956)
Trade and other payables	-	(2,703)	(2,703)	(2,703)	-
Intra-group derivatives not designated in a hedge relationship	(145)	-	(145)	-	(145)
Total financial liabilities	(145)	(7,863)	(8,008)	(3,907)	(4,101)
Total net financial assets/(liabilities)	404	(317)	87	3,956	(3,869)

NOTES TO THE FINANCIAL STATEMENTS (continued)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

(h) Reconciliation of financial instruments (continued)

2015	Fair value through income statement £ million	Loans and receivables and liabilities at amortised cost £ million	Total £ million	Current £ million	Non-current £ million
Trade and other receivables	-	6,460	6,460	6,460	-
External derivatives in cash flow hedge	12	-	12	12	-
Intra-group derivatives in fair value hedge	14	-	14	14	-
Intra-group derivatives in cash flow hedge	137	-	137	137	-
Intra-group derivatives not designated in a hedge relationship	126	-	126	126	-
Total financial assets	289	6,460	6,749	6,749	-
Borrowings	-	(4,921)	(4,921)	(558)	(4,363)
Trade and other payables	-	(1,664)	(1,664)	(1,664)	-
Intra-group derivatives in cash flow hedge	(19)	-	(19)	-	(19)
Intra-group derivatives not designated in a hedge relationship	(104)	-	(104)	-	(104)
Total financial liabilities	(123)	(6,585)	(6,708)	(2,222)	(4,486)
Total net financial assets/(liabilities)	166	(125)	41	4,527	(4,486)

At 30 June 2016 and 30 June 2015, the carrying values of cash and cash equivalents, other financial assets and liabilities approximate to fair values. At 30 June 2016 the fair value of borrowings, based on unadjusted quoted market data, was £5,487 million (2015 – £4,999 million).

(i) Capital management

The group's management is committed to enhancing shareholder value in the long term, both by investing in the businesses and brands so as to deliver continued improvement in the return from those investments and by managing the capital structure. Diageo manages its capital structure to achieve capital efficiency, provide flexibility to invest through the economic cycle and give efficient access to debt markets at attractive cost levels.

NOTES TO THE FINANCIAL STATEMENTS (continued)

10. TRADE AND OTHER CREDITORS

	30 June 2016 £'million	30 June 2015 £'million
Amounts owed to fellow group undertakings	**2,658**	1,625
Interest payable	**45**	39
	2,703	1,664

Amounts owed to fellow group undertakings include accrued and capitalised interest on the underlying balances at 30 June 2016 and at 30 June 2015. These balances are repayable on demand and bear interest at fixed and variable rates from 0.19% to 3.8675% for the year ended 30 June 2016 (2015 - from 0.15% to 3.8675%).

Amounts owed to fellow group undertakings represent transactions with companies in the Diageo group with which the company has a long term financing relationship. These financing relationships are expected to continue for the foreseeable future. Amounts owed to group undertakings are considered to have a fair value which is not materially different to the book value.

11. SHARE CAPITAL AND RESERVES

(a) Share capital

	30 June 2016 £
Allotted, called up and fully paid:	
200,000 (2015 - 200,000) ordinary shares of £1 each	**200,000**

(b) Fair value and hedging reserve

	Fair value and hedging reserve £'million
At 30 June 2014	57
Effective portion of changes in fair value of cash flow hedges	
- gains taken to other comprehensive income	34
- recycled to income statement	(72)
At 30 June 2015	19
Effective portion of changes in fair value of cash flow hedges	
- gains taken to other comprehensive income	**231**
- recycled to income statement	**(195)**
At 30 June 2016	**55**

NOTES TO THE FINANCIAL STATEMENTS (continued)

12. IMMEDIATE AND ULTIMATE PARENT UNDERTAKING

The immediate and ultimate parent undertaking of the company is Diageo plc which is the ultimate controlling party of 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.