Investor Day Presentations

26 February 2013

Driving Quality Sales Growth – Arthur van Benthem, Group Sales Director

Good morning ladies and gentlemen. My name is Arthur Van Benthem and I am the Group Sales Director at Imperial Tobacco.

Driving Quality Sustainable Growth

I'd like to talk to you this morning about how we are driving quality sales growth. Here we are looking at how we have used our in-depth consumer understanding to drive consistent KSB growth and how we have the opportunity to replicate this approach to those brands with more value to be unlocked, and to drive our footprint, as Alison mentioned. I'll talk about how our fresh approach to looking at our portfolio will give us many more levers to use in delivering sustainable sales growth of 2 to 4 per cent in line with our earnings model. Much of this starts with our understanding of the consumer, and I'll talk more about this in a minute. I then want to discuss how we are extending this approach from our key strategic brands, of which most of you are probably familiar by now, but taking this across our entire portfolio, and in doing so, viewing the roles of our many brands and markets differently, and I will talk about focus brands, portfolio brands, as well as drive profit markets, drive scale markets and drive share markets.

In Depth Consumer Understanding

At the heart of our key strategic brands growth is our understanding of consumer needs and consumption occasions. We navigate through these needs by using the model shown on this slide. Many of you will have seen us show this before. This is the generic version and you can see it identifies consumer motivations such as relaxing and enjoyment and we then work to map these to consumer rituals such as coping with frustrations and how consumers enhance their smoking experiences, such as tapping a cigarette before lighting it. We use this insight to create a portfolio which is more relevant to consumers, to create brand propositions that are more relevant to consumers and to drive a relevant innovation pipeline. We are understanding the needs states that sit behind the many consumer motivations, and in doing so, building greater relevance to our portfolio.

In Depth Consumer Understanding (continued)

Hopefully that video was useful insight into how we are using this model in managing our portfolio and building our innovation pipeline. We believe that if you realise, if you appreciate that this understanding and the world that sits behind this really allows us to understand why consumers choose the brands that they do. If we understand that, we can obviously influence why they would not be choosing our brands. So it's a very powerful model.

Key Strategic Brands Drive Growth

Understanding consumers has been key to growing our key strategic brands at 7 per cent in volume terms in FY12 and 13 per cent in revenues. This is a key enabler of our earnings model to generate the 2 to 4 per cent sales growth Alison highlighted earlier, but it does more than that, it drives high quality earnings growth. Growing these brands supports our high margins and strong cash flows, part of which we re-invest to ensure sustainability of growth.

Key Strategic Brands Performance

Our key strategic brands continue to grow volumes despite economic recession and declining industry volumes in many markets. In our financial year 2012 this group of four brands passed the 100 billion stick equivalent threshold and we see growth continuing.

Davidoff: Luxury Credentials

Let's examine each of the key strategic brands individually. Firstly Davidoff – our leading luxury cigarette asset, and like all successful luxury brands, Davidoff is able to generate a strong almost irrational emotional link well beyond functional benefits. Consumers want to make the ordinary moments special as well as demonstrate success by consuming luxurious brands. These consumers have the means to make everyday moments more special and they want to be praised for the success they are having in life. Davidoff remains true to the philosophy of its creator, Zino Davidoff, who strived "to make smoking the pleasure it should be." And here we see this in the attention to detail within the brand and the product, the many cues that demonstrate that this is a luxury brand that fits into their lifestyle and makes the everyday special. Today the portfolio is split across two key needs states, which generically translate into Power, being the classic range, and Enjoyment, which comprises the Black & White range and Davidoff iD – created a cigarette that offers an everyday indulgence, and extends the brand across more consumers and more occasions. Further building on luxury length line is the recently launched world first ultra slim Davidoff Boudoir, a cigarette already attracting the attention of Russian consumers.

Gauloises: Truly Unique

Next is Gauloises, a brand built around celebration being unique, enjoying our independence, on my own and with others. For consumers it sits up in the north to north-west corner of the needs model, enjoyment, vitality, wanting to stand out, experience freedom. Gauloises also has some unique qualities, with 45 per cent of its consumers under 35 years old. Its "savoir vivre" position portrays living the good life whilst remaining elegant and smart, this is unchallenged by any other brand and it great heritage within its French origin has been a key reason why it has delivered consistent volume growth in established markets. In Germany the brand has consistently grown with add free variants being added to the portfolio. In France we have stabilised decade long decline of Gauloises Blondes and we continue to see excellent growth within our Africa Middle East region where we have leveraged our local insights and invested into formats supported by demand shifts.

