"Our focus this year has been to drive improved market share in our priority markets while building the foundations for improved medium-term revenue growth. Our relentless focus on cost efficiencies and capital discipline has provided the resources to invest in this growth agenda, generate returns for shareholders and pay down debt."

OLIVER TANT
Chief Financial Officer

When managing the performance of our business we focus on non-GAAP measures, which we refer to as adjusted measures. We believe they provide a useful comparison of performance from one period to the next. These adjusted measures are supplementary to, and should not be regarded as a substitute for, GAAP measures, which we refer to as reported measures. The basis of our adjusted measures is explained in our accounting policies accompanying our financial statements, and reconciliations between reported and adjusted measures are included in the appropriate notes to our financial statements. Percentage growth figures for adjusted results are given on a constant currency basis, where the effects of exchange rate movements on the translation of the results of our overseas operations are removed.

SUPPORTING OUR SALES GROWTH AGENDA

This year has been defined by the significant £310 million investment we have put behind our Growth and Specialist Brands to drive better market share trajectories and improve revenue momentum. This increased investment, together with a tough trading environment, has impacted our revenue and profit delivery this year. The investment has strengthened our share position in most of our priority markets and enhanced our ability to deliver an improved top-line over the medium term.

Our financial discipline has led to strong improvements in our margin and cash generation in recent years, laying the foundations to fund this step-up in investment. We will continue to take action to protect and sustain these investments and in our plans for 2018 we will invest in excess of £300 million in Next Generation Products.

Our focus on core assets, cost efficiencies and cash generation is providing resources to reinvest to support growth and continue to generate returns for shareholders. We delivered our ninth consecutive year of 10 per cent dividend growth and further reduced adjusted debt by £0.8 billion.

IMPROVING SECOND HALF

Our investment strategy has resulted in an improved performance in the second half. Our volumes declined 4.1 per cent, outperforming the industry volume declines of 4.4 per cent; while our second half volumes declined only 2.6 per cent against industry volumes down 4.5 per cent. Market size declines were affected by new regulations, including EUTPD II, and increased excise in certain markets.

We achieved an improving price/mix during the year with second half price/mix of 2.6 per cent to deliver a 1.5 per cent improvement for the year. Tobacco net revenue was down 2.6 per cent at constant currency for the year reflecting our decision to invest behind our portfolio but reported an improved second half performance up 0.1 per cent on the previous year. We improved the quality of our revenue with the proportion of Group net revenue from our Growth and Specialist Brands increasing to now represent 62.7 per cent.

Tobacco adjusted operating profit decreased 2.4 per cent at constant currency reflecting our increased investment to improve sales growth and the impact of the tough trading environment. We mitigated these through increased cost control initiatives, including our cost optimisation programme and other non-operating income of £114 million. This includes £81 million from pension restructuring and £18 million curtailment gain from US post-retirement benefits.

GROUP RESULTS – CONSTANT CURRENCY ANALYSIS

£ million (unless otherwise indicated)	Year ended 30 September 2016	Foreign exchange	Constant currency movement	Year ended 30 September 2017	Change	Constant currency change
Tobacco Net Revenue						
Growth Markets	1,568	203	(3)	1,768	+12.8%	-0.2%
USA Market	1,477	184	4	1,665	+12.7%	+0.3%
Returns Markets North	2,645	222	(112)	2,755	+4.2%	4.2%
Returns Markets South	1,477	167	(75)	1,569	+6.2%	5.1%
Total Group	7,167	776	(186)	7,757	+8.2%	-2.6%
Tobacco Adjusted Operating Profit						
Growth Markets	443	44	(76)	411	-7.2%	-17.2%
USA Market	823	107	83	1,013	+23.1%	+10.1%
Returns Markets North	1,439	94	(48)	1,485	+3.2%	3.3%
Returns Markets South	655	70	(39)	686	+4.7%	6.0%
Total Group	3,360	315	(80)	3,595	+7.0%	-2.4%
Logistics						
Logistics distribution fees	809	95	10	914	+13.0%	+1.2%
Logistics adjusted operating profit	176	19	(14)	181	+2.8%	-8.0%
Group Adjusted Results						
Adjusted operating profit	3,541	332	(112)	3,761	+6.2%	-3.2%
Adjusted net finance costs	(524)	(57)	44	(537)	+2.5%	-8.4%
Adjusted EPS (pence)	249.6	22.9	(5.5)	267.0	+7.0%	-2.2%

