DELIVERING SHAREHOLDER RETURNS

"A strong cost and capital discipline is at the heart of all our activities. This is providing the resources to invest in our growth agenda in both tobacco and NGP, 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 an important 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.

STRONG FINANCIAL DELIVERY

This year's results demonstrate the benefit of our investment in tobacco & NGP.

In 2017 we invested an additional £310 million in Growth and Specialist Brands to improve market share and net revenue performance. The investment has strengthened our share position in many of our priority markets and enhanced our ability to deliver an improved top-line over the medium term.

This year we further increased investment in our NGP business to support the roll-out of *my*blu in new and existing markets, resulting in accelerated net revenue growth.

A strong cost and capital discipline is central to everything we do and has delivered improvements in our margin and cash generation in recent years. We have also created the headroom to invest in both tobacco and NGP, pay down debt and generate growing returns for shareholders.

This year we grew the dividend by 10 per cent for the tenth consecutive year and further reduced adjusted debt by £0.8 billion at constant currency.

BUILDING GROWTH MOMENTUM

Our performance continues to benefit from the investment we have made and we are in a strong position to generate further growth.

Tobacco volumes fell 3.6 per cent, outperforming industry volume declines of 5.0 per cent. This was driven by our Growth Brands, which achieved share gains of 70 basis points.

Price/mix improved by 5.7 per cent in the year, benefitting from a second half price/mix increase of 11 per cent. This is reflected in our net revenue growth, up 2.1 per cent, following a 6 per cent increase in the second half.

Net revenue grew 2.1 per cent driven by both tobacco and NGP. We improved the quality of our growth, with the proportion of Group net revenue from Growth and Specialist Brands increasing by 420 basis points to 66.9 per cent.

Group adjusted operating profit increased 2.9 per cent at constant currency. However, on an underlying basis, Group adjusted operating profit grew 5.9 per cent, after excluding the increased investment in NGP (£44 million), adverse transaction foreign exchange (£34 million) and the reduction in other gains included in operating profit (£34 million). Other gains of £80 million (2017: £114 million) consisted of £40 million of profit on disposal of other tobacco products in the USA and £40 million from property sales in the UK.

Group adjusted operating profit consists of tobacco & NGP adjusted operating profit which grew 1.9 per cent at constant currency and the adjusted operating profit of Logista of £212 million (2017: £181 million). This 15.5 per cent increase at constant currency reflects improved trading in tobacco, the development of their non-tobacco business and a continued focus on cost efficiencies.

Reported operating profit increased 5.7 per cent at actual exchange rates to £2,407 million, reflecting the increased adjusted operating profit and lower restructuring charges.

GROUP RESULTS – CONSTANT CURRENCY ANALYSIS

£ million (unless otherwise indicated)	Year ended 30 September 2017	Foreign exchange	Constant currency movement	Year ended 30 September 2018	Change	Constant currency change
Tobacco & NGP Net Revenue						
Growth Markets	1,768	(72)	99	1,795	+1.5%	+5.6%
USA Market	1,665	(105)	111	1,671	+0.4%	+6.7%
Returns Markets North	2,755	(18)	12	2,749	-0.2%	+0.4%
Returns Markets South	1,569	4	(58)	1,515	-3.4%	-3.7%
Total Group	7,757	(191)	164	7,730	-0.3%	+2.1%
Tobacco & NGP Adjusted Operating Profit						
Growth Markets	411	(29)	(18)	364	-11.4%	-4.4%
USA Market	1,013	(69)	96	1,040	+2.7%	+9.5%
Returns Markets North	1,485	(13)	35	1,507	+1.5%	+2.4%
Returns Markets South	686	4	(44)	646	-5.8%	-6.4%
Total Group	3,595	(107)	69	3,557	-1.1%	+1.9%
Distribution						
Distribution fees	914	15	60	989	+8.2%	+6.6%
Adjusted operating profit	181	3	28	212	+17.3%	+15.5%
Group Adjusted Results						
Adjusted operating profit	3,761	(104)	109	3,766	+0.1%	+2.9%
Adjusted net finance costs	537	(93)	43	487	-9.1%	-8.0%
Adjusted EPS (pence)	267.0	(8.2)	13.4	272.2	+1.9%	+5.0%

