



Morgan Stanley Conference

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Morgan Stanley Global Consumer Conference 2011

Hello and welcome to Imperial's presentation at this year's Morgan Stanley Global Consumer Conference.

Unlocking Our Potential

My name is Bob Dyrbus, Finance Director of Imperial Tobacco and I am here today with Gerry Gallagher, our Director of Investor Communications.

The theme of my presentation today is "Unlocking our Potential".

Over the past two years we have enhanced our focus on sales growth and are building momentum behind the top line. In my presentation today I will be looking at examples of how we are delivering against our top line objectives and how we see opportunities to further realise our potential and deliver high quality sustainable earnings growth.

Our Strategy

Our strategy will be familiar to most of you by now, comprising sales growth, cost optimisation and cash utilisation which all drive our delivery of sustainable shareholder returns.

Sales growth sits at the heart of the strategy, supported by our key assets:

- our market footprint,
- our unique Total Tobacco portfolio, which gives us access to, or the ability to create, consumer growth segments in every market,
- our very strong brand equity
- and not least of all our excellent people.

We introduced the 4 sales growth drivers at our investor day in July this year and I will talk about these in more detail later in this presentation. But before I do, lets see how we performed in 2011.

FY11 Highlights – delivering our strategy

In 2011 we drove sales and profit growth through our Total Tobacco portfolio and made gains across our market footprint.

In the EU our profit model continues to deliver. We grew profits by 7 per cent in Germany and 3 per cent in our Rest of EU region, supported by gains in cigarette and in fine cut tobacco where we reinforced our world leadership in this growing category.

In our Non-EU markets we grew volumes in our emerging markets and delivered 10 per cent profit growth due largely to the success of our key strategic cigarette brands, complemented by a great performance from our luxury cigar portfolio.

Cost optimisation remains a core strength and despite facing leaf cost pressures during the year, our disciplined approach to investment delivered group tobacco operating margins above 42 per cent. In non-EU markets margins were up 150 basis points. We continue to drive efficiencies across the business including a 3 per

Morgan Stanley Conference

15 November 2011

cent productivity improvement.

Cash conversion was strong at 88 per cent and we generated 1.6 billion pounds of free cash flow, an excellent result given our increased capital investment. And we're increasing returns to shareholders. We grew the dividend by 13 per cent and also bought back shares worth 181 million pounds.

As these results illustrate, we continue to progress our strategic agenda whilst successfully creating further value for shareholders.

Unlocking Our Potential

The challenge for our business is to consider how we can move to the next step and unlock our true potential.

To do this we need to change our mindset and see things differently, do things differently, different to the industry and different to how we have approached things in the past.

Seeing things differently includes developing a deeper understanding of what drives consumers, and how we can translate these consumer insights into opportunities for our Total Tobacco portfolio.

Doing things differently is about delivering execution excellence through fewer, bigger and better initiatives that will accelerate our sales growth.

Sales Growth Drivers

To see things differently and do things differently, ensuring we maximise the potential of our assets, we have identified the 4 sales growth drivers at which we want to excel:

- portfolio management; which is our drive for more consumers in more markets on more occasions
- innovation; which is about delivering new products based on consumer needs
- pricing; how we model pricing strategies and manage excise to maximise revenue growth; and
- customer engagement; partnering with our trade customers and enhancing advocacy and the availability of our products.

Our Key Enablers

Our success in these growth drivers will be supported by how well we perform these three areas which we call our enablers.

The first enabler is consumer insight and foresight. This is an essential pre-requisite for growth. We will continue to engage with consumers, understanding their needs and decoding their behaviours to take the business in the right direction aligned with and fulfilling consumer needs.

Operation and supply alignment is a core part of our focus on execution – using our agility to bring ideas to market efficiently and effectively.

And finally, shaping our environment, this is an area in which we've always been proactive, proactive in defending the tobacco industry, and increasingly, proactive in defending our consumers.

Morgan Stanley Conference

15 November 2011

Maximising Shareholder Returns

Here you can see how these elements come together to maximise shareholder value.

The 4 growth drivers, supported by our key enablers, have been chosen to deliver sustainable sales growth and that sales growth drives high margins. These margins generate strong cash flows, which we use to maximise returns and reward our shareholders whilst also reinvesting in the business.