GROUP EARNINGS PERFORMANCE

	Adjusted		Reported	
£ million unless otherwise indicated	2017	2016	2017	2016
Operating profit				
Tobacco	3,595	3,360	2,199	2,126
Logistics	181	176	94	98
Eliminations	(15)	5	(15)	5
Group operating profit	3,761	3,541	2,278	2,229
Net finance costs	(537)	(524)	(450)	(1,350)
Share of profit of investments accounted for using the equity method	33	28	33	28
Profit before tax	3,257	3,045	1,861	907
Tax	(651)	(609)	(414)	(238)
Profit for the period	2,606	2,436	1,447	669
Earnings per ordinary share (pence)	267.0	249.6	147.6	66.1

RECONCILIATION OF ADJUSTED PERFORMANCE MEASURES

	Operating profit		Net finance costs		Earnings per share (pence)	
£ million unless otherwise indicated	2017	2016	2017	2016	2017	2016
Reported	2,278	2,229	(450)	(1,350)	147.6	66.1
Amortisation of acquired intangibles	1,092	1,005	–	–	90.5	78.0
Fair value (gains)/losses on derivative financial instruments	–	–	(112)	807	(10.3)	76.2
Post-employment benefits net financing costs	–	–	25	19	1.9	1.3
Restructuring costs	391	307	–	–	28.3	23.9
Tax on unrecognised losses	–	–	–	–	11.0	5.9
Items above attributable to non-controlling interests	–	–	–	–	(2.0)	(1.8)
Adjusted	3,761	3,541	(537)	(524)	267.0	249.6

Logista reported adjusted operating profit of £181 million compared with £176 million last year, reflecting the benefit of foreign exchange movements. On a constant currency basis, adjusted operating profit fell 8.0 per cent as a result of the excise increases in France and Italy not being passed on by the tobacco manufacturers and a Spanish court ruling over pensioner free tobacco rights. These were partially offset with the benefit from the sale of shares in Banca ITB.

Adjusted net finance costs were higher at £537 million (2016: £524 million) reflecting the foreign currency impact of a higher euro and US dollar against the pound.

Reported net finance costs were £450 million (2016: £1,350 million), incorporating the impact of the net fair value and exchange gains on financial instruments of £112 million (2016: losses of £807 million) and post-employment benefits net financing costs of £25 million (2016: £19 million).

Our all in cost of debt remained at 3.9 per cent (2016: 3.9 per cent) as older debt maturing at higher rates was offset by higher USD floating interest rates. Our interest cover increased to 7.5 times (2016: 7.1 times). We remain fully compliant with all our banking covenants and remain committed to retaining our investment grade ratings.

After tax at an effective adjusted rate of 20.0 per cent (2016: 20.0 per cent), adjusted earnings per share grew by 7.0 per cent to 267.0 pence, a reduction of 2.2 per cent at constant currency. The effective reported tax rate is 22.2 per cent (2016: 26.2 per cent).

The effective tax rate is sensitive to the geographic mix of profits, reflecting a combination of higher rates in certain markets such as the USA and lower rates in other markets such as the UK. The rate is also sensitive to future legislative changes affecting international businesses such as changes arising from the OECD's (Organisation for Economic Co-operation and Development) Base Erosion Profit Shifting (BEPS) work.

Our Taxation Policy is publicly available and can be found in the Governance section of our corporate website – www.imperialbrandsplc.com.

Reported earnings per share were 147.6 pence (2016: 66.1 pence) reflecting non cash amortisation of £1,092 million (2016: £1,005 million) and restructuring costs of £391 million (2016: £307 million), as well as the effects of fair value and exchange losses in finance costs mentioned above. The difference between reported (147.6p) and adjusted earnings per share (267.0p) is materially due to the same three items.

The weakening of sterling versus the euro and US dollar positively impacted reported and adjusted measures. On a constant currency basis, adjusted earnings per share reduced by 2.2 per cent.

The restructuring charge for the year of £391 million (2016: £307 million) relates mainly to our cost optimisation programme announced in 2013 and 2016.

The total restructuring cash flow in the year ended 30 September 2017 was £201 million (2016: £268 million).

COST OPTIMISATION

We continue to simplify the business and optimise our manufacturing footprint and overhead base to realise operational efficiencies.

Phase 1 of our cost optimisation programme, announced in January 2013, is expected to deliver savings of £300 million per annum from September 2018 at a cash restructuring cost in the region of £600 million and Phase II, announced in November 2016, is expected to deliver a further £300 million of annual savings from September 2020, at a cash restructuring cost in the region of £750 million.

