DIAGEO PLC
Form 6-K
July 28, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 6-K

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

28 July 2016

Commission File Number: 001-10691

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

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

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

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Preliminary results, year ended 30 June 2016
28 July 2016

Stronger organic growth underpins improving momentum across the business

Organic results improved with volume growth of 1.3%, net sales growth of 2.8%, and operating profit growth of 3.5%

Reported net sales declined 3.0% as organic growth in each region and acquisitions were more than offset by adverse exchange and disposals

Reported operating profit grew 1.6% with organic growth, lower exceptional operating charges and acquisitions partially offset by adverse exchange and disposals

Free cash flow continued to be strong at £2.1 billion, up £134 million on last year. Operating cash flow was £2.5 billion

Basic eps of 89.5 pence was down 6% as lower exceptional income reduced basic eps by 6.1 pence. Pre-exceptional eps increased 1% to 89.4 pence

The board recommended a final dividend increase of 5% bringing the full year dividend to 59.2 pence per share

See explanatory notes section for explanation of the use of non-GAAP measures.

Ivan Menezes, Chief Executive, commenting on the results said:

"This is a good set of results delivering what we set out to achieve this time last year and demonstrating our momentum.

This better performance reflects the work we have done to strengthen our big brands through marketing and innovation, as well as expanding our distribution reach. Our six global brands and our US spirits business are all back in growth and we have seen a significant improvement in the performance of our scotch and beer portfolios. The delivery of volume growth; organic margin expansion; increased free cash flow; and the disposal of £1bn in non-core assets, comes from Exaim to improve the role of alcohol in society, partner with our communities and reduce our environmental impact.
These results position us well to deliver a stronger performance in F17. We are confident of achieving our objective of mid-single digit top line growth, and in the three years ending F19 delivering 100bps of organic operating margin improvement."

Key financial information
For the year ended 30 June 2016
Summary financial information

		2016	2015	Organic growth %	Reported growth %
Volume	EUm	246.4	246.2	1	-
Net sales	£ million	10,485	10,813	3	(3)
Marketing	£ million	1,562	1,629	(2)	(4)
Operating profit before exceptional items	£ million	3,008	3,066	3	(2)
Exceptional operating items	£ million	(167)	(269)		

Operating profit	£ million	2,841	2,797	2
Share of associates and joint ventures profit after tax	£ million	221	175	26
Exceptional non-operating items	£ million	123	373	
Net finance charges	£ million	327	412	
Tax rate	%	17.4	15.9	9
Tax rate before exceptional items	%	19.0	18.3	4
Profit attributable to parent company's shareholders	£ million	2,244	2,381	(6)
Basic earnings per share	pence	89.5	95.0	(6)
Earnings per share before exceptional items	pence	89.4	88.8	1
Recommended full year dividend	pence	59.2	56.4	5

Exceptional items (for further details see notes 3)	2016 £ million
Operating items before taxation	
Impairment of Ypióca	(118)
Disengagement agreement relating to USL	(49)
Total operating items before taxation	(167)
Non-operating items before taxation	
Sale of Jamaica, Singapore and Malaysia brewing businesses	457
Sale of wines	(229)
Provision for a receivable related to a loan guarantee	(92)
Other	(13)
Total non-operating items before taxation	123

Outlook for exchange

Using current exchange rates (£1 = $1.31; £1 = €1.19), the exchange rate movement for the year ending 30 June 2017 is estimated to favourably impact net sales by approximately £1.1 billion and operating profit by approximately £370 million, and have an adverse impact of approximately £20 million on net interest. This is primarily driven by the weakness of sterling post the EU referendum.

Outlook for tax

The tax rate before exceptional items for the year ended 30 June 2016 was 19.0% compared with 18.3% in the prior year. It is expected that the tax rate before exceptional items for the year ending 30 June 2017 will be 21%.

United Kingdom (UK) and the European Union (EU)

Following the UK's vote to leave the EU, Diageo is working closely with government and industry bodies to ensure its views are reflected in the transition process. Diageo welcomes the formation of a specialist international trade department, as it is important for Diageo that the UK continues to benefit from open access to the EU as well as favourable international trade agreements.

Net sales (£ million)

Organic net sales growth of 2.8% driven by volume and mix

Net sales	£ million
2015	10,813
Exchange(i)	(172)
Disposals	(400)
Acquisitions	90

Volume	131
Price/mix	145
Asia Pacific net sales adjustment(ii)	(122)
2016	10,485

(i) Exchange rate movements reflect the translation of prior year reported results at current exchange rates.
(ii) Diageo has reflected the full year impact of an accounting change USL made in its most recent quarterly results to account for sales by third party manufacturers on a net sales basis. See additional financial information section for more details.
Net sales declined 3.0%. Adverse impact of exchange and disposals reduced net sales by 5.3%. These movements were partially offset by organic net sales growth of 2.8% with volume growth of 1.3% and positive price/mix, primarily mix.

