

INVESTING FOR GROWTH

CREATING VALUE FOR SHAREHOLDERS



“This was an important year of progress in which we improved our share position in a number of priority markets. We invested significantly behind our Growth and Specialist Brands to deliver these results, creating a stronger platform for generating further quality growth in the years ahead.”

ALISON COOPER
Chief Executive

Last year the Board and my senior leadership team conducted a review of our strategy to refine our priorities for growth over the next decade in tobacco and consumer adjacencies, including e-vapour.

A key element of our strategy is the simplification of our brand portfolio. By reducing the number of brands and stock keeping units, and prioritising our strongest equities, our Growth and Specialist Brands, we have created a more powerful portfolio that is delivering a higher quality of growth.

We increased investment in these brands by £310 million in the year, focusing spend in a number of areas including portfolio simplification, advertising and marketing, consistent pricing, our sales force and customer engagement. This higher level of support, aligned with the roll-out of our Market Repeatable Model, delivered market share gains in many of our priority markets and improved share trajectories in others. Growth Brands performed well, outperforming the market with volume growth and a share gain of 80 basis points. We also continued to make good progress in e-vapour, further building our capabilities and consumer insights in preparation for an enhanced programme of activity in 2018.

The increased investment in our brands impacted full year revenue and profit, while supporting a stronger second half revenue and share performance in a tough industry environment. It has also strengthened the business to support improved top-line growth over the medium term.

The drive and commitment of our people have been integral to the delivery of these results and I would like to thank everyone for their hard work and continued support.

MARKET REPEATABLE MODEL: OUR FOCUS FOR GROWTH

Our investments were aligned behind our Market Repeatable Model. This model builds on the success of the Sales Growth Drivers we have been using in the business for many years and provides a structured framework for quality growth that is being deployed across our markets.

The six elements of the model ensure that wherever we operate we always have: a simple market-focused portfolio, sustained brand investments, a consistent price strategy, a focus on maximising the availability of our core range, tailored customer solutions and honest and accurate learning mechanisms. How each section is applied in our markets is explained on page 7.

Our investments supported all six elements of the model, strengthening our ability to maximise the performance of our brands in market.

STRENGTHENING OUR PORTFOLIO: EXCELLENT RESULTS FROM GROWTH BRANDS

Streamlining our portfolio has not only improved our quality of growth, it has also substantially cut the level of complexity and cost in the business.

The core principle behind the reshaping of our portfolio has been to reduce the number of weaker Portfolio Brands through migrations and delistings, while driving the performance of our Growth and Specialist Brands.

As a result we have consistently increased the contribution that Growth and Specialist Brands make to our success and in doing so, we have steadily improved our quality of growth. These brands now deliver around 63 per cent of the Group's tobacco net revenue and our target is for them to eventually account for 75 per cent.

During the year we migrated multiple Portfolio Brands into Growth Brands in a variety of markets. We also began rolling out a more radical portfolio simplification exercise to reduce complexity and improve on-shelf availability of our brands in Russia, France, Germany, Italy, Spain and Australia, with other markets to follow.

Our Growth Brands delivered good results, with the performance of JPS, West, Winston, Davidoff and Gauloises Blondes benefiting from higher investment in a range of priority markets, including the UK, Germany, Italy, Japan, Australia and the USA.

This was complemented by strong revenue growth from a number of our Specialist Brands, including Skruf in Scandinavia, Backwoods in the USA and Premium Cigars in a number of markets.

NEXT GENERATION PRODUCTS: EXPANDING OUR POSITION

Next Generation Products (NGP) offer considerable growth opportunities and we will be significantly stepping up our level of activity in 2018, expanding our portfolio with new product launches in new and existing markets. This is building on the strong foundations and capabilities we have established over recent years.

E-vapour remains our priority; in our view this is by far the largest NGP opportunity and we believe it offers the greatest current potential for long-term sustainable growth.

In blu, we have one of the best e-vapour brands in the world and we continue to focus on improving the consumer experience. Vaping technology is continually evolving and in October 2017 we substantially enhanced our technical capabilities with the acquisition of the e-vapour innovation business Nerudia.

During the year we also continued to secure intellectual property royalties from companies using our first generation technology.