West: Our No.1 Value Brand

West is our leading value brand, synonymous with taste and quality since the 1980s. We have invested behind this brand and grown our portfolio of new tastes and experiences as well as enhancing the product quality. By effectively leveraging demand shift formats, we have successfully grown West's volumes and its share is up in 10 of its top 15 markets. Let's have a look at how West looks today.

West: Our No.1 Value Brand (continued)

As you can see WEST offers the VFM consumer security and reassurance, achieved through brand equity and the taste & quality experience. It's a value brand so it sits at the south end of the needs wheel.

JPS: Unique Style

JPS is an iconic brand with a unique style and an important legacy, many consumers remember the iconic black JPS formula 1 car, and JPS always available in black. JPS delivers on what generically is the Power need, a bold quality within a value brand, and a unique offering to the value-minded consumer who usually seeks reassurance around the south east region of the needs wheel, but this is a brand that has proven it can beat Marlboro and other premium brands by achieving 10 per cent share in UK, Germany, Austria and most recently also in Portugal and continues its strong growth in Australia.

For Different Needs and Occasions

JPS consumers want to pay a fair price for an international brand without compromising on quality and style. They want to act and look smart with a brand that provides style and elegance.

Originally a virginia blend cigarette, JPS now boasts a full range of different tastes and formats. JPS is our true Total Tobacco brand – firing on all cylinders in FMC and FCT. On the innovation side, it leverages its black elegance and style whilst offering the consumer the choice of GlideTec, crush ball and new RYO flavours and there is more to come.

Driving Quality Sustainable Growth – Portfolio Potential

So in summary, we have used our consumer-focused approach to drive growth in our key strategic brands. Now we see other opportunities for further sales growth by replicating this approach to those brands with more value to be unlocked, and to drive our footprint.

Driving Quality Sustainable Growth

As you can see on the slide, 5 of the 6 total tobacco assets are in growth and our focus is now firmly on the portfolio of 150 regional and local cigarette brands which collectively are currently a drag on our growth. These are mostly a legacy of our acquisition strategy over the past 16 years and currently represent 58 per cent of our group volumes. We are excited about the possibilities for value creation when we get this part of the portfolio right, and so we continue to work to question role of each brand in the portfolio, assessing levels of brand equity, consistency of performance, ability to generate cash or scale and how we might apply a similar to that taken with our key strategic brands, or whether we have to migrate consumers into other areas of our portfolio.

Clear Portfolio Priorities

To address the challenge we have created 3 brand clusters. Firstly the key strategic brands, these are our power brands, they lead segments across key markets, they have strong equity and generate high returns from sales growth. Next we have our focus brands, and here we will extend approach taken with our key strategic brands. Initially there will be 4 brands in this cluster: Bastos, News, Fine and L&B. These brands have leading position in key markets, strong equity with consumers and have proven to deliver strong returns. And thirdly, a cluster we call our portfolio brands. The role here is to provide scale and cash to support the other clusters, whilst the opportunity is to reduce brand portfolio complexity, remove costs and shift investments to fuel growth in key strategic and focus brands. So a very clear approach here in managing our brand portfolio.

In Market Focus and Differentiation

From the our Consumer motivations work we can quantify the volume of each of the consumer needs, concluding that a market typically requires 3 to 5 brands to meet consumer needs spanning from value to premium price segments. We are reviewing this for each market as far as implications for our portfolio. If you consider that Davidoff and Gauloises Blondes cover off the purple and red needs, which generically are labelled power and vitality, then 1, 2 or in high volume markets possibly 3 value brands are required to complete the portfolio for that market, and these brands would address consumer's needs (generically) to achieve belonging, security and control. With this view, you easily see how we will end up with a significantly reduced portfolio of brands, reduced portfolio complexity, reduced costs, and the ability to shift investments into those areas generating the best return.

Clear Portfolio Priorities

Key strategic brands we have already discussed, so I'll move to the focus brands, and as I said, there are initially 4 focus brands, collectively representing 25 billion stick equivalents or approximately 7 per cent of our portfolio by volume. These are local jewels with regional or national coverage and strong equity and consumer base with weighted average market share of 10 per cent and sales growth of around 5 per cent in our financial year 2012. We will be applying a similar approach with these brands as we did with our key strategic brands last year. Let me introduce each of them to you now.

Maximising Brand Equity: L&B

The first of the 4 focus brands 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. Many of you will also be aware we have been applying some of the key strategic brand approach to support this brand, all based on consumer needs and rituals, and you will have seen how some of our innovations were brought to market with this brand, such as GlideTec on all king size variants, which added 60bpts in share, that's £10 million of gross margin, L&B Fresh Burst with our crushball technology, which also added share, and L&B Profile, a queen size format offer. All of these variants spread the L&B brand across more consumer needs as per our needs wheel, for example, crushball addresses consumer's need for control, a consumer wants a normal cigarette at 9am but appreciates a menthol flavour boost around lunch time and by broadening the choice we are driving more consumers in more occasions. We are looking at L&B differently, rather than simply applying a pricing lens to managing its portfolio.

