Consumer Analyst Group of Europe Conference, London

19 March 2013

Hello and welcome to the Imperial Tobacco Group presentation at this year's Consumer Analyst Group of Europe Conference.

Disclaimer

No script

Sustainable Growth; Growing Cash Returns – Alison Cooper, Chief Executive Officer

My name is Alison Cooper, Chief Executive at Imperial Tobacco, and I am joined today by Arthur van Benthem, our Group Sales Director, as well as Bob Dyrbus, our Finance Director, and Gerry Gallagher, our Director of Investor Communications.

Both Arthur and I will be presenting to you, and the theme of our presentation will be Sustainable Growth; Growing Cash Returns.

Sustainable Growth; Growing Cash Returns

We will be focusing on three key messages.

The first one is around the strategic choices we're making and how those are delivering quality sales growth. You've seen this over the last few years with the growth in our key strategic brands and our total tobacco portfolio, and you'll see further evidence of this through the course of today's presentation, how we are reinforcing the success of those strategic choices, and how we are thinking about the future.

Then on costs; cost focus is a key strength of Imperial and as part of the strategic journey we're on, the strategic focus is enabling us to further optimise our cost base.

And thirdly, combining our quality sales growth with the cost optimisation and cash utilisation opportunities gives us confidence in delivering sustainable earnings growth and enables us to grow dividends by at least 10% per annum for the medium term.

So these are the three key messages for you to take away today, and Arthur and I will be giving you more information on this over the next 30 minutes.

Our Strategy

To begin with here's a familiar slide to most of you I'm sure. It is our strategy, our consistent focus in Imperial over the last few years.

It's all about sustainable shareholder returns, how we drive maximum value from our key assets, our total tobacco portfolio, brand equity, footprint and people.

This is supported by our sales growth drivers and enablers, and Arthur will be talking specifically about how our consumer insights are at the heart of our decisions around our portfolio and our footprint, and where we see opportunities for growth.

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The Strategic Journey

Let's quickly reflect on where we've been going. Here I've articulated it as a journey, as we have commenced the transition from a tobacco manufacturer to today's consumer orientated business.

Developing our understanding of why consumers behave as they do has been and remains, a priority across the business, and we've got a differentiated approach to understanding consumers which we apply across our entire portfolio. Our priority to date has been our key strategic brands, and you've seen the delivery against those coming through in our recent results. That's really, in terms of the strategic journey, how far we've got. So what's next?

The next stage is to take the approach used with our key strategic brands and translate that expertise across the broader portfolio. This has implications in terms of our resource allocation, further refining that within our footprint. And it's that focus on resource allocation within markets that enables us to further optimise our cost agenda, all driving the sustainable delivery of our earnings model.

This slide will be our road map for today's presentation. Starting on the left hand side, Arthur will talk you through the first three boxes, these are the consumer-focused areas, and they will cover the strategic choices point I talked about as part of my three key messages. I will then touch on how these three areas are driving our refreshed approach to allocating resources and optimising our cost base, before finishing by bringing it all together to deliver sustainable growth and maximising shareholder returns.

So our first stop is the consumer and I'll hand over now to Arthur.

A Differentiated Consumer Understanding

Thank you Alison and good morning everyone.

As Alison has mentioned, we have a differentiated approach to how we build and use consumer insights. This slide shows our approach: it's differentiated because it's based on consumer motivations and underlying consumer needs and not on observed behaviours or consumer trends. The model you see here is the generic model, internally we have created a bespoke tobacco model that now drives much of our communication and thinking within the business.

This is very intuitive and has been rapidly absorbed throughout the organisation. It drives our decisions around our total tobacco portfolio, around our brand equity investments, and how we position our brands. It's a very powerful tool, and one which we are still yet to apply across our full portfolio.

You have seen how this has transformed the performance of our key strategic brands, and more on this in a minute, but what about the rest of our portfolio and market footprint?

Driving Quality Sustainable Growth – Key Strategic Brands

This slide outlines three areas which show our approach to driving quality sustainable growth. Each of these three areas is where we see real opportunities to drive the future performance of the business.

The first area on this slide covers how we are continuing to apply our differentiated consumer understanding to drive further strong growth in our key strategic brands.

But there are other brands in the portfolio capable of enhanced performance and we want to maximise their brand equity. We call this our portfolio potential. We want to identify those brands with the potential to grow more successfully with some additional KSB-type investment, as well as identifying those brands that are absorbing more than their fair share of investment. It's about reallocating existing spend, not necessarily about spending more.

