> "We will further optimise our cost base and capital discipline to prioritise investment more effectively and deliver growing returns."

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 better 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.

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.

We have committed to change our financial disclosure with a view to further simplifying the adjusted performance measures. Details of these plans are set out later in this statement.

PERFORMANCE OVERVIEW

Our tobacco business produced a resilient performance in the USA and Europe, offsetting difficult environments in our Africa, Asia and Australasia (AAA) division. We continue to prioritise Asset Brands performance in our priority markets, which has delivered further growth in tobacco net revenue and adjusted operating profit.

Our vapour brand blu has now been launched in 16 markets, establishing leading positions in some of the key European territories. We also successfully launched our first heated tobacco product Pulze in Japan and made good progress in expanding the availability of our oral nicotine offerings.

Increasing competition and regulatory uncertainty over vapour in the USA and a slowdown in Europe in the second half impacted on our overall Next Generation Products (NGP) delivery. We decided to step up investment to build blu brand awareness and address an increased level of consumer promotion in certain markets, which delivered improved share towards the end of the year but did not translate into the increased sales we had expected.

We diversified our NGP portfolio with an investment in Auxly Cannabis Group Inc. which will accelerate the delivery of Auxly's business plan and the launch of derivative products after regulatory change to the Canadian cannabis market in October 2019.

ACTIVE CAPITAL DISCIPLINE

Our focus on cost and capital discipline saw adjusted operating cash conversion at 95 per cent. In July we began a share buyback programme that will purchase £200 million shares by the end of the 2019 calendar year, of which £108 million had been completed in the financial year.

We continued to progress divestments of assets that are not central to our growth plans and announced that our premium cigar business would be sold as part of the programme.

2019 will be the eleventh year of 10 per cent dividend growth. Our revised capital allocation and shareholder distributions policy is effective from our 2020 financial year and will grow the dividend progressively, considering the underlying performance of the business to provide greater flexibility in our capital allocation.

RESILIENT TOBACCO AND ADDITIVE NGP GROWTH

Tobacco volumes fell 4.4 per cent, broadly in line with market dynamics and we delivered share growth in six of our 10 priority markets.

Tobacco price/mix was 5.5 per cent, with gains in several priority markets driving tobacco net revenue growth of 1.1 per cent at constant currency. NGP revenue grew 48 per cent at constant currency, supporting Group net revenue up 2.2 per cent at constant currency.

Group adjusted operating profit fell by 2.4 per cent at constant currency. This decline was driven primarily by increased NGP investment including higher advertising and promotion spend and overheads as well as the impact of provisions for slow-moving NGP inventory of £34 million and NGP supply chain contract termination costs of £20 million. This more than offset growth in tobacco adjusted operating profit. Other gains of £10 million from Auxly were also lower (2018: £80 million). Further inventory provisions may occur if regulatory changes, such as a potential US flavour ban were to come into force that limit the ability to sell product.

On a reported basis, Group operating profit declined 8.7 per cent driven by a goodwill impairment and associated costs of disposal of the Premium Cigar Division of £525 million, a provision for Russian excise taxes of £139 million, a fair value adjustment of acquisition consideration for Von Erl of £129 million, which has subsequently been settled in October, partly offset by reduced restructuring costs of £144 million (2018: £196 million) and the prior year impact from the administration of Palmer & Harvey of £110 million. For further details see notes 3, 8 and 11 to the financial statements.

GROUP RESULTS – CONSTANT CURRENCY ANALYSIS

£ million (unless otherwise indicated)	Year ended 30 September 2018	Foreign exchange	Constant currency movement	Year ended 30 September 2019	Change	Constant currency change
Tobacco & NGP Net Revenue						
Europe	3,523	(15)	128	3,636	+3.2%	+3.6%
Americas	2,248	128	96	2,472	+10.0%	+4.3%
Africa, Asia and Australasia	1,926	19	(55)	1,890	-1.9%	-2.9%
Total Group	7,697	132	169	7,998	+3.9%	+2.2%
Tobacco & NGP Adjusted Operating Profit						
Europe	1,701	4	(6)	1,699	-0.1%	-0.3%
Americas	1,036	59	(27)	1,068	3.1%	-2.6%
Africa, Asia and Australasia	820	11	(67)	764	-6.8%	-8.1%
Total Group	3,557	74	(100)	3,531	-0.7%	-2.8%
Distribution						
Distribution fees	989	(1)	27	1,015	+2.6%	+2.7%
Adjusted operating profit	212	(1)	21	232	+9.4%	+9.9%
Group Adjusted Results						
Adjusted operating profit	3,766	73	(91)	3,749	-0.5%	-2.4%
Adjusted net finance costs	(487)	(8)	46	(450)	-7.8%	-9.4%
Adjusted EPS (pence)	272.2	5.5	(4.4)	273.3	+0.4%	-1.6%

2018 revenue restated following adoption of IFRS 15.