Net sales and operating profit were impacted by adverse exchange movements driven by the weakness of a number of currencies against sterling, in particular the Nigerian naira, the South African rand, the Venezuelan Bolivar, the Brazilian real and the Turkish lira, partially offset by the strengthening of the US dollar.

Operating profit (£ million)
Organic operating profit growth of 3.5%

Operating profit	£ million
2015	2,797
Exceptional operating items	102
Exchange	(83)
Disposals	(96)
Acquisitions	22
Organic movement	99
2016	2,841

Operating profit growth of 1.6% was driven by organic growth, acquisitions and lower exceptional operating charges (£167 million in 2016; £269 million in 2015). These movements were partially offset by adverse exchange and the impact of disposals.

Acquisitions and disposals

Acquisitions made in 2015 increased net sales in the year ended 30 June 2016 by £90 million and operating profit by £22 million, largely due to the acquisition of the remaining 50% shareholdings in Don Julio and United National Breweries.

Businesses which were disposed of in the year ended 30 June 2015, primarily Bushmills and Gleneagles, and those disposed of in the year ended 30 June 2016, the sale of wines and certain beer assets, contributed net sales of £655 million and operating profit of £121 million in the period ended 30 June 2015, and contributed net sales of £255 million and operating profit of £25 million in the period ended 30 June 2016. The year on year movement on net sales was £400 million and £96 million on operating profit.

For further details on the impact of acquisitions and disposals see explanatory notes, acquisitions and disposals.

Organic growth by region

	Volume		Net sales		Marketing		Operating profit (i)	
	%	EUm	%	£ million	%	£ million	%	£ million
North America	1	0.5	3	97	(2)	(10)	4	56
Europe, Russia and Turkey	2	0.8	4	102	5	20	6	45
Africa	9	2.3	3	34	1	1	(11)	(27)
Latin America and Caribbean	(2)	(0.4)	1	5	-	-	(1)	(2)
Asia Pacific	-	(0.1)	2	34	(12)	(42)	13	44
Corporate	-	-	13	4	(50)	(6)	(13)	(17)
Diageo	1	3.1	3	276	(2)	(37)	3	99

(i) Before operating exceptional items.

Operating margin (%)

Organic margin improved by 19 bps

Operating margin	Ppt
2015	25.87
Exceptional operating items	0.89
Exchange	(0.32)
Acquisitions and disposals	0.14
Gross margin	0.55
Marketing	0.78
Overheads and other	(1.14)
Asia Pacific net sales adjustment(i)	0.33
2016	27.10

(i) Diageo has reflected the full year impact of an accounting change USL made in its most recent quarterly results to account for sales by third party manufacturers on a net sales basis. It has no impact on gross profit or operating profit. See additional financial information for more details.

Operating margin improved by 123bps mainly driven by lower exceptional operating charges, a 19bps improvement in organic margin and the net sales adjustment in Asia Pacific. These movements were partially offset by an adverse exchange impact. Organic operating margin improvement was driven by favourable mix, including the return to growth in North America which drove gross margin improvement, as well as net procurement efficiencies after reinvestment in increased marketing activity. These benefits were partially offset by higher overheads driven by a year on year increase in annual incentive plan costs and inflation.

Basic earnings per share (pence)
eps before exceptional items increased from 88.8 pence to 89.4 pence

Basic earnings per share	pence
2015	95.0
Exceptional items (i)	(6.14)
Exchange on operating profit	(3.33)
Acquisitions and disposals	(2.97)
Operating profit excluding exchange	3.95
Associates and joint ventures	1.83
Finance charges	3.39
Tax	(1.37)
Non-controlling interests	(0.82)
2016	89.5

(i)
Exceptional items net of tax and non-controlling interests.

Lower exceptional income(i) (£2 million in 2016; £156 million in 2015), reduced basic earnings per share by 6.1 pence. Pre-exceptionals eps was up 0.6 pence as adverse exchange, net impact of acquisitions and disposals, a higher tax rate and the increase in non-controlling interests from higher operating profit in USL, were more than offset by organic operating profit growth, higher associate income and lower finance charges. Finance charges were lower on the fall in both net interest charge and other financing charges. Net interest charges declined from debt reduction and lower interest rates. Other finance charges dropped due to lower hyperinflation charge for Venezuela as we moved to a consolidation rate which recognised the impact of the inflation rate as well as the impact of lapping a £13 million charge in 2015 in respect of an increase in value of Zacapa related financial liabilities.

