



“Our tobacco business continued to generate modest growth, with Next Generation Products adding to our revenue delivery.”

ALISON COOPER

Chief Executive

We have remained focused on driving the performance of our tobacco business, while expanding our Next Generation Products (NGP) operations. We achieved success in a number of areas, including further revenue and profit growth in tobacco and year-on-year NGP net revenue growth.

However, our overall Group results have fallen short of our expectations, impacted by two main factors: a challenging vapour market, particularly in the USA, and lower than anticipated profit delivery in our Africa, Asia and Australasia (AAA) division.

We are taking action to drive a better performance in 2020, which will strengthen our ability to create long-term value for our stakeholders.

RESILIENT TOBACCO RESULTS

We have a robust tobacco value creation model with a long track record of financial delivery, with pricing more than offsetting cigarette volume declines to deliver growing revenues. We expect this to continue in the years ahead and remain focused on maximising opportunities for our Asset Brands in our priority markets.

Our Market Repeatable Model provides a structured framework for driving quality tobacco growth and is consistently applied across our footprint.

The resilience of our tobacco business was demonstrated with the good performances we delivered in Europe and the Americas, which more than offset tough trading conditions in the AAA division.

We achieved share growth in six of our 10 priority markets, including in the USA where our focused portfolio strategy delivered gains in cigarette and mass market cigars and strong financial results.

In our Europe division we continue to balance market share progression with financial delivery, generating good financial contributions from a number of our priority markets including Germany, the UK and Italy.

Our share performance was good in the AAA division, with gains in our priority markets of Australia, Japan and Russia, although our revenue and profit were lower.

Asset Brands accounted for 65.9 per cent of our tobacco and NGP net revenue, up 120 basis points on last year.

NEXT GENERATION PRODUCTS

Our focus on transitioning adult smokers to potentially less harmful alternatives to cigarettes is aligned to our purpose: to create something better for the world's smokers.

We want to see more smokers choosing products with lower health risks and encourage them to make that change by providing a portfolio of high-quality vapour, heated tobacco and oral nicotine products, all underpinned by leading-edge science.

Overall net revenue of our NGP business grew by 48 per cent this year, led by the growth of our vapour brand blu in Europe, where we have established leading retail positions, and Japan. We also made good progress with the roll-out of other NGP, including a successful city pilot of our heated tobacco product Pulze in Japan and the launch of oral nicotine products in several European markets.

However, we did not make as much progress with blu in the USA and Europe as we anticipated. Our own performance fell below expectations and was also impacted by deteriorating trading conditions, increasing competitor activity and the slower than anticipated growth of the vapour category.

The situation was compounded in the USA, where an increasingly volatile regulatory environment coincided with a significant step-up in our retail engagement programmes, brand investment and consumer promotions. Although this activity delivered share gains, overall blu growth was below the level we had planned for.

The volatility in the USA and the broader learnings we have gained have led to a reprioritisation of our investment plans. In 2020, we are instilling a sharper focus on the category and market combinations that offer the greatest opportunities for sustainable, profitable growth. We have clear plans to deliver a more differentiated blu consumer experience in the coming year, coupled with a fresh brand approach that builds a stronger emotional connection with adult smokers.

We are also stepping up our regulatory engagement activities to encourage higher product and marketing standards, which are critical for creating a stable and orderly vapour market that we can invest behind.

PRIORITISING RESPONSIBILITIES

Our commitment to sustainability is central to the long-term development of the business, ensuring that we maintain a sustainable supply of tobacco, develop a pipeline of Next Generation Products and operate responsibly at all times. These three focus areas define the approach we take to addressing our environmental, social and governance (ESG) responsibilities.

During the year we convened an independently facilitated panel of stakeholders, including an investor, a consumer, an employee, suppliers and representatives from non-governmental organisations, to review these responsibilities and help shape the way we manage them.

We have prioritised our ESG issues to reflect the panel's feedback and going forward we will provide more information on how we are fulfilling our responsibilities in each of these five areas. We have also taken on board a number of other suggestions and have formally responded to the panel's key comments in a report, which has been published in full on our corporate website.

Overall, our stakeholders feel we are making good progress in delivering against our sustainability agenda and did not identify any additional ESG issues we should be addressing. The panel also approved of the way we have aligned our ESG responsibilities with the UN Sustainable Development Goals.

This was an extremely valuable engagement exercise for Imperial and we are grateful to everyone who took part.



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The panel was invited to prioritise the most important ESG issues facing Imperial and ranked the top five as follows:

1

CONSUMER HEALTH

This was considered pivotal to the sustainability of Imperial as a successful commercial business. The panel felt every effort must be made to produce products that are potentially less harmful to health than tobacco.