Maximising Brand Equity: News

Next is News, which is a key brand in France with 5.6 per cent cigarette share and growing. News covers the same consumer needs state as Lambert & Butler and not surprisingly there are similarities in how we have invested into this brand. Assessing needs states allows us to build one brand platform and then duplicate key initiatives across markets. The News portfolio now features a Glide-Tec proposition, a crushball proposition, and significant growth in the make your own category, driven mainly by offering portion sized MYO called Dosettes, which are offered for those News cigarette smokers who wish to downtrade into fine cut tobacco but are not use to making their own with loose tobacco. This has been very successful for us in growing News overall volumes.

More Consumers, More Occasions: Bastos

Then we have Bastos, a lesser known brand. Bastos was created in 1838 at the Juan Bastos tobacco factory in Algeria. For us this brand plays key role in some of our emerging markets and has close to 10 share of the market in Vietnam. It delivers on the traditional value brand consumer need state of (generically) belonging and we think this brand will further benefit from the global brand platform approach. What we've done is to extend the accessibility of this brand, also into the left-hand side of the needs wheel, with Bastos Black, as well as make it available in slightly lower price tiers for the more value-seeking consumer needs states in the south east part of the wheel. And that is driving growth in this brand in the Vietnamese market and has a lot of potential going beyond that. So again, a brand on which we can apply the belonging needs state brand template that we've started to actually grow in 2012.

More Consumers, More occasions: Fine

Finally, there's Fine, a brand created in the late 1970s and rooted in European aspirational heritage. It has a significant presence in some key Western African markets as well as some emerging Asian markets. Given its value price and quality attributes, we are confident this brand will continue to benefit from the JPS-type brand template in order to deliver on the (generic) purple need state of power, delivering to the consumer respect and acknowledgement, praise for success and achievement.

Focus Brands

18 months ago we started to apply some of the key strategic brand approach across these brands, with our financial year 2012 being the first full year of

application and as you can see from this slide, the results are encouraging, both in volume and value.

Clear Portfolio Priorities

Moving now to the remainder of the cigarette portfolio and here we see many of the brands that we have accumulated as part of our acquisition strategy. There are over 150 brands in this cluster and this is a key area of focus, but it's not simple as they are not all the same. Most have no global or even international reach and some are what we call local jewels and therefore they may generate consistent value in future. Some brands we will want to nurture, some we will migrate, some will be scaled up, but how many do we need? 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 so as to invest in key growth areas within the business.

Nurture

Nobel is a typical nurture brand - well known in Spain, where it has a loyal, mainly female consumer base. None of the consumer needs addressed by this brand overlap with the key strategic brands in the Spanish market. Therefore, we will look to nurture this brand because it has a distinct target audience. It will benefit from our group innovation pipeline to unlock its potential and support future performance.

Migrate

John Brandon was solid performer in Australia for many years. However, in recent years brand inflow has become exhausted and it has started to lose volume. Also, it overlaps with JPS on consumer needs. So, prior to the implementation of plain packaging, we migrated its consumers to JPS and I am pleased to report that not only has this reduced complexity but also the 2 brands combined have achieved a greater share than they held collectively prior to migration. This was a success, but obviously this will not always be the case, but we can take the lessons learned from this exercise and apply them to other brands suitable for migration.

Cash

Brands falling within this category are typically brands with high consumer loyalty, like Gauloises Blue, our non-filtered dark tobacco brand which required little activity to maintain its current returns despite being in structural decline due to an ageing consumer base. These returns fuel investment in key strategic and focus brands.

Clear Portfolio Priorities

So, I have highlighted how we are balancing and optimising our portfolio for future growth in order to achieve our goal of developing an optimal profile of our brand portfolio by volume such that key strategic brands represent 50 per cent, focus brands 30 per cent and portfolio brands 20 per cent. We see this as achievable and are excited by the value this will create.

Driving Quality Sustainable Growth – Footprint Opportunities

Looking at our overall growth roadmap, we have now talked about our key strategic brands and I have given you some more detail on how we will maximise the brand equity to unlock further value across the remainder of our portfolio through our consumer-focused approach to examining role of each portfolio brand.

Now let's turn to market footprint opportunity.

