Deutsche Bank Global Consumer Conference

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Bob Dyrbus, Finance Director

Deutsche Bank Global Consumer Conference

Good morning. I am pleased to have the opportunity to present Imperial to you today.

I'm Bob Dyrbus, Finance Director and with me today is Gerry Gallagher, our Director of Investor Communications.

I want to spend the next 25 minutes or so looking at how our portfolio is aligned to consumers – where consumers are today and where they're going – a portfolio aligned to satisfy their needs, wants and demands.

It's an area of our business we call Total Tobacco, an area when combined with our brands is at the heart of our sales growth agenda.

I will also be looking at how this approach has helped to drive our half year performance along with cost optimisation and effective cost utilisation, to achieve further value for our shareholders.

Before I continue I would like to remind of you of the statement we made yesterday regarding our Spanish business.

In recent weeks there have been a number of price moves in Spain impacting all market participants. We have acted to protect our market position and the long-term sustainability of our Spanish business and continue to monitor the situation closely.

Based on retail prices as at last Friday we currently estimate that for the financial year to 30 September 2011, adjusted operating profits derived from Spain could reduce by up to 110 million pounds against our previous expectations. Of this, up to 40 million pounds represents a one-off non-recurring impact on our logistics business.

Excluding Spain, the anticipated financial performance and position of the Group for the financial year to 30 September 2011 remains in line with the Board's expectations.

Strategic Focus

Moving on to today's presentation, let's start with our strategy

Cost and cash are still very important but at the heart of our agenda is sales growth.

Our strategy recognises the strength and balance of the assets we use to drive sales growth: our brands, our portfolio of products, our extensive geographic footprint, and our people.

We focus on how we leverage these assets and do so by three means:

- By being consumer centric. Applying a consumer mindset and local consumer insights and using these insights to drive portfolio choices;
- By leveraging our execution excellence – applying speed, flexibility and quality to all we do. It's about being responsive to consumer and customer preferences, being fast from idea to implementation; and:
- Building future foundations that underpin our sales strategy and enhance our long-term sustainability. This is fundamental to the way we manage our business, particularly in an industry with regulation and illicit trade. And it is also about getting ahead of where the consumer is going.

These three focus areas of how we leverage our assets are not just banners – they are key to driving sales growth in the business.

We have two other growth drivers: cost optimisation and cash utilisation. Both are clear Imperial strengths. We employ flat structures and our focus on value creation ensures that we avoid unnecessary spend.

How we use our cash is critical and in the absence of any transformational acquisitions on the horizon, we look to return cash to our shareholders.

Last month we announced the commencement of a share buyback programme of 500 million pounds on an annualised basis and following our move to a 50 per cent payout ratio in 2011, our intention is to continue to grow dividends above the growth in earnings beyond 2011.

Assets, Opportunities, Capabilities

In terms of assets, we have a balanced portfolio with lots of opportunities. We have built a great portfolio through M&A over the last decade or so:

- We have international, regional and local brands with a comprehensive price presence;
- We have a broad product range and are uniquely placed as the only international Total Tobacco company. This means that we are not only focussed on factory made cigarettes but also on fine cut tobacco, cigars, snus, and papers & tubes, covering luxury through to value;
- And we have a strong geographic footprint with many growth opportunities.

In terms of capabilities, clearly our people are key to our delivery and we have recently added to our bench strength with the recruitment of Roberto Funari as head of marketing from Reckitt Benckiser and Arthur van Bentham from Metro and Coca Cola as head of sales.

EU & Non-EU Market Balance

To give you a better feel of our geographical opportunities. We operate in over 160 countries with 53 per cent of our stick equivalent volumes in non-EU markets. We have both strong EU and non-EU market presences.

EU markets are a great place to be, they are highly profitable with opportunities to grow profit through share, price and our mix of products.

Despite our successes, as the chart shows, we have significant opportunities in a number of non-EU markets. We have more to go for in Eastern Europe, Africa, the Middle East and Asia.

Consumer Environment - consumers responding to a changing world

In order to understand the advantage of Total Tobacco we need to understand what is driving the consumer locally, there is no such thing as a global consumer.

The world is changing fast. Key drivers include affordability due to the economic environment, globalisation, changing societal roles and values and the fast paced demands of modern lifestyles.

Key trends arising from this include:

- A growing consumer focus on - not just a cheap product but added value at an attractive price;
- Consumers have international aspirations but are also attracted to brands with local heritage, emphasising the nostalgia of "old" favourites that have stood the test of time;
- Authenticity – the need for safe choices that consumers can trust.
- But also new experiences that can enrich their lives.
- And affordable luxury is also still relevant, if not more so, but with more emphasis on quality, innovation and connoisseur products.