GROUP EARNINGS PERFORMANCE

	Adjusted		Reported	
£ million unless otherwise indicated	2018	2017	2018	2017
Operating profit				
Tobacco & NGP	3,557	3,595	2,282	2,199
Distribution	212	181	128	94
Eliminations	(3)	(15)	(3)	(15)
Group operating profit	3,766	3,761	2,407	2,278
Net finance costs	(487)	(537)	(626)	(450)
Share of profit of investments accounted for using the equity method	42	33	42	33
Profit before tax	3,321	3,257	1,823	1,861
Tax	(648)	(651)	(396)	(414)
Profit for the period	2,673	2,606	1,427	1,447
Earnings per ordinary share (pence)	272.2	267.0	143.6	147.6

RECONCILIATION OF ADJUSTED PERFORMANCE MEASURES

	Operating profit		Net finance costs		Earnings per share (pence)	
£ million unless otherwise indicated	2018	2017	2018	2017	2018	2017
Reported	2,407	2,278	(626)	(450)	143.6	147.6
Amortisation of acquired intangibles	1,053	1,092	–	–	90.0	90.5
Administration of UK distributor	110	–	–	–	9.3	–
Fair value losses/(gains) on derivative financial instruments	–	–	126	(112)	10.9	(10.3)
Post-employment benefits net financing costs	–	–	13	25	0.8	1.9
Restructuring costs	196	391	–	–	14.9	28.3
Deferred tax impact of US tax reforms	–	–	–	–	(3.0)	–
Tax on unrecognised losses	–	–	–	–	8.0	11.0
Items above attributable to non-controlling interests	–	–	–	–	(2.3)	(2.0)
Adjusted	3,766	3,761	(487)	(537)	272.2	267.0

Adjusted net finance costs were lower at £487 million (2017: £537 million). This is primarily due to our management of the debt portfolio ahead of expected proceeds from divestments, in addition to lower underlying debt levels.

Reported net finance costs were £626 million (2017: £450 million), incorporating the impact of the net fair value and exchange losses on financial instruments of £126 million (2017: gains of £112 million) and post-employment benefits net financing costs of £13 million (2017: £25 million).

Our all-in cost of debt decreased to 3.7 per cent (2017: 3.9 per cent) due to our management of the debt portfolio ahead of expected proceeds from divestments. Our interest cover increased to 8.2 times (2017: 7.5 times). We remain fully compliant with all our banking covenants and remain committed to retaining our investment grade ratings.

Our effective adjusted tax rate was 19.5 per cent (2017: 20.0 per cent) and the effective reported tax rate is 21.7 per cent (2017: 22.2 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

Adjusted earnings per share were 272.2 pence (2017: 267.0 pence), up 5.0 per cent at constant currency (up 1.9 per cent at actual rates), reflecting increased operating profit and lower tax and interest charges. Reported earnings per share was 143.6 pence (2017: 147.6 pence) down 2.7 per cent, driven primarily by the administration of the UK distributor Palmer & Harvey of £110 million (2017: nil) and by the effects of fair value and exchange losses in finance costs of £126 million (2017: £112 million gain). The reported earnings per share is lower than adjusted due to the two impacts mentioned above as well as the amortisation of acquired intangibles of £1,053 million (2017: £1,092 million) and restructuring costs of £196 million (2017: £391 million).

The strengthening of sterling versus the US dollar has negatively impacted reported and adjusted measures, partly offset by the weakening of sterling against the euro. On a constant currency basis, adjusted earnings per share increased by 5 per cent.

The restructuring charge for the year of £196 million (2017: £391 million) relates mainly to our cost optimisation programmes announced in 2013 and 2016. The total restructuring cash flow in the year ended 30 September 2018 was £241 million (2017: £201 million).

COST OPTIMISATION

We continue to optimise our manufacturing footprint and overheads to realise operational efficiencies.

Our five year cost optimisation programme announced in January 2013 has delivered savings of £300 million per annum from September 2018 at a cash restructuring cost of around £600 million. The additional cost programme we 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 £110 million in 2018 (£10 million from the first cost programme and £100 million from the second) bringing the cumulative cost savings to £480 million (£300 million for the first and £180 million for the second).