GROUP EARNINGS PERFORMANCE

	Adjusted		Reported	
£ million unless otherwise indicated	2019	2018	2019	2018
Operating profit				
Tobacco & NGP	3,531	3,557	2,074	2,282
Distribution	232	212	137	128
Eliminations	(14)	(3)	(14)	(3)
Group operating profit	3,749	3,766	2,197	2,407
Net finance costs	(450)	(487)	(562)	(626)
Share of profit of investments accounted for using the equity method	55	42	55	42
Profit before tax	3,354	3,321	1,690	1,823
Tax	(642)	(648)	(609)	(396)
Profit for the year	2,712	2,673	1,081	1,427
Earnings per ordinary share (pence)	273.3	272.2	106.0	143.6

RECONCILIATION OF ADJUSTED PERFORMANCE MEASURES

	Operating profit		Net finance costs		Earnings per share (pence)	
£ million unless otherwise indicated	2019	2018	2019	2018	2019	2018
Reported	2,197	2,407	(562)	(626)	106.0	143.6
Acquisition and disposal costs	22	–	–	–	2.3	–
Amortisation & impairment of acquired intangibles	1,118	1,053	–	–	116.4	90.0
Excise tax provision	139	–	–	–	13.0	–
Administration of UK distributor	–	110	–	–	–	9.3
Fair value adjustment of acquisition consideration	129	–	–	–	13.5	–
Fair value and exchange movements on derivative financial instruments	–	–	107	126	8.0	10.9
Post-employment benefits net financing costs	–	–	5	13	0.1	0.8
Restructuring costs	144	196	–	–	11.4	14.9
Tax on unrecognised losses	–	–	–	–	–	(3.0)
Deferred tax impact of US tax reforms	–	–	–	–	6.4	8.0
Items above attributable to non-controlling interests	–	–	–	–	(3.8)	(2.3)
Adjusted	3,749	3,766	(450)	(487)	273.3	272.2

The increase in the amortisation and impairment of acquired intangibles is driven primarily by a goodwill impairment and associated costs of disposal of £525 million relating to the Premium Cigar Division, which is now treated as an asset held for sale with net assets of £1.1 billion. It is expected that on completion of the divestment cumulative foreign exchange gains of approximately £300 million to £400 million that have been recognised in reserves will be recycled to the income statement.

The restructuring charge for the year of £144 million (2018: £196 million) relates mainly to our cost optimisation programmes announced in 2013 and 2016. The total restructuring cash flow in the year ended 30 September 2019 was £146 million (2018: £241 million).

Adjusted net finance costs were lower at £450 million (2018: £487 million). This is primarily due to our active management of the debt portfolio to align with our strategic disposal initiatives. Reported net finance costs were £562 million (2018: £626 million), incorporating the impact of the net fair value and exchange losses on financial instruments of £107 million (2018: losses of £126 million) and post-employment benefits net financing costs of £5 million (2018: £13 million).

Our all-in cost of debt decreased to 3.6 per cent (2018: 3.7 per cent) as we continue to optimise our debt portfolio. Our interest cover increased to 8.8 times (2018: 8.2 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 19.1 per cent (2018: 19.5 per cent) and the effective reported tax rate is 36.1 per cent (2018: 21.7 per cent). The slight reduction in the effective adjusted tax rate was due to a more favourable profit mix. The adjusted tax rate is lower than the reported rate due to a number of adjusting items having no or limited associated tax, with a larger quantum of such items in the current year causing the increase in the reported tax rate compared with 2018.

We expect our effective adjusted tax rate for the year ended 30 September 2020 to be around 21 per cent. The increase in rate is due to legislative changes in several jurisdictions and the expiry of certain tax agreements.

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. Whilst we seek to mitigate the impact of these changes, we anticipate there will be further upward pressure on the adjusted and reported tax rate in the medium term. Our UK Tax Strategy is publicly available and can be found in the Governance section of our corporate website.

Adjusted earnings per share were 273.3 pence (2018: 272.2 pence), down 1.6 per cent at constant currency (up 0.4 per cent at actual rates), reflecting continued operating profit growth from tobacco, more than offset by increased investment in our NGP business, the impact of NGP inventory provisions of £34 million and NGP supply chain contract termination costs of £20 million, following the slowdown in sales growth in the second half and lower non-operating income compared to 2018.

Reported earnings per share was 106.0 pence (2018: 143.6 pence) down 26.2 per cent, mainly impacted by reported operating profit. The weakening of sterling versus the US dollar positively impacted our revenue and earnings by around 2 per cent.

COST OPTIMISATION

We optimise our cost base to realise operational efficiencies. Our first optimisation programme announced in January 2013 delivered savings of £305 million per annum from September 2018 at a cash restructuring cost of around £600 million. This first programme has now concluded although there remain some cash costs. The second cost programme, announced in November 2016, is expected to deliver a further £300 million of annual savings from September 2020, at a cash restructuring cost of c.£750 million.

