

Hello and welcome to the Imperial Tobacco Group presentation at this year's Deutsche Global Consumer Conference.

### **Execution Excellence – Operation & Supply Chain Alignment**

My name is Walter Prinz, Group Manufacturing Research & Development Director and I'm joined today by Neil Southey, our Interim Group Marketing Director, as well as Gerry Gallagher, our Director of Investor Communications.

Both Neil and I will be presenting to you and the theme of our presentation will be execution excellence, specifically in respect of the alignment of our operations and supply chain. This isn't just about cost optimisation – it's about aligning our approach with the portfolio strategy.

### **Disclaimer**

No script

### **Our Business Model**

Our Business Model starts with one of our key differentiators – Total Tobacco. Alongside our other key assets, our portfolio of consumer experiences provides a significant competitive advantage and is at the core of our business model.

Our four Sales Growth Drivers are about maximising our assets via portfolio management, innovation, pricing and customer engagement. When combined with our tobacco portfolio and the key enablers, which include operation and supply chain alignment, these are the drivers that generate sales growth at high margins and deliver strong cash flows that we use to reinvest back in the business and maximise value to our shareholders.

And as you know, this model is designed to generate earnings growth of 6-10% per annum, including the benefit of share buybacks.

The alignment of our operations and supply chain is a key enabler to support our sales growth strategy. It delivers not only cost related benefits but also provides revenue related to being consumer focused.

### **Execution Excellence – key success areas**

We have a very well established process containing four key areas that deliver execution excellence, not only resulting in cost related benefits but also providing revenue related ones by being consumer focused.

All four of these strategic areas are driven by consumers:

Firstly quality, where we have to ensure that our products meet the consumer and customer needs and preferences;

Secondly responsiveness, we have to respond more flexibly and quickly to demand shifts, innovation opportunities and changes in regulations. In order to get the product to the consumer faster, we are focusing on factory agility, complexity reduction and on improving our processes and systems capability;

Thirdly efficiency, we will keep our focus on value creation and cost leadership by managing our cost base in the most effective way without compromising on quality.

Sales growth and smart cost optimization are strong building blocks for future success;

And finally innovation, this is an important driver for sales growth and brand equity building. We are translating consumer needs and motivations into product, pack and brand experiences.

To ensure we meet the consumer and customer needs and motivations we are driving the quality agenda through improvement of our processes, systems, working methods and our behaviour.

### Execution Excellence – key success areas

So let's start by looking at quality.

Quality – consumer centric product quality

Quality is a joint process and common mind-set. To become more consumer-centric we have developed a deeper awareness and understanding of consumer behaviour and translated this into our internal quality systems.

We are distinguishing between two levels of quality management:

- The strategic level is where we join up with Sales & Marketing to build consumer insight capability, define the right consumer quality standards and translate it into product attributes. This includes the product itself, the feel, the look, the appearance of the product and how it is presented to the consumer. This is all total tobacco focused; and
- The operational level, which is clearly a pure manufacturing responsibility.

We have aligned our quality systems and our manufacturing capability to consumer requirements. We have translated the required Design Quality into Product & Process Quality across our Total Tobacco portfolio.

It is about setting standards and specifications and meeting these consistently.

Process quality reflects the consistency of matching specifications over time. A quality product consists of these three elements which are strongly linked with each other.

Our Total Tobacco business did not just emerge; it's the result of a number of critical strategic acquisition choices made over many years.

### Consumer Driven Quality – creating value through product differentiation

We are driving the quality agenda through improvement of our processes, systems, working methods and our behaviour.

This slide shows the five operational focus areas to ensure consumers receive the quality they need and to ensure the avoidance of unnecessary costs.

Product specifications are strategic and have to be aligned with the brand strategies. It is all about understanding the quality attributes that are key to consumers – and in their language. Neil will explain more about this shortly.

The definition of attributes are then taken a step further into a measurable quality rating system, reflecting how close specifications are matched and covering the complete route from production to consumer.

Based on this consumer research, we implemented a new fault catalogue across the portfolio in our operations and introduced the Group Quality Index as a KPI, which reflects the Operations driven quality development.

A new supplier qualification and risk assessment has been introduced to avoid faults.

We have conducted a full factory and key machinery capability review in relation to all quality aspects and developed an investment strategy accordingly.

And finally, our revised Complaint Management System has been rolled out further to ensure the consumer is being heard.

### **Consumer Driven Quality - translating consumer quality perception**

We carry out In-depth qualitative and quantitative research in order to understand consumer preferences. The results of this research are decoded to determine which attributes are of high importance to the consumer. We also try to find which attributes are of less interest to them as this will highlight areas where less focus and investment might be required.