The third area is our market footprint. We see clear white spots within the global tobacco industry that are well suited to our total tobacco portfolio. We also see a number of opportunities within those markets where we already have a strong presence, as well as those in which our position is smaller than some of our competitors, and I will outline how we will be focusing on driving profit, share and scale.

But first let me cover off our key strategic brands.

Key Strategic Brands Drive Growth

Our four key strategic brands, Davidoff, Gauloises, West and JPS, have made an outstanding contribution to our growth in recent years.

Understanding consumers was key to growing these four brands at 7 per cent in collective volume terms in FY12 and 13 per cent in revenues, and the success of these brands remains a key enabler of our earnings model to generate our targeted group sales growth.

Growing these brands supports our high margins and strong cash flows, part of which we re-invest to ensure sustainability of growth.

These brands represent over 100 billion stick equivalents, or just over 30 per cent of our group volumes, and have strong growth momentum, and we will continue to invest behind their growth.

Let's take a quick look at a video on our key strategic brands.

Key Strategic Brands Video

So there you have it, our key strategic brands which continue to grow by delivering on consumer needs.

Driving Quality Sustainable Growth – Portfolio Potential

That covers the first area, being the key strategic brands.

Now let me talk about the larger slice of our volume portfolio and how we are going to maximise the brand equity across these brands.

Driving Quality Sustainable Growth

To give this context, let's take a step back and look at the growth we've been delivering against our total tobacco portfolio, which is split here into six groups.

The numbers in the arrows represent compound three-year numbers, and they show how five of the six groups are firing on all cylinders, but what about the problem group, or as we look at it in Imperial, the brands with the greatest opportunity, shown here in the top right hand box, our non-key strategic cigarette portfolio?

Largely comprising brands inherited from our M&A past, they represent 58 per cent of our stick equivalent volumes, roughly 150 brands, brands with varying degrees of equity, performance and potential. Here volumes have been down six per cent whilst strong pricing has compensated somewhat for this decline, but think of the possibilities if we can get these brands improving their volume trends.

Clear Portfolio Priorities

To address this challenge we have split our entire portfolio into three brand clusters.

Firstly the key strategic brands, our power brands, which we've covered already.

The middle group we call our focus brands: Bastos, News, Fine and Lambert & Butler. These brands have leading positions in key markets, strong equity with consumers and have proven to deliver strong returns.

And thirdly, a cluster we call our portfolio brands. The goal here is to provide scale and cash to support the other clusters, whilst taking the opportunity to reduce brand portfolio complexity, remove costs and shift investments to fuel growth in key strategic and focus brands.

So we have KSBs, focus brands, and portfolio brands, KSBs I've talked about so let's focus on the other two clusters in more detail.

Clear Portfolio Priorities – Focus Brands

As I said, there are initially four focus brands, collectively representing 25 billion stick equivalents or approximately seven per cent of our portfolio by volume. They have regional or national coverage and a loyal consumer base with weighted average market share of 10 per cent and sales growth of around five per cent in our financial year 2012.

Whilst there are four brands in this cluster, they are likely to expand over time.

So, the first focus brand is Bastos, a lesser known brand that has close to a 10 per cent share in Vietnam.

Next is News, a key brand in France with almost six per cent cigarette share and growing.

Third is Fine, a brand rooted in European aspirational heritage, it has a significant presence in some key West African markets as well as some emerging Asian markets.

And the fourth focus brand is Lambert & Butler, no doubt a familiar brand to many of you here today, a very significant brand in UK with over 11 per cent share. We have already applied some of the key strategic brand approach to support this brand based on our knowledge of L&B consumers, with good results.

So these are the four focus brands, and we want to unlock their full growth potential by applying a similar approach as we have with our key strategic brands.

Clear Portfolio Priorities – Portfolio Brands

Moving now to the remainder of the cigarette portfolio, what we are calling our portfolio brands, over 150 in total and many that have been accumulated as part of our acquisition strategy. Some have valuable equity and reasonable performance trends, whilst others may not fit within our future portfolio, so the challenge is to decide which brands will help us deliver our strategy.

Our approach is to split these brands into three groups: nurture, migrate and cash.