Consumer Environment - additional tobacco factors

Alongside these consumer wide factors, there are additional tobacco specific drivers that shape consumer trends, Regulation & Excise, that need to be appreciated to better understand the specifics of tobacco within FMCG.

Regulation can impact all aspects of the consumer experience and we actively engage with regulators in order to protect consumer choice and enjoyment. This combined with the other consumer drivers will impact consumer trends, such as the formats of cigarettes, new products and packing to name just a few.

Excise clearly also impacts the price consumers pay, which is occasionally unhelpful when increases are substantial, but excise in the price is a great buffer for manufacturer price increases, and due to consumer loyalty there is overall still relatively low price elasticity in tobacco.

Consumer Trends – value and luxury opportunities

So there are trends in relation to heritage, authenticity and new experiences but overarchingly there are two key areas of growth:

- In value – and again this isn't shorthand for cheap – value means a good price but it's about more than price; and
- At the luxury end of the market where tobacco is an affordable luxury, an affordable pleasure.

There is a lot of growth at the value end of markets but also opportunities at the luxury end – particularly in emerging markets.

Unique Total Tobacco Focus – more consumers…more markets…more occasions

That takes me to the essence of our focus on Total Tobacco, its about having more scope:

- More scope to respond to consumer shifts; and
- More scope to create consumer shifts.

It gives us more consumers, in more markets, over more occasions, whatever the economic circumstances, whether they be a luxury cigar smoker or someone seeking a value roll your own product.

One of our favourite internal banners is: "there is growth in every market" and we focus on identifying and capturing that growth, or making it happen.

Before I look further at our portfolio alignment – an obvious point:

To be successful we have to keep understanding what drives the consumer through listening, and I mean listening locally.

The winners in a fast changing consumer landscape are not the ones with the loudest voice but the sharpest ears. Listening to local consumers is key to our success, and we've been listening.

Let's take a further look at the two ends of the dumb bell, value and luxury, as part of our Total Tobacco approach. And let's also answer the "so what?" – What is this focus delivering?

Aligned with Consumer Trends

Consumers aspire to luxury and we have some fantastic luxury brands, Davidoff, Cohiba, Montecristo to name just a few.

Our luxury brands are recognised for their superior quality credentials and premium appeal. They have delivered a remarkable performance even during the recession with Davidoff's Eastern European volumes up 20 per cent compound over the last five years.

Consumers Aspire to Luxury – Davidoff

In cigarette, Davidoff continues to build volume momentum through appealing to the sophisticated, aspirational consumer, with its success based on its proposition as the ultimate smoking experience and the best cigarette you can buy, for smokers with excellent taste and style.

It's got momentum and we're continuing to build on this in 2011 in Asia, the Middle East and Africa as well as Eastern Europe.

Consumers Aspire to Luxury - the top cigar marks

In cigar we have the top luxury marks via our Habanos joint venture encompassing the most prestigious cigar brands in the world including iconic brands such as Cohiba and Montecristo.

This is also a very active portfolio, on the one hand we are continually looking to upgrade the offerings for the connoisseur, such as with Cohiba Behike, but also recognise that public smoking bans can reduce the time available for a cigar and have therefore been active in developing mini offerings with a reduced ring gauge and length. We have also catered for individual purchases via the tubes range, which has been in strong growth.

Our luxury cigar portfolio is continually evolving so that the offerings remain impactful and relevant for today's consumer.

Aligned with Consumer Trends

Moving onto our value portfolio, value has been a feature in tobacco for a long time and unsurprisingly value is a priority for a number of post-recession consumers.

Value is about price plus. That may be an international prestige brand with premium qualities or a "smart choice" brand. Or it maybe a local heritage brand offering authenticity, naturalness or trust.

Our portfolio has a great fit with these most prominent consumer trends, covering the full range and designed to deliver the best value choices across product categories, both in cigarette, fine cut tobacco and cigar.

Local tailoring is also key, listening and understanding.

Consumers Demand Value

Value has to be supported by attributes with which the consumer can identify, as I said it's not just about being cheap.

Consumers want more for less and it is key that brand propositions resonate with consumers – linking into the consumer drivers.

You can see a number echoed in the brand propositions, essence and values shown here:

- Innovative yet trustworthy with West;
- Premium on everything but the price with JPS;
- Fortuna – Spanish and genuine; and
- Route 66 – new perspectives – the open road.

Consumers Demand Value - global leader in fine cut tobacco

Moving to fine cut tobacco, offering the consumer value beyond factory made cigarettes.