A continued focus on reducing product cost and overheads realised cost savings of £55 million in 2019, all arising from the second programme. This brings the cumulative cost savings from both programmes to £545 million (£305 million from the first and £240 million from the second).

Cash restructuring costs in the year from the first programme were £24 million (2018: £43 million) and £108 million (2018: £173 million) for the second, bringing the cumulative net cash cost of the two programmes to £958 million (£545 million for the first and £413 million for the second).

CAPITAL ALLOCATION

Capital discipline is a key objective, with commercial analysis and hurdle rates underpinning returns. However, it is clear from these results that we did not deliver the expected returns from our significant step-up in NGP investment. As a result, we are now focusing investment more tightly around the brand and market combinations that will build a sustainable, profitable NGP business. We are also implementing a more dynamic investment model for NGP with clear finance guardrails that allows us to actively manage investment levels to support returns.

Potential acquisitions are judged on strict financial and commercial criteria including the ability to enhance the Group's return on invested capital (ROIC) over time. We may also make measured investments in growth adjacencies, such as cannabis, to support longer term growth and return opportunities, notwithstanding they may have lower return characteristics in the short term.

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 slightly ahead of last year at 14.4 per cent (2018: 14.2 per cent) despite our increased investments.

CASH FLOW AND NET DEBT

The conversion of adjusted operating profit to operating cash flow remained strong at 95 per cent (2018: 97 per cent). Movements in working capital were broadly flat compared to the prior year, supported by a c.£200 million working capital benefit (+5 per cent at constant currency) from a duty legislation change in Australia, which saw higher stocks more than offset by higher duty payable, a position that will unwind in 2020. This benefit was partly offset by higher working capital as a consequence of the step-up in NGP, the timing of tobacco stock builds across the Group and increasing debtors as global tobacco prices and duty rates increase. Capital expenditure increased as we stepped up investment in our NGP capabilities. Restructuring cash costs decreased due to the first cost optimisation programme ending in 2018.

Reported net debt increased by £0.1 billion to £12.0 billion and adjusted net debt decreased by £0.1 billion at actual rates, driven by a £0.2 billion movement in foreign exchange rates and the fair value of interest rate derivatives. The denomination of our closing adjusted net debt was split approximately 74 per cent euro and 26 per cent US dollar. As at 30 September 2019, the Group had committed financing in place of around £16.9 billion, which comprised 20 per cent bank facilities and 80 per cent raised from capital markets. Following the capital markets issuance during the year, approximately £780 million bilateral revolving credit facilities were no longer required and subsequently cancelled.

DIVIDEND GROWTH

The Group has paid two interim dividends totalling 62.56 pence per share in June 2019 and September 2019, in line with our quarterly dividend payment policy to give shareholders a more regular cash return.

The Board approved a further interim dividend of 72.00 pence per share and will propose a final dividend of 72.01 pence per share, bringing the total dividend for the year to 206.57 pence per share. The third interim dividend will be paid on 31 December 2019 with an ex-dividend date of 21 November 2019. Subject to AGM approval, the proposed final dividend will be paid on 31 March 2020, with an ex-dividend date of 20 February 2020.

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. In the event of a no deal Brexit, we estimate there could be additional costs of around £100 million relating to the restructuring of the Group for tax purposes.

NEW SEGMENTS AND ACCOUNTING STANDARDS

On 1 October 2018 we re-organised the tobacco and NGP business to manage our footprint based on geographic proximity changing from the previous approach to grouping markets based on their growth and returns profiles.

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

We also adopted two new accounting standards, IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from Contracts with Customers" on the same date. Implementation of IFRS 15 has resulted in changes to the treatment of customer discounts in revenue and to Master Settlement Agreement (MSA) payments, which were previously netted off against revenue. MSA payments are now taken to other cost of sales. On 1 October 2019 we will adopt the new accounting standard IFRS 16 "Leases". The impacts of adopting these standards are disclosed in Note 1 of the Accounting Policies.

ADJUSTED PERFORMANCE MEASURES

In managing the business, we focus on adjusted performance measures as we believe they provide a better comparison of performance from one period to the next.

Although we remain comfortable that our adjusted performance measures remain appropriate for the current year, we have decided to refine our approach by focusing more tightly on the performance drivers of our core activities of the manufacture, sales and marketing of tobacco and NGP. The changes will be implemented in 2020 to ensure the 2019 results are reported in line with previous external guidance. The key changes will be to exclude one-off gains from asset disposals and other non-recurring activities that do not relate directly to the core activities. In 2019, these gains related to our investment in Auxly and amounted to £10 million. We will continue to treat restructuring costs as an adjusting item through to the conclusion of the second cost optimisation programme in 2020. Thereafter we will review treatment in the light of any further restructuring requirement.

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.

Should the Group's planned disposal of its premium cigar division not materialise during the next financial year, the Group would look to finance its medium-term working capital and investment requirements through new debt issuances in accordance with its usual practice of managing its medium and long-term financing requirements.

OLIVER TANT
Chief Financial Officer