Movement in net finance charges

	£ million
2015	412
Net interest charge reduction	(51)
Reduction in other finance charges	(34)
2016	327

	2016	2015
Average monthly net borrowings (£ million)	9,245	10,459
Effective interest rate (i)	3.3%	3.5%

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

The fall in average monthly net borrowings arose from disposals proceeds and continued strong cash flow. The effective interest rate reduced in the year ended 30 June 2016 largely driven by changes in financing in USL together with the repayment of Diageo bonds with a higher interest rate.

Free cash flow (£ million)

Operating cash flow(i) was £2,548 million in 2016 a decline of £3 million on £2,551 million in 2015
Free cash flow was £2,097 million in 2016 an increase of £134 million

Free cash flow	£ million
2015	1,963
Capex	137
Exchange (ii)	(83)
Operating profit (iii)	152
Working capital	(170)
Interest and tax	93
Other (iv)	5
2016	2,097

(i)
Operating cash flow excludes capex, loans and other investments (collectively (£451) million in 2016 – (£588) million in 2015).
(ii)
Exchange - on operating profit before exceptional items.
(iii)
Operating profit excluding exchange, depreciation and amortisation, post-employment payments and non-cash items but including operating exceptional items.
(iv)
Other items include post-employment payments, dividends received from associates and joint ventures, loans and other investments.

Free cash flow improved £134 million driven by lower capex, increased operating profit before exchange, and lower interest payments. The negative working capital movement was driven by the year on year comparison to a significant reduction in receivables in 2015. This was partially offset by a favourable movement on inventory and payables.

Return on average invested capital (%)(i)
ROIC decreased 22bps

Return on average invested capital(i)	ppt
2015	12.3
Exchange	(0.62)
Acquisitions and disposals	(0.16)
Operating profit excluding exchange	0.47
Associates and joint ventures	0.14
Non-controlling interests	(0.08)
Other	0.03
2016	12.1

(i)
ROIC calculation excludes exceptional items.

ROIC before exceptional items decreased 22bps driven mainly due to the adverse impact of exchange which was partially offset by the increased return from growth in operating profit and income from associates.

Notes to the business and financial review

Unless otherwise stated:

commentary below refers to organic movements

volume is in millions of equivalent units (EUm)

net sales are sales after deducting excise duties

percentage movements are organic movements

share refers to value share

GTME refers to Global Travel Asia and Middle East

BUSINESS REVIEW
For the year ended 30 June 2016
North America

North America delivered net sales growth of 3%, following the expected strong performance in the second half in US Spirits. Full year depletion and net sales growth in US Spirits was 3%. Growth in North American whiskey, scotch and tequila drove positive mix. North American whiskey, with net sales up 6%, was the main driver of net sales growth as Crown Royal and Bulleit continued to gain share in the category. Performance of Smirnoff and Captain Morgan improved, with net sales up 2% for both brands. In scotch, Johnnie Walker and Buchanan's both performed well, with net sales up 7% and 9%, respectively. Reserve brands performance also improved, with net sales up 5%, driven by Johnnie Walker reserve variants, Bulleit, Don Julio and Ketel One vodka. Elsewhere in the region DGUSA net sales grew 1%, with growth in ready to drink offsetting a decline in beer, and in Canada net sales were up 4%. Marketing in North America was down 2% as a result of procurement efficiencies and more focused spend on innovation. Operating margin increased 39bps for the year, as improvement in gross margin and lower marketing more than offset higher overheads.

Key financials £ million:

	2015	FX	Acquisitions and disposals	Organic movement	2016	Reported movement %
Net sales	3,455	172	(159)	97	3,565	3
Marketing	542	23	(14)	(10)	541	-
Operating profit before exceptional items	1,448	77	(30)	56	1,551	7
Exceptional operating items	(28)				-	
Operating profit	1,420				1,551	9

Markets:

	Organic volume movement %	Reported volume movement %	Organic net sales movement %	Reported net sales movement %
North America	1	(1)	3	3
US Spirits	1	(1)	3	4
DGUSA	-	(3)	1	5
Canada	2	2	4	(5)
Spirits	1	1	3	8
Beer	(3)	(7)	(2)	(2)
Ready to drink	4	1	5	7

	Reported volume movement(ii) %	Organic net sales movement %	Reported net sales movement %
Crown Royal	6	6	12
Smirnoff	1	2	6
Captain Morgan	3	2	6
Johnnie Walker	-	5	10
Ketel One vodka	2	4	10

Cîroc	(6)	(7)	(1)
Baileys	(2)	-	4
Guinness	-	-	5
Tanqueray	5	7	13
Don Julio	30	34	42
Bulleit	25	28	36
Buchanan's	3	9	16

(i)
Spirits brands excluding ready to drink.
(ii)
Reported equals organic volume movement.