We try to establish what differences of quality perception exist such as Asian versus European culture and a value versus premium smoker. This is done via a structured and thorough research process designed to generate full consumer understanding. There are three key steps:

- Qualitative and quantitative research on an unbranded level
- Semiotic research to decode cultural differences
- Full mix test to validate

This all gets translated into product pack and experience design with all product specifications being aligned with the new brand strategies.

All of this consumer led work is directly input and determines the approach to the five focus areas that Walter introduced.

### **Consumer Driven Quality – JPS**

Here's an excellent example with our JPS brand of our quality approach in action. The great thing about this slide is that all these evaluations come from consumers, not our internal systems.

In terms of packaging, you see on the left how consumers evaluate the JPS brand against the market average. On the right you see how our JPS MYO product is evaluated.

This is all as a result of our consumer led approach to quality.

### **Execution Excellence – key success areas**

Moving on to our second strategic area of focus – responsiveness:

It is key that we respond more flexibly and more quickly to changes in demand, regulation and innovation opportunities. In order to get the product to the consumer faster, we have adjusted our processes and systems as well as improved our capability.

### **Responsiveness – agility: reduce time to market**

To further improve our speed and flexibility we focus on three areas:

First of all, business simplification and complexity reduction; this is a continuous process and cross-functional collaboration is a key success factor. We have made great progress over the last three years on our component based reduction program with reductions in the number of our blends, ingredients, papers and filter tow.

Our stock keeping unit reduction programme, through our migration and delisting strategy, actively supports our business simplification efforts.

Secondly, our investment strategy is another key pillar to reduce time to market. We developed a new machine procurement programme, implemented an agility buffer and improved our lead times by seven months.

To convert idle machines into new formats, such as 'Big Box' or queen size, is also part of our new investment strategy and further improves our speed and flexibility

### **Responsiveness – Agility: reduce time to market**

Factory agility and scalability is the third key component to further improve our responsiveness.

To this end, we implement Lean Management tools. Lean Management is all about best practice, continuous improvement, common KPIs and local ownership.

We started to implement Lean Management tools in our key factories and they improved our factory effectiveness, flexibility and supply reliability as well the engagement of the management and workforce.

### **Responsiveness – centres of excellence**

It has also led to the creation of centres of excellence to ensure:

- Fast execution
- Flexibility
- Quicker scalability
- Better quality

Here are some examples where we increased our capacity significantly in a short period of time and reacted very quickly to consumer demand shifts.

We established special filter centres in Radom, Poland and Kiev, Ukraine; our factory in Sävsjö, Sweden doubled its snus production; we've just opened a new tobacco expansion plant in Tarnowo, Poland; our Nottingham factory in the UK scaled up our unique Glide Tec production; and Volgograd, Russia is focused on special cigarettes formats.

### **Responsiveness – scalability**

Over the last few years there has been significant growth in queen size formats, particularly in Eastern Europe. These cigarettes have a slightly smaller diameter than the traditional king size. In order to meet this increase in consumer demand, we had to quickly build up the required capacity on time and in the right place.

Our investment strategy and fast decision making processes enabled this success.

### Responsiveness – speed of response

And here are the results.

We average 18 per cent share across all markets where we have launched queen size format.

However, in the queen size segment we have over 24 per cent share – clearly showing the benefit of leveraging the speed of response capability that we have. We have launched in 26 markets to date and this number is growing fast.

We are also very fast to align this with our portfolio strategy with 87 per cent of our queen size volume being through our Key Strategic Brands.

### Execution Excellence – key success areas

Our third strategic focus area is efficiency.

We will maintain our focus on value creation and cost leadership by managing our cost base in the most effective way without compromising on quality. Sales growth and smart cost optimization are strong building blocks for future success.

### Efficiency – value creation

This slide shows the five components of efficiency on which we are focusing to deliver the £300 million annual cost savings programme after five years, which we've already announced.

Today, I only want to focus on the first of these elements, Product Cost & Complexity Reduction, which is already contributing to the savings programme with over £3 million expected to come through this financial year.

As a result of all the acquisitions we made between 1997 and 2008, we are faced with a significant diversity of technology, management approaches and maturity levels.

Lean Management is a consistent method of operating and embedding continuous Improvement, ownership, best practice procedures and common KPI's. Lean is an organizational journey.

The programme will deliver reduced conversion costs due to increased overall equipment effectiveness, reduced change-over times, lower waste levels and higher productivity. It will also improve the engagement of the management and workforce.

**Footprint/capacity review:** we are constantly reviewing, in conjunction with Supply Chain, our capacity requirements and factory footprint. Over the last 12 months, we've closed six sites (Cadiz and Palazuelo, Spain; Berlin, Germany; Menen, Belgium; Tampa and Richmond, USA).