Firstly brands we want to nurture, these brands have a loyal consumer base and cover consumer needs that do not significantly overlap with the key strategic brands in their respective market. Therefore, we will continue to sell these brands to their distinct target audience.

Second is migrate, where we will look to transfer the consumer base into another of our brands that we will support in future.

Then there is the cash group, those that don't require significant support or investment but that deliver consistent returns despite being in structural decline. We will continue to leverage their loyal consumer base to generate value without actively investing to change their volume trajectory.

Needless to say there is a massive opportunity here if we can get this right, and that means maximising growth, reducing brand portfolio complexity and reducing costs, allowing us to invest in key growth areas within the business. So what gives us confidence we can deliver on this approach?

Clear Portfolio Priorities

You can see already that the investment made into key strategic brands is paying off. We have had great success applying our consumer insights, leading us to develop slimmer format cigarettes, GlideTec pack roll outs, crushball variants and additive free blends.

Equally, you can see some examples of how we have invested behind our focus brands, and there are some portfolio brands that have valuable equity and make a valuable contribution to the Group.

All of this tells you that we are investing behind our brands to drive growth. We know this approach works and we are allocating more sales and marketing firepower behind it.

Driving Quality Sustainable Growth – Footprint Opportunities

We have now covered our key strategic brands and I have given you some more detail on how we will use our consumer focused approach to unlock further value across the remainder of our portfolio.

Let's now turn to our market footprint opportunity.

Size of Prize and Footprint Opportunity

Our global market footprint is one of our key assets, we are present in over 160 countries, but there are opportunities to strategically grow this.

We see a global tobacco profit pool of approximately 27 billion pounds, this can be split into three groups, as shown here on the slide.

Firstly on the left hand side, we see opportunities in some of the white spots, the markets where we currently have no presence. We are taking a fresh look at where we can capture some of the estimated 5 billion pounds of this profit pool.

The middle group of markets are our stronghold, we have 30 per cent of the estimated 8 billion pounds of profits that exist across these markets and here we will continue to use our strength to drive profit growth.

The third group of markets represent the largest profit pool, being 14 billion pounds, and here we see tremendous opportunities to leverage our existing foothold to grow future returns.

This is a fresh perspective to reviewing our footprint and classifying the role of each of our markets.

Focussing Resource Investments

To this end, we have created three market groups that we call drive profit, drive share and drive scale. These groups help us determine resource allocation and set investment criteria. Let me examine this in more detail.

Firstly our drive profit group, here our objective is to build on our strong positions, defend our market share and focus on our key assets. By reducing portfolio complexity we will drive the quality of our growth.

Second our drive share markets, here we will balance growing profit and growing share, focusing on investing in our brands as drivers to accelerate enhancing our growth quality and capture above our fair share of key growth segments.

And thirdly, our drive scale markets, here our objective is to leverage our existing foothold to exploit the huge growth opportunities that exist in these markets. We aim to achieve superior long term growth from prioritised investment in long term assets.

Let me show you how this works.

Focussing Resource Investments – Drive Profit

The typical drive profit market is mature and experiencing declining industry volumes. We have a strong and well established presence in these markets with a portfolio that spans across multiple segments and categories.

Poland is a good example of a drive profit market. We take a consistent approach to growing the value of our Polish business, and whilst this may mean at times we lose a few basis points of market share, we ensure strategic decisions are guided by delivery of year on year profit growth, to date led by our key strategic brands.

Focussing Resource Investments – Drive Share

Next are our drive share markets. These are typically featuring growth in new segments and demonstrating emerging consumer trends. In these markets we have critical mass but not leadership, so the opportunity exists for us to grow across portfolio and in particular within growth segments.

Kazakhstan is a drive share market, a 25bn stick market with one third of its volumes within the premium segment. We have already had success launching Davidoff and West since organically entering this market a few years ago, and we see further opportunities ahead.

Focussing Resource Investments – Drive Scale

The third group is the drive scale markets, and these are typically offering significant profit and volume pools but where there is a small Imperial position, but we are positive about this, we see opportunities to grow scale and bring meaningful growth to our portfolio.

Turkey is a good example here, an 85bn stick market of which we have just over a four per cent share, but growing. We have developed a unique approach to our route to market and this is supporting growth in our key strategic brands. We have a long term view to growth in Turkey and are positive about the progress to date.

Driving Quality Sustainable Growth

So that takes us through the three areas I highlighted earlier.