2

CLIMATE AND ENERGY

Given the growing global concern for climate change and Imperial's global reach and influence, the panel felt that climate and energy impacted Imperial across its value chain, from crop production to manufacturing and distribution.

3

FARMER LIVELIHOODS AND WELFARE

The panel agreed that farmer livelihoods and welfare was of paramount importance to tobacco production and that the work being done to support farmer livelihoods was vital for providing farming communities with better incomes and higher standards of living, thereby reducing the risk of poverty and child labour.

4

HUMAN RIGHTS

Given the global scale of the business, it was recognised that Imperial has the potential to impact on the communities in which it operates. Tackling child labour in tobacco growing and addressing instances of modern slavery were seen as key priorities.

5

WASTE

This was considered to have a huge environmental impact and the panel challenged Imperial to explore how it can better support consumers to recycle by reducing packaging, particularly in relation to NGP. Imperial's ambition should be to produce NGP that consist entirely of recyclable components.

In addition, in the USA we are focused on finalising our premarket tobacco product application (PMTA) for blu, which will be submitted to the Food and Drug Administration before the May 2020 deadline.

We still view NGP as a significant additive growth opportunity for Imperial and the actions we are taking are strengthening the foundations of our NGP business, which in the coming year will see a brand refresh for blu and expanding availability of our heated tobacco and oral nicotine products.

AUXLY CANNABIS GROUP INC.

In July we announced we were diversifying our NGP portfolio through a research and development partnership with Auxly Cannabis Group Inc., a listed Canadian cannabis company. This provides further options for future growth and builds on the investment we made in Oxford Cannabinoid Technologies last year.

The transaction was completed in September, ahead of the further liberalisation of cannabis regulation in Canada in October 2019. At this time, the sale of derivative products, such as cannabis edibles, extracts and topicals, will be legally permitted.

As part of the deal we have granted Auxly global licences to our vaping technology and access to our innovation business, Nerudia.

COST AND CASH MANAGEMENT

Optimising cost and cash opportunities is a core element of our strategy, enabling us to improve efficiencies and release funds for investment.

Our commitment to capital discipline underpins our focus on cash generation and the effective management of our working capital.

We increased NGP investment considerably during the year but given the current state of the vapour market we are now refining our approach for 2020. We will invest selectively to support growth, prioritising blu sales in key markets and widening distribution of Pulze and our oral nicotine offerings.

We made good progress with our cost optimisation programme, realising £55 million of annualised savings in the year. The programme will deliver £300 million of savings a year from our 2020 financial year.

Cash conversion remained strong at 95 per cent and we grew the dividend per share by 10 per cent.

Following a revision of our dividend policy announced by the Board in July, dividend growth will be progressive, increasing annually from its current level, taking into account underlying business performance.

CREATING ADDITIONAL VALUE

In sharpening our focus on the brands, products and markets that are essential to our long-term success, we have identified assets that are less central to our growth ambitions.

We are exiting or divesting these assets, including our premium cigar business, to create further value for our shareholders and to simplify the structure of the business, creating a leaner, more agile organisation.

Over the past two years we have advanced other divestment opportunities but chose not to conclude them, largely due to a deterioration in tobacco valuations. These opportunities will be kept under review but further divestments will only be progressed if they will realise appropriate value.

OUTLOOK

Tobacco will continue to be resilient, delivering modest revenue growth, high margins and strong cash flows, while our NGP business provides opportunities for additional revenue growth, with its strong growth prospects contributing to margins and cash returns over the medium term.

We remain focused on managing the operational and regulatory challenges associated with a rapidly evolving NGP category, including active regulatory engagement for higher product and marketing standards for vapour.

Given the increased uncertainties in NGP, we have reduced and reprioritised our NGP investment behind the markets and categories with the best prospects for sustainable and scalable growth and will focus on delivering a stronger performance in the coming year.

We have taken a more cautious approach to our outlook for 2020, with low single digit revenue and earnings per share growth expected, excluding any impact from the divestment programme. Performance is expected to be weighted to the second half as the benefit of our NGP investment reset takes effect through the year.

Our revised capital allocation policy supports a progressive dividend, which will grow annually taking into account underlying business performance.

Towards the end of the year, it was announced that I and the Board had agreed that after nine years as Chief Executive, I would step down once a suitable successor is found.

It has been a privilege to be CEO of this business and to have worked with such great people. I remain committed to leading Imperial during the succession process and would like to thank employees around the world for all their hard work and support over the years.



ALISON COOPER

Chief Executive