

## Operating and financial review continued

In order to assist the reader of the financial statements, the comparisons of both 2005 with 2004 and 2004 with 2003 include tables which present the exchange, acquisitions and disposals and organic components of the year on year movement for each of turnover, net sales (after deducting excise duties) and operating profit before exceptional items.

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

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

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

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

### Operating results – 2005 compared with 2004

#### Summary consolidated profit and loss account

	Year ended 30 June 2005			Year ended 30 June 2004		
	Before exceptional items £ million	Exceptional items £ million	Total £ million	Before exceptional items £ million	Exceptional items £ million	Total £ million
<b>Turnover</b>	9,036	–	9,036	8,891	–	8,891
<b>Operating costs</b>	(7,092)	(208)	(7,300)	(6,980)	(40)	(7,020)
<b>Operating profit</b>	1,944	(208)	1,736	1,911	(40)	1,871
Share of associates' profits	185	–	185	451	(13)	438
Investment income	17	–	17	–	–	–
Disposal of fixed assets	–	(19)	(19)	–	(35)	(35)
Disposal of businesses	–	46	46	–	(10)	(10)
Finance charges	(143)	–	(143)	(295)	–	(295)
<b>Profit before taxation</b>	2,003	(181)	1,822	2,067	(98)	1,969
Taxation	(481)	98	(383)	(517)	30	(487)
<b>Profit after taxation</b>	1,522	(83)	1,439	1,550	(68)	1,482
Minority interests	(64)	–	(64)	(90)	–	(90)
<b>Profit for the year</b>	1,458	(83)	1,375	1,460	(68)	1,392
Dividends	(866)	–	(866)	(833)	–	(833)
<b>Transferred to reserves</b>	592	(83)	509	627	(68)	559

**Turnover** On a reported basis, turnover increased by £145 million (2%) from £8,891 million in the year ended 30 June 2004 to £9,036 million in the year ended 30 June 2005. Turnover was adversely impacted by exchange rate movements of £228 million, principally arising from weakening of the US dollar.

**Operating costs** On a reported basis, operating costs increased by £280 million (4%) from £7,020 million in the year ended 30 June 2004 to £7,300 million in the year ended 30 June 2005. Operating exceptional items increased by £168 million from £40 million to £208 million. On a reported basis before exceptional items, excise duties increased by £98 million from £2,09 million for the year to 30 June 2004 to £2,307 million, while cost of goods sold increased by £7 million and marketing investment was down 2% from £1,039 million to £1,023 million. Marketing investment on global priority brands (excluding ready to drink) was £587 million while marketing spend on ready to drink brands was £128 million. Reported group overheads increased by £23 million in the year to 30 June 2005 to £1,176 million. Overall, the impact of exchange rate movements reduced total operating costs before exceptional items by £137 million.

**Exceptional operating costs** Operating profit for the period is after £208 million of exceptional operating costs. Exceptional operating costs include a charge of £149 million in respect of payments to the Thalidomide Trust. Diageo currently makes an annual payment of £2.8 million to the Trust although in the year ended 30 June 2005 an additional contribution of £4.4 million was made. Based on the current negotiations it is expected that the future annual payment will increase to around £6.5 million per annum. This amount will be index-linked and is expected to be a final settlement payable over the period to 2037. Provision has been made for the discounted value of these payments. Also included in exceptional costs is £29 million of accelerated depreciation in respect of the Park Royal brewery which, as announced in April 2004, closed in June 2005 and £30 million (2004 – £40 million) of final costs related to the integration of the Seagram spirits and wine businesses, acquired in December 2001.

**Operating profit** Reported operating profit decreased by £135 million from £1,871 million to £1,736 million. Exchange rate movements reduced operating profit before exceptional items for the year ended 30 June 2005 by £91 million (US dollar reduction of £79 million, euro benefit of £3 million, other currencies reduction of £15 million).

**Post employment plans** Post employment charges calculated under FRS 17 resulted in a charge to operating profit of £96 million (2004 – £101 million) and other finance income of £16 million (2004 – charge of £18 million). In October 2004, four million shares in General Mills with a market value of £100 million were transferred to the group's UK pension fund. At 30 June 2005, Diageo's deficit after taxation for all post employment plans was £902 million (30 June 2004 – £750 million).

**Associates** The group's share of profits of associates before exceptional items was £185 million for the year compared to £451 million last year. Diageo ceased to equity account for its share of the results of General Mills from 23 June 2004. In the year ended 30 June 2004, General Mills contributed £258 million to share of profits of associates. In the year ended 30 June 2005 the Group's 34% equity interest in Moët Hennessy contributed £169 million to share of profits of associates before exceptional items (2004 – £176 million).

**Investment income** Income from fixed asset investments was £17 million, arising on dividends receivable from General Mills.

**Finance charges** Finance charges decreased from £295 million in the year ended 30 June 2004 to £143 million in the year ended 30 June 2005.

The net interest charge decreased by £120 million (44%) from £271 million in the prior year to £151 million in the year ended 30 June 2005; £42 million of this decrease results from lower debt offset by higher floating interest rates year on year. The balance of the reduction in the net interest charge mainly results from the cessation of equity accounting for General Mills shares (£59 million) and from the weaker US dollar (£11 million).

Other finance income of £8 million included income of £16 million (2004 – charge of £18 million) in respect of the group's post employment plans. This beneficial movement principally reflects the increase in the value of the assets held by the post employment plans between 1 July 2003 and 30 June 2004.

**Non-operating exceptional items** Non-operating exceptional items before taxation were a credit of £27 million in the year ended 30 June 2005 compared with a charge of £45 million in the year ended 30 June 2004. This credit includes a loss on disposal of fixed assets totalling £19 million comprising a loss on disposal of part of the group's investment in General Mills of £26 million and a net gain on disposal of other fixed assets of £7 million. In October 2004, 49.9 million shares in General Mills were sold for £1.2 billion and a further four million shares were transferred to the group's UK pension fund. These disposals generated a loss before tax of £26 million after writing back goodwill previously written off to reserves of £247 million and other costs, including the costs of terminating related hedge instruments, of £25 million. Also included in non-operating exceptional items is the net profit on disposal of businesses of £46 million comprising a credit relating to Burger King Corporation of £53 million, a provision of £8 million in respect of the sale of part of the United Beverages distribution business in Ireland and a net credit of £1 million relating to other disposals. The credit in relation to Burger King Corporation, which was sold in 2002, reflects the release of provisions relating to residual financing obligations following the successful refinancing of Burger King Corporation on 13 July 2005. This resulted in the repayment of the subordinated debt (including accrued interest receivable) and the release of Diageo from its obligations under the guarantee.

**Profit before taxation** After exceptional items, the profit before taxation and minority interests decreased by £147 million from £1,969 million to £1,822 million in the year ended 30 June 2005.

**Exchange rates** The impact of adverse exchange rate movements on profit before exceptional items and taxation for the financial year ending 30 June 2006 is estimated to be £50 million (excluding transaction exchange on share of profits of associates). This is comprised of an adverse impact in respect of our hedged transaction exposure of around £70 million and £20 million favourable translation exposure based on current exchange rates, including £1 = \$1.80 (2005 – \$1.86) and £1 = €1.47 (2005 – €1.46).

**Taxation** The effective rate of taxation on profit before exceptional items for the year was 24%, compared with 25% for the year ended 30 June 2004, the reduction arising primarily as a consequence of the sale of the General Mills shares. The effective tax rate on exceptional items benefits from a provision release related to various disposals in previous years.