**Global Procurement:** the implementation of a new centre led Global Procurement organization is a huge opportunity to realize sustainable value creation by global visibility and leverage of current spending and supplier base.

**Working Capital:** to control and optimize our capital employed is a permanent task.

**Product Cost & Complexity:** It's about value creation through strategic portfolio simplification. We've gained new information, insights and tools relevant for our consumers and introduced a 'design-to-cost' approach for our portfolio to minimize our product costs and complexity. All individual product elements, Non-Tobacco Materials and tobacco, are aligned with consumer needs and preferences as well as brand strategies.

### **Consumer Needs Based Portfolio Strategy**

This slide demonstrates our approach to product cost and complexity avoidance we don't compromise our portfolio strategy for the program – it's the opposite, it actually drives the program.

We aim to generate value creation through strategic portfolio simplification. Firstly it's about whether the brand is a strategic or focus one and then whether it is a premium brand or value. As an example a strategic premium brand such as Davidoff will receive investment in every relevant consumer area and actively seek to meet the consumer requirement of 'more for more'. You'll see an example of this later with our Davidoff Boudoir ultra-slim initiative recently launched. On the other hand a non-focus value brand will absolutely meet the consumer's minimum quality requirements but we don't invest where additional value cannot be created.

How we apply this approach is firstly through a clear process and governance model, which oversees our tobacco and NTM (non-tobacco materials) toolboxes.

These toolboxes make very clear what is right to invest in for any given brand and what sort of elements we can seek to reduce or remove to either reduce complexity (e.g. less blends being used in overall production or alternatively remove unnecessary cost). As an example very few of our brands for sale domestically now use display outers as the consumer has a much higher interest in individual pack quality.

This approach has several benefits including not only complexity avoidance and cost reduction, but also it creates opportunities to align brands when seeking to migrate one brand to another. It also generates headroom for innovation and investment.

### **Execution Excellence – key success areas**

The last of our focus areas is product innovation capability, which is an important driver for sales growth and is a key element for brand equity building.

### **Focus on Innovation – creating tomorrow's enjoyment**

For Imperial, innovation is anything that is new and adds value to the consumer. Manufacturing services our total tobacco portfolio whilst our wholly owned subsidiary Fontem Ventures is focussed on developing next generation products.

### Focus on Innovation

We are translating consumer needs into new product, pack and brand experiences. We have further strengthened our R&D capability through a reorganization and creation of a new Innovation & Development department.

Manufacturing innovation holds all required capabilities from engineering, packaging, ingredients, blends and non-tobacco materials. This team focusses entirely on successful up-stream product innovation. Product Development services down-stream innovation initiatives.

Aspiration and passion, as well as flexible resource allocation, are key success factors.

### Focus on Innovation – creating value

Best Practice stage gate process & RASCI now adapted to our needs and products.

Our new operating model is based on people capability and flexibility.

We post problems we can solve to the internet community and our suppliers.

Innovation with suppliers is based on shared IP, exclusivity or development contracts.

We are striving for ownable innovations and we are delivering unique initiatives

### Focus on Innovation – unique initiatives

Whilst, as Walter rightly says, innovation is all about anything which the consumer perceives as new and adding value, we also know that where we can create uniqueness we have the additional potential commercial benefit of competitive advantage, either because we are the first to act in a new opportunity area or, alternatively, because we have patent and/or design protection. Here are three great examples of just this – all delivered via our approach and process that Walter shared with you:

- Davidoff Boudoir ultra-slim Superfine
- Glide Tec pack innovation
- Ceka can FCT

However, we know with all unique initiatives that true success can only be judged when we have positive consumer feedback. This drives sustainability and informs the scaling up of investments. Here is some early feedback from consumers in Russia, which has been folded into a video about Davidoff Boudoir, our unique superfine ultra-slim cigarette.

### Video

**Execution Excellence – key success areas**

We have a very well established process containing four key areas that deliver execution excellence, not only cost related benefits but also provides revenue related ones by being consumer focused. As we have demonstrated today, executional excellence for us is a very complementary enabler for our sales growth strategy.

**The Earnings Model**

So let me finish with a familiar slide: our earnings model. This has been more or less the same for a number of years and against which we've consistently delivered.

It's about sales growth of two to four per cent, both its quality and sustainability, that's important for the continuation and delivery against the earnings model.

And then there's the one to two per cent on both cost optimisation and cash utilisation plus around two per cent from share buybacks to deliver annual earnings growth in the range of six to ten per cent.

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Thank you for your attention, we'd be happy to take any questions you may have.