Sales Growth Drivers – Portfolio Management

Let me explore the 4 growth drivers with you in more detail.

As I touched on earlier, portfolio management is about taking advantage of our Total Tobacco portfolio to increase our share of consumer consumption.

More Consumers, More Occasions

Our Total Tobacco approach is unique to Imperial – it's a key advantage in driving sales growth.

It means we have more consumers in more markets, with more consumption occasions, as well as benefitting our relationships with the trade.

It means we see growth in every market. We cover all the bases and there are opportunities in all markets on which we can capitalise.

Total Tobacco also provides us with a broader portfolio with which to develop and innovate as consumers are impacted by regulation and the economic environment. Our strong relationships with the trade, in part driven by our Total Tobacco approach, mean we are particularly well placed in highly regulated environments.

Same Consumer, Multiple Needs for Multiple Occasions

Delivering sustainable sales growth is not just about having the assets. It's about how you apply and deploy them.

Each consumer is different. Each has different needs and these needs can vary.

In this slide we have one individual, but viewed in many different scenarios, some formal, some informal, some with a few friends, some with many friends and some where he is alone.

His clothes differ, his choice of drink differs and his preferences differ based on the given set of circumstances.

This is typical of all consumers and presents an opportunity for all FMCG companies to develop a portfolio of products that can target multiple needs, behavioural opportunities as well as motivational opportunities. Our Total Tobacco portfolio and consumer insight gives us a significant advantage.

We are in a great position to use our capabilities to drive further growth in the future but we have already been very successful.

Let's look at the recent performance of our key strategic brands starting with Davidoff.

Morgan Stanley Conference

15 November 2011

Davidoff – FY11: +6% to 18 billion

In 2011 we increased Davidoff volumes by six per cent driven by another impressive performance in Non-EU markets.

We were particularly pleased to see continued growth in its core classic line after last year's brand rejuvenation as well as growth from new variant launches, which together led to Davidoff volumes increasing in eight of its top ten markets, with some excellent results in Saudi Arabia, Taiwan, Ukraine and Russia.

Davidoff is well suited to our focus on consumer needs-based portfolio management, and given its relative youth to other global brands, we are confident there is significant growth to come.

Gauloises Blondes – FY11: +2% to 29 billion*

Gauloises Blondes is our biggest selling brand by volume and in 2011 we achieved 2 per cent volume growth with strong underlying momentum partly offset by sanction compliance in the Middle East.

The brand is very popular within our Africa and Middle East region. By working to expand distribution we grew volumes by 12 per cent in the brand's top 5 markets. There was an exceptional performance in North Africa, up by 28 per cent with gains in Algeria and Morocco.

West – FY11: -2% to 25 billion*

West has achieved a number of gains by proving its strength as a fast follower of innovation and offering consumers premium attributes at a value price.

Whilst 2011 volumes declined two per cent, primarily due to market weakness in Poland and Turkey, we have been making good progress in consumer growth segments such as king size super slims in the emerging markets of Eastern Europe and Asia. Consumers' search for greater value has driven West's growth in volumes and share in key emerging markets such as Russia and Taiwan.

JPS – FY11: +12% to 24 billion*

JPS had another excellent year with total stick equivalent volumes reaching 24 billion compared to just 9 billion 6 years ago. A tremendous achievement reflecting our success in developing the brand in line with consumer trends.

The brand grew volumes in seven of its top ten markets. Highlights included 8 per cent cigarette volume growth in Germany, 34 per cent in the UK and in Australasia volumes more than doubled.

Fine Cut Tobacco – FY11: +4% to 41 billion*

Fine cut tobacco continues to grow, particularly in the EU, where it is a strong value proposition for consumers. Fine cut tobacco now accounts for more than 110 billion stick equivalents in the EU. More than one in every six stick equivalents smoked in the EU is a fine cut tobacco product and we continue to capture growth in this dynamic category.

We grew overall fine cut tobacco volumes by 4 per cent largely due to the

*stick equivalents

Morgan Stanley Conference

15 November 2011

outstanding growth of Route 66, which was up 49 per cent achieving great results in Germany, the Czech Republic and in Poland.

We grew West fine cut volumes by 16 per cent with strong growth in the Netherlands, whilst JPS fine cut tobacco was up 14 per cent boosted by its successful launch in the UK and Australia.