We are the global leader and are number one in four of the five major markets in the world.

These markets are growing, and our volumes are growing.

What Consumers & Customers Want

In terms of Total Tobacco I have taken you through how we see our portfolio aligned with what consumers want.

It also provides another key advantage with the trade, by giving them a full portfolio offering, it enables us to manage their tobacco business in its entirety with them – not just cigarettes, and it's also what customers want.

What is good for the consumer is great for the trade.

Our trade marketing activities have clearly been supported by our Total Tobacco strength and our success with the trade has been regularly recognised for its excellence through customers' feedback.

So What?

A question often ducked in such presentations with nice brand pictures. It all sounds great, but so what?

HY11 Results

Let me try to answer that question by taking a look at our half year results to the 31st of March and demonstrating how our Total Tobacco portfolio has delivered growth.

Imperial Tobacco

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HY11 Overview

Starting with the headline numbers.

In terms of our overall volume performance total stick equivalent volumes were down just 0.7 per cent in the first half – a pleasing result given the difficult trading conditions in Spain.

Looking at year on year comparatives, the half year was significantly impacted by foreign exchange translation, principally the Euro.

Performance is therefore better understood using constant currency, and on that basis tobacco net revenues were up by 2.7 per cent, tobacco adjusted operating profit up by 3.8 per cent and adjusted earnings per share up by seven per cent.

Group Underlying Growth - ex Spain; adjusted for UK trade buying

In our pre-close trading update in March we highlighted a shift in trade buying patterns in the UK from the first to the second half.

To give you a feel for our underlying performance, if we adjust our results for this and exclude Spain, given the exceptional environment, Group stick equivalent volumes were up 1 per cent, revenues up 4.4 per cent and tobacco operating profits up over seven per cent.

Total Tobacco – 5% global strategic brand growth

Our investments in the rejuvenation of Davidoff, Gauloises Blondes and West with new formats and variants have made these brands more dynamic and relevant for today's consumers.

Davidoff had an excellent first half, growing nine per cent with very strong performances in a number of key markets in Eastern Europe, Asia and the Middle East. In 19 of its top 20 markets Davidoff either grew or maintained its market share.

The core premium line franchise grew over 8 per cent and we've made very encouraging progress with new variants such as King Size Super Slims.

We improved volumes of Gauloises Blondes, our biggest selling brand, by five per cent following the supply disruption last year with good results in markets across Africa and the Middle East including Morocco and Algeria.

And finally West, our leading international value brand, grew one per cent, performing well in Eastern Europe where new variants such as West Fusion, our King Size Super Slims offering, have provided consumers with an innovative product at an attractive price.

Total Tobacco - JPS: 16% volume growth

We've also been evolving the JPS portfolio – reinforcing its smart choice positioning with the consumer, and this is reflected in another excellent performance.

Volumes were up 16 per cent overall with strong growth in the UK, Germany and

Australia.

We achieved a significant milestone in Germany this half, with JPS capturing 10 per cent market share for the first time, confirming its position as the second largest brand in the market.

while rapid growth in Australia has resulted in the brand achieving a 3.8 per cent market share, up from 2.2 per cent last year.

Total Tobacco – 5% fine cut tobacco growth

Fine cut tobacco is in growth in many EU markets and we have continued to capitalise on our leadership in this segment to drive volumes up five per cent in the first half, and this was complemented by strong growth in papers which grew 8 per cent and tubes which were up 12 per cent.

A key element of our fine cut tobacco success story has been leveraging cigarette brand equity into fine cut tobacco and JPS is a great example of this, having achieved 6 per cent volume growth this half, the brand now accounts for almost nine per cent of the German fine cut tobacco market and over three per cent in France.

We're focused on building on this success and recently launched JPS in a roll your own and make your own format in the UK and Ireland.

Elsewhere we've been very successful with West, particularly in make your own, and delivered 10 per cent volume growth in the first half.

Route 66 is also gaining traction, achieving excellent results in our Rest of EU region. The brand now represents over 11 per cent of our total fine cut tobacco volumes.

Total Tobacco - Habanos: 16% sales growth outside EU

In cigars, our luxury Habanos portfolio grew sales outside the EU by 16 per cent and delivered two per cent overall volume growth, a great performance given Spain is the largest Habanos market.

Cohiba, Romeo y Julieta, Partagas, Hoyo del Monterrey and H.Upmann all grew volumes.

In terms of markets, volume growth was driven by very strong performances outside the EU including Russia, Brazil, the Middle East, Asia and in particular China.