Net sales in US Spirits were up 3%, with a 10% net sales increase in the second half following a transition to a replenishment model for innovation launches. Diageo's North American whiskey brands accounted for half of the overall net sales growth as Crown Royal and Bulleit continued to gain share. Crown Royal net sales increased 5%, with net sales of Crown Royal Deluxe up 5% as it benefitted from the new "The One Made For A King" campaign which focused on the quality and heritage of the brand. Crown Royal Regal Apple continued to benefit from the popularity of the shot occasion and delivered a solid performance, with net sales up 15%, as it entered its second year after launch. Cîroc performance improved in the second half, as the brand benefitted from the launch of its Apple flavour. Smirnoff net sales were up 2% but it underperformed the vodka category. Growth from a more focused flavours portfolio and the newly launched Smirnoff Sourced, a blend of real fruit juice and spirit, offset a decline in Smirnoff Red which lapped last year's brand renovation and promotional activity and continued to be impacted by a competive price environment. Performance in scotch improved as Johnnie Walker's net sales increased 7%, largely driven by reserve variants, up 23%. Buchanan's net sales were up 9% and share increased, as the 'A lo Grande' campaign enhanced the connection with hispanic consumers. Increased investment in the on-trade and focus on recruiting new consumers amongst millenials had a positive impact on Captain Morgan which gained share despite weakness in the rum category. Net sales for the brand were up 2%, largely driven by the Original Spiced variant and Cannon Blast, which proved to be popular in the shot occasion. Don Julio, with net sales up 34%, was the fastest growing brand in the portfolio and gained share.

DGUSA net sales increased 1%, as growth in ready to drink offset a decline in beer. In ready to drink the launch of Smirnoff Electric and a solid performance of Smirnoff Ice, which benefitted from new flavours and packaging, drove net sales growth of 7%. Beer net sales were down 3% largely driven by a decline in Smithwick and Harp. Guinness net sales were broadly flat as the launch of Guinness Nitro IPA offset the net sales decline of Guinness American Blonde Lager, which lapped the previous year launch, and Guinness draught which continued to be impacted by a crowded craft beer segment.

Net sales in Canada increased 4%, largely driven by Crown Royal which benefitted from the launch of Crown Royal Northern Harvest Rye, rated '2016 world whiskey of the year' by Jim Murray's Whiskey Bible, distribution gains, and the 'We Make Whisky The Canadian Way' campaign, which highlights the brand's quality and craftmanship. Performance in vodka and ready to drink was also good, with net sales up 2% and 6%, respectively.

Marketing reduced 2% driven by procurement efficiencies and more focused spend on innovations. Spend was also focused against the largest brands in US Spirits, with investment in Smirnoff, Crown Royal and Captain Morgan up 6%, and fast growing brands such as Don Julio, Bulleit and Buchanan's where investment was up 16%.

Europe, Russia and Turkey

The region's performance reflects momentum in Europe, strong net sales growth in Russia driven by price increases in a tough economic and exchange environment and good growth in Turkey. In Europe, net sales were up 3% with Great Britain and Continental Europe the main contributors and with share gains across the market. Baileys performed strongly driven by execution against core growth drivers, especially sampling. Guinness net sales were up 2% supported by innovations from 'The Brewers Project' and Tanqueray grew net sales double digit in most countries across Europe. Reserve brands continued to perform well also growing double digit. In Russia, price increases led to net sales increase of 27% while volume was down 9%, with share gains in rum but share losses in scotch in the face of increased competition. In Turkey net sales were up 6% driven by Johnnie Walker underpinned by steady growth in raki at 3%. Gross margins were up in both Europe and Russia. Overall region operating margins improved by 51bps. In Europe procurement savings offset increased marketing and overheads leaving margin improvement in Russia to drive the region's increase.

Key financials £ million:

	2015	FX	Acquisitions and disposals	Organic movement	2016	Reported movement %
Net sales	2,617	(87)	(88)	102	2,544	(3)
Marketing	388	1	(5)	20	404	4
Operating profit before exceptional items	804	(24)	(24)	45	801	-
Exceptional operating items	(20)				-	
Operating profit	784				801	2

Markets:

	Organic volume movement %	Reported volume movement %	Organic net sales movement	Reported net sales movement