In Spain, we positioned Ducados Rubio make your own to meet consumer value trends with great results. We've increased the brand's share to over 16 per cent, making it Spain's number one fine cut tobacco brand.

We remain world leader in fine cut tobacco and expect to continue growing volumes within this increasingly profitable category.

Habanos – FY11: +4% volumes in Non-EU

We have also been actively managing our luxury cigar portfolio.

Whilst many smokers have been seeking value, those smokers who appreciate luxury cigars are being attracted to some of the exclusive editions developed within our Cuban Habanos range.

In 2011 we had considerable success in emerging markets with our non-EU volumes up 4 per cent reflecting excellent momentum in high growth markets such as Brazil, Russia and China.

Our successful launch of new exclusive editions during the year meant sales grew ahead of volumes at 5 per cent and twelve per cent outside the EU.

Sales Growth Drivers - Innovation

The second sales growth driver is innovation.

We continue to build on our existing innovation pipeline and will develop a broader set of scalable consumer-needs based innovations looking to expand our portfolio and accelerate incremental growth rather than simply replacing existing formats.

Incremental Growth Pipeline

We already have a selection of innovations that have been delivered into markets, and as you can see, we have made good progress since our new marketing director, Roberto Funari, established this innovation programme in April of this year.

The key now is to build and manage a very strong pipeline so that we generate more ideas, bring more into the feasibility phase and have more developments that make it to market.

We will focus on investing behind those ideas capable of being scaled in order to have a significant impact on our sales growth. We call this approach FEWER, BIGGER, BETTER and by executing in this way we will build more impactful consumer-lead ideas whilst generating a higher return on our invested capital.

High Return Innovation Model

Historically, the mindset of the industry towards innovation has been to focus on making product feature improvements, often based on technology, and to feed growth by replacing slow moving products with newer fresher products. This can be

Morgan Stanley Conference

15 November 2011

a costly exercise and one that restricts the ability to drive incremental growth.

At Imperial we are focussed on meeting the demands of consumers by working with consumers. We aim to deepen our understanding of what drives consumer choice and then manage and develop our category and brand portfolio to ensure we maximise our share of consumption. We have a Total Tobacco portfolio and an extensive market footprint with which to do so.

Exploiting Scalable Innovation

We intend to be the best at consumer insights based innovation and an excellent example of this is the new patented GlideTec pack.

This innovation really creates a wow factor – it stands out for consumers who are intrigued, curious or think it's smart and want one.

This pack is based on the consumer insights around the “sociability of smoking” and the ability to offer a cigarette with a one-handed motion.

The consumer research on this has been some of the most positive we have ever seen. We have launched this pack in selected accounts in the UK since the end of April and the results have been tremendous, confirming our expectations for success as we roll this out across the UK whilst finalising plans for implementation in other markets.

Innovation Within Value Segment

GlideTec is not the only recent innovation to go to market.

We are able to introduce innovation to all parts of our portfolio, from our luxury cigar and premium cigarette brands to our value cigarette and fine cut.

Our JPS brand has been very successful in our key Western European markets and much of this success is driven by our innovations with this brand.

One such innovation recently launched in Germany and Portugal is the new JPS round pack. It is the only pack we know of that has these dimensions, which are in tune with the brand's attribute of modernity and creativity.

West Fusion in Russia

We have proven that we don't always have to be first to market with new innovations in order to grow sales. Our business is agile and our ability to respond quickly to changing market trends is one of our competitive advantages.

A good example of recent fast follower success is the growth of West Fusion in Russia's king sized super slim segment.

West's share of this growing segment reached 3 per cent in September 2010 having been launched just 12 months prior and its FY11 volumes grew 112 per cent on the prior year.

Sales Growth Drivers - Pricing

Moving now to our third growth driver – pricing, or more specifically, how we use all aspects of pricing to maximise our revenue growth.

Clearly pricing is a major value creation driver in tobacco, more so than other FMCG industries and, despite occasional price skirmishes, this driver is very much intact with 2011 pricing benefits finishing well ahead of 2009 and just under 2010.

Enhancing Our Capabilities

This growth driver incorporates our strategies on excise management, as well as focusing on how we can best use pricing across the multiple sales channels.

By enhancing our ability to model various scenarios and deepening our market and consumer insight, we aim to identify segmented opportunities where we can create consumer value and then develop tailored sales solutions to capture these profitably.