Total Tobacco – Snus 19% volume growth

Finally our highly successful snus business, where total volumes grew 19 per cent across Sweden and Norway with growth from Skruf and Knox.

Both brands were recently rejuvenated and with our new factory having removed capacity limitations we are well placed to drive further growth in this category.

Growth in EU and non-EU

Turning to our markets.

One of the key consumer trends in the EU is the move to value and we are well placed to capitalise on this trend given the versatility of our Total Tobacco portfolio. We have a strong presence in all the key tobacco segments and at all price points providing us with the flexibility to respond quickly to consumer growth trends.

This has meant we have reinforced our leadership in the UK with a stable cigarette share and increased cigarette and fine cut tobacco share in Germany.

Spain continues to be a difficult market as a result of duty increases, public smoking bans, the economic recession as well as the ongoing price war but there are opportunities in growing segments such as soft packs, queen size cigarettes and little cigars. We've also made excellent progress in growing our domestic fine cut tobacco share.

We made further gains in the Rest of EU, notably with JPS cigarette volumes up 12 per cent and total fine cut tobacco volumes up 5 per cent.

In the USA, it's also a value seeking story with consumers economising in cigarettes and cigars in a very competitive environment. In order to strengthen our customer and consumer interface, last month we began integrating our cigarette and mass market cigar sales forces.

In our Rest of the World region we are capitalising on the considerable opportunities there are for us to develop our business. We are driving growth in key consumer growth segments through the success of our global strategic cigarette brands and our strong portfolio of local and regional brands.

Profits grew by over 30 per cent in Eastern Europe, by over 20 per cent in Asia Pacific and by just under 10 per cent in Africa & Middle East.

In addition, there is great potential for our prestigious luxury Cuban cigar brands and we achieved significant growth in a number of major emerging markets including China, Russia and Brazil.

Cost Optimisation

Turning now to what we have been doing to optimise our cost base.

On a constant currency basis, grew our Tobacco margin by just under half a percentage point to 42.5 per cent.

We maintain our cost disciplines while continuing to invest for growth, in brands, in growing segments, or in expanding capacity.

We continue to focus on maximising the returns from our assets and there are still opportunities for us to become more effective, and the merger of our US cigarette and mass market cigar sales forces is a current example.

Cash Utilisation

Turning to the third of our growth drivers, cash utilisation, where our strategy is about delivering sustainable shareholder returns with efficient cash utilisation a key component of value creation.

Following successful debt pay down and announcing the 50 per cent dividend payout for 2011, we have reviewed our options as to how best to deploy our ongoing strong cash flows.

A higher dividend payout and share buybacks are not mutually exclusive, and noting where our shares trade, we recognise the value in both.

Accordingly, from a base of around a 4.5 per cent dividend yield we envisage growing dividends per share ahead of earnings per share over the long-term thereby steadily increasing the payout ratio.

By steadily increasing the payout ratio we are able to offer strong dividend growth from an already attractive yield while also employing a share buyback programme starting last month at an annualised rate of 500 million pounds.

Absent M&A, for which, as always, returns have to exceed both a risk adjusted weighted average cost of capital and the returns from a share buyback, utilising a combination of a steadily increasing payout ratio and an appropriate level of share buybacks allows us to maximise our cash returns and maintain an appropriate capital structure.

Conclusion

So, as you can see, our first half performance is strong evidence of the successful execution of our strategy.

Our portfolio is the most comprehensive in the industry and our Total Tobacco approach provides many growth opportunities, opportunities we are capitalising on.

Sales grew 3 per cent, we grew combined cigarette volumes of our global strategic brands Davidoff, Gauloises Blondes and West by 5 per cent. JPS volumes were up 16 per cent, we grew fine cut tobacco volumes five per cent, Habanos sales grew 16 per cent outside the EU, we grew snus volumes by 19 per cent, and we remain focussed on building on this momentum in the second half.

Our Strategy

We continue to focus on the three key components of our growth strategy: sales, cost and cash.

Consumer choices are continually evolving and it's our understanding of how consumers behave, coupled with the versatility of our brands and products, which will ensure that we continue to make the most of our sales growth opportunities.

Our Total Tobacco performance supported by our geographic footprint, brand strengths and high quality people, has driven and will further drive our growth, and that sales success will continue to be enhanced by our diligent approach to managing costs and cash.

We maintain our cost discipline whilst continuing to invest behind our portfolio to drive sustainable sales growth. While dividend increases in 2011 and beyond, and our share buyback programme will return excess cash to our shareholders further enhancing their returns.

We have the assets, the opportunities and the capabilities to deliver long term success.

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Thank you, I'm happy to take any questions you may have.