Our key strategic brands, our growth engines in recent years, they have benefited the most from our increased investment, and we will continue to apply our differentiated consumer understanding to drive further strong growth.

We covered what we see as our portfolio potential, where we have identified focus brands to which we can apply the same approach and principles as we have to date with the KSBs, as well as the three groups of portfolio brands – nurture, migrate and cash. This is a new approach for Imperial, and we are excited about the possibilities.

I then talked about our market footprint opportunities, and how we see opportunities in those markets in which we operate as well as those where we have no current position, the so called white spots, and I talked about how we have profiled markets in terms of those where we can drive profit, drive share or drive scale.

As I said earlier, that covers the consumer focused areas of what I wanted to discuss with you today. Let me wrap up my part of the presentation by sharing with you how this fits within our business model.

Driving Quality Sales Growth

Here you see these three consumer focused areas feeding into our business model.

The combination of key strategic and focus brands, supported by enhanced performance of our portfolio brands, and with a focussed market footprint approach shows you the levers available to drive sustainable two to four per cent sales growth in line with our earnings model.

This sales growth generated at high margins delivers strong cash flows that we return to shareholders whilst also reinvesting back into the business to drive sustainability of these returns.

That concludes my part of the presentation, I'll now hand you back to Alison.

Strategic Focus Enable Cost Optimisation

Thanks Arthur, so that's the consumer, portfolio and footprint covered. I would now like to talk about how this focused approach to managing and investing in our portfolio and footprint feeds into cost optimisation, a key pillar within Imperial's strategy as you will recall.

We kicked off the programme looking at costs last year. Some of it has been running for over a year already and we wanted to align that with the strategic priorities of the business. The strategic focus Arthur discussed is the key enabler to this cost optimisation programme. When you focus on the portfolio and footprint, they provide optimisation opportunities: optimisation of investment, optimisation of product cost and optimisation of overheads.

All up, we see an opportunity for savings of £300 million per annum by the end of 2018 and this will provide us with funds to put behind our investments in the business but also to reinforce our earnings model.

I think most of you are aware this is the last year of our significant step-up in investment in the business. I'm going to put a bit more meat on the bones for you now but more detail will be available around this programme at our half-year results at the end of April.

Strategic Focus Enable Cost Optimisation

There are three areas to discuss here; allocating our investments to drive growth; reducing complexity to drive lower product costs; and reviewing our operating model, and within that, our approach to procurement.

So firstly, on investment, focusing on a smaller number of brands generates resource allocation opportunities as well as efficiencies, given you roll out initiatives over a smaller number of brands, all directed at accelerating top line growth.

The biggest cost saving opportunities are from product costs. Rationalising the portfolio reduces complexity and means fewer SKUs, simplifying the manufacturing process and enabling greater standardisation of blends and non-tobacco materials. There are also opportunities for cost optimisation within our current footprint, and we continue to keep this under review. Operational excellence is an initiative that's already been going on for about a year. This is around effectiveness and efficiencies within our manufacturing footprint.

And lastly, on overheads, where we have two key areas of focus - the first being the operating model and the other being procurement. As we continue to move from local autonomy to a more centrally-led organisation, there are clearly opportunities around the operating model to realise further cost reduction in the business. On procurement, we do very well already at non-tobacco materials and leaf, but as we take the operating model forward, there's more we can do from a procurement perspective across the globe on the remainder of our cost base.

So, that's costs! I realise some of you will want more detail but you may have to hold off until our half year results.

Sustainable Growth; Growing Cash Returns

As you can see, by extending our strategic approach to investment and resource allocation across our portfolio, as well as refining and refocusing our footprint, we have a number of levers to deliver growth.

Sales growth is the key focus, this gives us between two and four per cent earnings growth. Cost optimisation contributes one to two per cent and cash utilisation also one to two per cent. We have been highly effective in our tax management, so perhaps there are more cash opportunities from interest rather than tax going forward.

All of this supports our confidence in our ongoing delivery of dividend growth of at least 10 per cent for the medium term.

Sustainable Growth; Growing Cash Returns

Now we're back at our three key messages, focused around the strategic choices and the quality of the sales growth. How that's coming through and how we'll further strengthen that. The cost opportunity and how we're driving that forward. All of which enables sustainable dividend growth at 10 per cent plus.

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Thank you for your attention, I'd like to now invite any questions you may have.