Heated tobacco is currently a much smaller NGP category that is growing, most notably in Japan. While our investments will continue to be focused on supporting e-vapour we have developed options in heated tobacco which can be deployed if we see broad-based sustainable growth developing and we will begin consumer trials of our own heated tobacco products in December 2017.

IMPERIAL BRANDS AND CHINA TOBACCO

In January we announced a long-term joint venture business with China Tobacco, aimed at developing growth opportunities in China and international markets.

China is the world's largest tobacco market, with annual volumes close to 2.5 trillion cigarettes.

The joint venture, Global Horizon Ventures Limited (GHVL), is based in Hong Kong and is focused on:

- leveraging the expertise of China's largest tobacco company, Yunnan Tobacco, to drive the sustainable development of our Growth Brands West and Davidoff in China
- maximising the potential of two Yunnan Tobacco cigarette brands, Jadé and Horizon, in markets outside of China

An early focus for GHVL was the migration of Style to Jadé. This was successfully completed and Jadé is now one of our Specialist Brands.

We have been very encouraged by the performance of GHVL in the first nine months of operation and believe that over the coming years, the joint venture has the potential to deliver additional meaningful Growth Brand volumes.

As well as driving the performance of the four cigarette brands, GHVL will also be evaluating other tobacco and Next Generation Product launches, along with potential merger and acquisition opportunities.

The joint venture builds on a track record of co-operation between Imperial and Yunnan Tobacco, which began in 2003.

DEVELOPING OUR FOOTPRINT: DRIVING SUCCESS IN PRIORITY MARKETS

We delivered a number of good performances in priority markets across our geographic footprint.

Our successes in Growth Markets included strong share gains in Japan, Saudi Arabia, Italy and Russia. In China, the world's largest tobacco market, we have been very encouraged by the performance of our new joint venture with China Tobacco.

ITG Brands delivered another strong performance in the USA, underpinned by volume and share gains from our Growth Brand Winston and our Specialist Brand Kool, offset by declines in our defocused Portfolio Brands. In addition, our mass market cigar business continues to perform well following last year's changes to our route to market.

In Returns Markets we achieved share increases in three of our most important markets, the UK, Germany and Australia, complemented by additional share gains in other markets including Poland and Portugal. We also delivered improved share trends in France and Spain.

COST OPTIMISATION AND CAPITAL DISCIPLINE: NINTH YEAR OF 10 PER CENT DIVIDEND GROWTH

Effective cost and cash management supports our strategy by improving efficiencies and releasing funds to fuel growth.

We made good progress with our two cost optimisation programmes. The first programme will deliver annual savings of £300 million from the end of the 2018 financial year. The second programme will deliver a further £300 million of savings from the September 2020 financial year.

In 2017 we realised total savings of £130 million through a range of initiatives that are reducing complexity and enhancing the way we operate.

Strong cash flow is a hallmark of our business and we use this cash to reward our shareholders, invest in the business and pay down debt.

Cash conversion remained strong at 91 per cent and we grew the dividend per share by 10 per cent for the ninth consecutive year.

In September we sold 13,275,000 shares in our European distribution business Logista, reducing our stake by 10 per cent to approximately 60 per cent of Logista's issued share capital. The sale raised around £220 million, which has been used to buy back shares in Imperial Brands and reduce net debt.

OUTLOOK: PRIORITISING VALUE CREATION OPPORTUNITIES

The execution of our strategy has resulted in a stronger and more focused portfolio and footprint, which we have invested behind to deliver improving share performances in priority markets. Central to this has been the embedding of our codified Market Repeatable Model, which provides a structured approach for generating sustainable quality growth.

We will build on this momentum in the coming year and will continue to take necessary actions to protect our investments and deliver quality revenue growth in tobacco.

We will also be further enhancing our presence in Next Generation Products. We have added to our innovation capabilities and will be launching new e-vapour products in new and existing markets, as we look to realise the significant growth opportunities that e-vapour offers.

As always, our focus on driving the performance of our brands and products will be supported by our diligent approach to cost, capital discipline and cash management.

In the context of a volatile industry environment and our continued commitment to investing behind our tobacco and next generation products businesses, we are targeting delivery of constant currency revenue and earnings per share growth within our medium-term guidance.

We have the strategy and people to succeed in a challenging and changing world and will continue to prioritise opportunities that sustainably create value for our shareholders.



ALISON COOPER
Chief Executive