By abandoning a one-size-fits-all approach, we can place selected brands and products in specific channels and differentiate our pricing to reflect how effectively we satisfy our consumers' needs.

Many examples exist throughout Imperial. For instance, in the UK we introduced the 10-pack Lambert & Butler which caters for those who trade up to an L&B for a night out.

In Germany, we offer German consumers who seek value the ability to purchase larger pack sizes containing more cigarettes. This reduces the price per stick when compared to a pack of 19s and has proved very popular as evidenced by our competitors following with similar offerings.

Pricing Strategy Drives Growth

Managing pricing proactively and reactively is about capabilities in analytical skills and the application of specific tools.

By developing a common framework and toolbox, we will widen and deepen our capability across our market footprint, but clearly we have “pockets of excellence” we can leverage.

For example, in Australia we developed an analytical tool that gave us a deeper understanding of price elasticities by individual brand. Using this tool led us to strategically reposition our Horizon brand which resulted in a sharp turnaround in the brand's market share trend. This was a key driver behind the growth in our overall market share in Australia of 1.6 per cent in 2011.

Another example is here in the UK where we analysed the relationship between brand prices and share in more detail. Our insight led us to increase the price of Windsor Blue relative to its previous benchmark of Sterling.

As you can see in the chart on the right, Windsor Blue market share has been boosted, as has this brand's profit contribution, whilst Sterling share has lagged this growth.

Morgan Stanley Conference

15 November 2011

Sales Growth Drivers – Customer Engagement

And finally, our fourth sales growth driver – customer engagement.

This is about a deeper understanding of customer and shopper needs as a basis for enhanced customer management.

By building on our understanding of specific shopper profiles, channel trends and market environments, we can tailor a route-to-shopper proposition that will best meet the needs of the consumer and retailer.

Morocco RTM Strategy

Our Moroccan business is an excellent example of how we have developed customer-centric solutions that generate benefits for us and our customers.

The monopoly in Morocco ended in January 2011. In order to maintain our strong position, our team implemented a new business strategy last year focussing on 5 key points, the first of which was to create a route to market system.

By placing the retailer firmly at the centre of our strategy, we changed from a model that relied solely on 27 Cash & Carry's offering the retailer a supermarket-like shopping experience to a free door-to-door delivery service utilising only 19 order preparation sites.

To strengthen our sales and marketing activity, a telephone sales centre was created in Casablanca to take and manage customer orders.

The result is that we have stronger relationships with our retail customers as evidenced by our cigarette market share remaining stable in FY11 at 83.1 per cent despite the more competitive market conditions.

Outperforming in Dark Markets

Imperial has significantly invested in the development of its sales forces and we measure their performance growth across 30 markets worldwide.

The litmus test of our effectiveness in driving customer engagement is of course in dark markets and this chart demonstrates that in the darkest markets – like Australia and Norway – we are growing market share.

Our clear focus across display ban markets has been on:

- optimising the portfolio;
- aligning call frequency to influence outlets;
- ensuring on-shelf availability;
- trade investment; and importantly
- education programs for our sales forces and customers.

As you can see this is paying off with share gains in Australia where our MAT share in FY11 was up 1.6 per cent despite last year's 25 per cent tax increase, and in Norway where our snus and FMC shares were up 0.9 and 0.2 per cent respectively.

Sales Growth Drivers

Having looked at our 4 sales growth drivers I would like now to close by talking about how sales growth translates into maximum returns to our shareholders.



Morgan Stanley Conference

15 November 2011

Maximising Shareholder Returns

Maximising shareholder returns is about growing the business, maximising our cash flow and successfully redeploying that cash.

We have identified the critical sales growth drivers and we know the key enablers that are best used to drive sales growth.

From that revenue growth, our high gross margins and efficient operations will drive cash flow growth, which we will reinvest in the business while also managing the capital we deploy to further maximise returns and reward our shareholders.

We have demonstrated our ability to drive growth through Total Tobacco, particularly within growth segments, and there are growth segments in all markets. By focussing on the things I have mentioned today, we see opportunities to further unlock our potential and deliver high quality sustainable earnings growth.

Morgan Stanley Global Consumer Conference 2011

Thank you for your attention. I would now like to invite any questions.