Through our continued focus on reducing product cost and overheads we realised cost savings of £130 million in 2017 (£50 million from Phase I and £80 million from Phase II) bringing the cumulative cost savings to £370 million (£290 million for Phase I and £80 million for Phase II).

The cash restructuring cost of Phase I of the programme was £42 million (2016: £123 million) and £132 million (£2016: nil) for Phase II, bringing the cumulative net cash cost of the programme to £610 million (Phase I £478 million, Phase II £132 million).

CAPITAL DISCIPLINE

All of our capital allocation decisions are subject to relevant commercial analysis and hurdle rates to ensure they deliver appropriate levels of return, and potential acquisitions are judged on strict financial and commercial criteria including the ability to enhance the Group's return on invested capital (ROIC). Our investment appraisal framework aims to closely align the risks and expected returns from capital allocation decisions, to ensure that investment is focused on delivering our strategic objectives whilst generating attractive returns.

We typically seek an overall internal rate of return in excess of 13 per cent across the investments we make in our existing business in order to support our investment choices and underpin returns for shareholders. Our ROIC measure increased this year to 14.3 per cent (2016: 13.9 per cent) assisted by our continued focus on capital discipline.

During the year we took the opportunity to realise value via a further sell-down of our Logista holding, and the proceeds have been used to repurchase shares and reduce debt, redeploying capital in an efficient manner.

CASH FLOW AND NET DEBT

The conversion of adjusted operating profit to operating cash flow remained strong at 91 per cent (2016: 95 per cent), rising to 96 per cent when restructuring cash flows are excluded. We achieved another year of working capital reduction and neutrality of net capex and depreciation. Principal financing cash flows in 2017 comprise the payment of the final dividend, interest payments, the repayment of a £450 million bond and $900 million term loans that were put in place to finance the US acquisition, the sale of Logista shares, which reduced our holding by 10 per cent of the share capital, and associated share buy-back.

Reported net debt and adjusted net debt have decreased by £0.8 billion and £0.7 billion respectively. The decrease in reported net debt represents a £0.8 billion debt reduction from our continued focus on capital discipline after reflecting the impact of the Group's share repurchases of £0.1 billion. Adjusted net debt decreased by £0.7 billion, reflecting reported net debt movements plus an adverse movement of £0.1 billion relating to the fair value of interest rate derivatives.

The denomination of our closing adjusted net debt was split approximately 57 per cent euro and 43 per cent US dollar. As at 30 September 2017, the Group had committed financing in place of around £15.7 billion. Some 21 per cent was bank facilities, and 79 per cent was raised through capital markets.

During the year the remaining bank facilities that were put in place specifically for the USA acquisition were repaid from free cash flow generation, and we issued a new capital markets bonds of €1 billion.

STRONG DIVIDEND GROWTH

Our continued strong cash flow generation has enabled a further £0.8 billion of debt reduction at constant currency, and delivered another year of 10 per cent growth in our dividend, demonstrating our commitment to growing shareholder returns. This is our ninth consecutive year of double digit dividend growth. Our dividend pay out ratio of 64 per cent remains one of the lowest among our tobacco peers.

The Group has paid two interim dividends of 25.85 pence per share each in June 2017 and September 2017, in line with our quarterly dividend payment policy to give shareholders a more regular cash return.

The Board has approved a further interim dividend of 59.51 pence per share and will propose a final dividend of 59.51 pence per share, bringing the total dividend for the year to 170.72 pence per share, up 10 per cent and in line with our policy of growing dividends by at least 10 per cent per year over the medium term.

The third interim dividend will be paid on 29 December 2017 with an ex dividend date of 16 November 2017. Subject to AGM approval, the proposed final dividend will be paid on 29 March 2018, with an ex-dividend date of 22 February 2018.

LIQUIDITY AND GOING CONCERN

The Group's policy is to ensure that we always have sufficient capital markets funding and committed bank facilities in place to meet foreseeable peak borrowing requirements.

In reviewing the Group's committed funding and liquidity positions, the Board considered various sensitivity analyses when assessing the forecast funding and headroom requirements of the Group in the context of the maturity profile of the Group's facilities. The Group plans its financing in a structured and proactive manner and remains confident that sources of financing will be available when required.

Based on its review, and having assessed the principal risks facing the Group, the Board is of the opinion that the Group as a whole and Imperial Brands PLC have adequate resources to meet operational needs for a period of at least 12 months from the date of this Report and concludes that it is appropriate to prepare the financial statements on a going concern basis.

The Board's statement on its assessment of longer-term viability is set out on page 28.

OLIVER TANT
Chief Financial Officer