Size of Prize and Footprint Opportunity

We see a global profit pool of approximately 27 billion pounds, excluding China, but we are all too aware that two thirds of our profits come from the EU, so we understand the opportunity that exists for Imperial outside the EU. We have split the global profit pool into three group, as you can see on the slide. The first group we refer to as white spots, where we currently have no presence. It is here that we are taking a fresh new look at our footprint to see where we can capture some of the estimated 5 billion pound profit pool in these markets. The middle group of markets are our stronghold, we have 30 per cent of the estimated 8 billion pounds of profits in 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'll be looking at very selective opportunities in these markets to invest for medium-long-term growth to actually scale these businesses because of the 14 billion profit pool that is available there.

Focussing Resource Investments

As I mentioned, this is a fresh perspective to reviewing our footprint and classifying the role of each of our markets. 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 hurdles. Every single market in our portfolio has been classified in this way, so let me examine this in more detail.

Firstly our drive profit group, and 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 brand assets 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.

Drive Profit: Poland

Poland is a good example here. We aim to drive our profit in the Polish market despite competitive and environmental pressures. Most of you are aware of the recent challenges within this market, namely the uncut leaf issue and significant competitor entry into the fine cut tobacco segment, but we take a very consistent approach within this market in driving our profit, sometimes at the expense of some basis points of market share, but always with a year on year view to profit delivery, particularly within fine cut tobacco. We've created the Polish fine cut tobacco market and we continue to lead this segment with our strong brands and it's an important driver of our profitability within this market. On the right hand side of the slide you can see how we have been able to grow key strategic brands from 23 per cent of our Polish volumes in 2010 to 26 per cent in 2012 and just over 30 per cent of revenues in that business. So our focus for the future will be to continue growing our key strategic brands and overall value in this market and we think complexity reduction will assist us in driving a more concentrated portfolio and delivering future profitability.

Focussing Resource Investments – Drive Share

Now to 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.

Drive Share: Kazakhstan

Kazakhstan is a market we haven't spoken about much in the past, it is a good example of a drive share market for Imperial. This market boasts considerable size, at 25 billion stick equivalent volumes, one third of which is in the premium segment. We made organic market entry a few years ago, and since then we have established a strong foothold by gaining share year on year through focused activation with Davidoff and West with particular emphasis into the growth segments in this market, capitalising on consumer demand shifts. Key strategic brands represented 53 per cent of our volumes and 73 per cent of our value in this market in financial year 2012 and we are confident of further growth.

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.

Drive Scale: Turkey

Turkey is a drive scale market for us, it has significant volumes, at roughly 85 billion sticks, there is strong competition and the market is heavily regulated. There are parallels between what we are doing in Turkey and what we are doing in the US, so please recognise this. Both markets we have been hovering around 3 to 4 per cent share. In Turkey, our competitors are bigger in terms of share, and most of them operate a direct store delivery model, or DSD, which can be costly particularly without considerable critical mass. It also means that many retailers hold little to no stock as they are being supplied on a daily basis. It was towards the end of 2011 that we started seeing things differently and thought about doing things differently, different to our competitors. Out of this we have developed is a route to market that differentiates between tier 1 and 2 cities and rural areas and this has enabled us to start building scale in the market. This has been supported by focused brand portfolio led by Davidoff and West and the result is that our share in our first quarter of 2013 was up to well over 4 per cent and reaching 8 per cent in tier 1 cities. This is a very pleasing result and the parallels with the US are again we don't have the size of our competitors, so we are thinking differently, focusing our brands and sales teams into specific states and build critical mass in our tier one states, then expand on it, step by step, as opposed to a mile wide and inch deep, which is what we had previously. Turkey also highlights the strength of our KSBs, which represent well over 65% of volumes and even higher in revenues, so our focused approach here and leveraging the needs of Turkish consumers is paying off.

Focussing Resource Investments

So, as you can see, plenty of geographic opportunity. A focussed investment approach with a clear role for each market, and you can well imagine how we might extend our regional focus to say, well actually, we want to be having regions that actually are focused on driving profit, share or scale because the leadership, the best practice, the sharing of information, the capabilities are quite different when you are as clear as we are now on the role that different markets, that different regions have to play in this global footprint that we have. Our greater clarity and focus will bring results.

Clear Portfolio Priorities

That covers the three main sections within our portfolio priorities: our key strategic brands, our focus brands and the portfolio brands. We continue to build on our strong consumer insights and apply rigour in addressing consumer needs with distinctive roles for our brands portfolio. We are refreshing our review of portfolio brands, over 150 brands that we see great opportunities to take complexity and cost out of the business here, and in doing so, we can reallocate investments across our portfolio. This provides us with greater levers to use in delivering the 2 to 4 per cent sales growth as part of our earnings model.

Driving Sustainable Quality Sales Growth

My final slide, and here you see how this comes together to drive our powerful 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 2 to 4 per cent sales growth.

Thank you and that's it for me.