The cash restructuring cost of the first programme was £43 million (2017: £42 million) and £173 million (2017: £132 million) for the second, bringing the cumulative net cash cost to £826 million (£521 million for the first and £305 million for the second).

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. 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 investment is focused on delivering our strategic objectives whilst generating attractive returns.

NGP investment will initially be subject to a different set of investment thresholds as we look to grow market size and share.

We typically seek an overall internal rate of return in excess of 13 per cent across the investments we make in order to support our investment choices and underpin returns for shareholders. Our ROIC measure is in line with last year at 14.2 per cent (2017: 14.3 per cent) despite our increased investments. This was assisted by our capital light approach to NGP and 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 sale of UK properties. The proceeds were used to reduce debt.

PALMER & HARVEY

The UK distributor, Palmer & Harvey, went into administration in November 2017 and we reported an expected one-off impact on Group operating profit of £160 million.

Since its collapse, we have been working closely with the administrators, and have reduced the impact to £110 million, the majority of which still relates to non-recoverable excise duty.

CASH FLOW AND NET DEBT

The conversion of adjusted operating profit to operating cash flow remained strong at 97 per cent (2017: 96 per cent). Movements in working capital were broadly flat compared to the prior year, and there was a slight increase in capital expenditure relative to depreciation to support our growth agenda. Principal financing cash flows in 2018 comprise the payment of the final dividend, interest payments, the repayment of $1.75 billion and €850 million bonds, and the sale of Logista shares which reduced our holding by 9.99 per cent of the share capital.

Reported net debt and adjusted net debt decreased by £0.6 billion and £0.7 billion respectively, in line with our continued focus on capital discipline. The decrease in adjusted net debt reflects an underlying cash flow of £0.8 billion, offset by £0.1 billion of adverse fair valuations of interest rate derivatives.

The denomination of our closing adjusted net debt was split approximately 68 per cent euro and 32 per cent US dollar. As at 30 September 2018, the Group had committed financing in place of around £16.1 billion, which comprised 25 per cent bank facilities and 75 per cent raised from capital markets in the form of bonds and commercial paper. During the year, approximately £1 billion bilateral revolving credit facilities were put in place with minimum tenors of two years to provide flexibility in the Group's financing structure, whilst opportunities associated with the Group's capital allocation programme are considered and finalised.

STRONG DIVIDEND GROWTH

Our continued strong cash flow generation enabled a further £0.8 billion debt reduction at constant currency and delivered another year of 10 per cent dividend growth.

The Group has paid two interim dividends totalling 56.87 pence per share in June 2018 and September 2018, 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 65.46 pence per share and will propose a final dividend of 65.46 pence per share, bringing the total dividend for the year to 187.79 pence per share.

The third interim dividend will be paid on 31 December 2018 with an ex-dividend date of 22 November 2018. Subject to AGM approval, the proposed final dividend will be paid on 29 March 2019, with an ex-dividend date of 21 February 2019.

BREXIT

The Group has looked into potential Brexit impacts under a number of different scenarios: soft, hard and no deal.

The key risks that have been identified include: potential increase in import duties and impact on UK customers; additional risk of tobacco smuggling; inventory requirements to ensure supply; impact on consumer confidence; and implications on existing international tax treaties.

NEW SEGMENTAL REPORTING AND ACCOUNTING STANDARDS

From 1 October 2018 we have decided to re-organise the management of our business on a geographic basis to reflect the growth opportunities NGP offers across our footprint.

Our financial reporting will be split into four areas: Europe, Americas and Africa, Asia & Australasia plus Distribution. Similarly, our tobacco business has been re-named Tobacco & NGP.

From 1 October 2018, we will also adopt two new accounting standards, IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from Contracts with Customers".

Analysis of IFRS 15 has refined our judgement as to the treatment of MSA payments which currently net off against revenue. Going forwards MSA payments will be taken to other cost of sales. The impacts of adopting these standards and change in judgements are disclosed in Note 1 of the Accounting Policies.

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 funding arrangements. 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 29.

OLIVER TANT
Chief Financial Officer