# Acquisition of US assets completed

15 June 2015

## Alison Cooper

Good afternoon, everyone, and thank you for joining us today. I'm Alison Cooper, Chief Executive, and I'm here with CFO Oliver Tant, Chief Financial Officer, Matt Phillips – who, as you will have noted from our completion announcement, is our new Chief Development Officer – and also David Taylor, the CEO of ITG Brands, who joins us from Greensboro. I'll take it you've read our disclaimer.

I'm going to start by putting the deal in the context of our key strategic objectives, against which we are continuing to make good progress, as per our interim results announcement in May. One of the key priorities as part of developing our footprint was completion of the US deal, followed by rapid and efficient integration with our existing US operations. And as you're all aware, we've completed the acquisition and ITG Brands is now operational. Our focus over recent years has been on building a platform for sustainable growth in revenue, earnings and returns to shareholders. The acquisition of these US assets and expansion of our US business is strongly aligned to that strategy.

The combination of a stronger and more complete brand portfolio, more extensive infrastructure and enhanced operational capabilities transforms our US business. From having been number 5 in the market, we are now the clear number 3, a far stronger competitor with a day one market share in cigarettes of 9.5%. As I've commented before, when compared to certain markets in the EU and in many developing economies, the US market is one in which changes in regulation tend to be more measured. The FDA adopts a largely scientific approach, looking at evidence before making decisions which, combined with the relative affordability of cigarettes in the US, results in a positive operating environment.

The expanded US business will now be our largest in net revenue terms and on a 2014 pro forma basis would have represented around 20% of Group adjusted operating profit. The integration of assets with our existing US business will generate cost synergies, which will be reinvested behind the brand portfolio, and we expect the business to be strongly cash-generative, supporting dividend growth and debt reduction.

Just to reinforce the affordability point, this is a chart that we referred to back in July but one I think is worth remembering. US cigarette prices are currently amongst the most affordable in the world measured against local purchasing power.

So let me quickly summarise the completion highlights. Following the receipt of regulatory approval from both the FTC and DoJ, we have completed the transfer of all Reynolds and former Lorillard assets as per the detail in our circular back in December. I should also add that there have been no material changes to the deal structure or additional remedies applied. For those of you questioning our definition of the seasons over the past few months, I'm also pleased to confirm that with nine days still to go until midsummer's day, we've completed the deal in the spring.

The consideration for the deal of $7.1 billion has been settled, drawing upon the committed bank facilities put in place in July last year though, as many of you expect, we are currently looking at refinancing opportunities and will keep you posted on any activity going forward.

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We've already undertaken an extensive amount of work to ensure a smooth transition of brands, facilities, systems and people. The completion of the deal and operational readiness has been down to the immense effort and commitment shown by a dedicated team of people drawn from Imperial, Commonwealth and Lorillard. My thanks for a truly fantastic job.

As per the purchase agreement, we and Reynolds are now in a managed transition period of a few months, which helps provide stability as we introduce new commercial arrangements for the trade. Our commercial and operational strategies, including portfolio investments and customer relationship activities, have been finalised and are starting to be deployed. The total share of acquired cigarette brands over the latest quarterly period to 9 June is 6.8%, which is in line with the day one assumptions originally used to evaluate the deal. The latest quarterly data shows the combined market share of Winston, Kool and Salem to be 4.9%, and Doral has therefore not been included in the acquired brands at closing. Together with our existing Commonwealth share of 2.7%, ITG brands day one share of the US cigarette market is 9.5%. Winston, Kool, Maverick and USA Gold in cigarettes; Dutch Masters and Backwoods in mass market cigars, and blu and e-vapor give us a strong portfolio, materially increasing our relevance to key retail accounts and influence with the trade across the US.

We have completed a full training schedule for the sales team, who are ready to start work with the new portfolio. And as David has said to me on a number of occasions, it's not the brand that builds the team but the team that builds the brand. The team is already in place, with a structured design to reflect both the existing strength of the new portfolio and our opportunities for growth on a state-by-state basis.

This is not a deal which has been driven by the opportunity to reduce costs. Whilst those opportunities do exist and will be realised, we've been clear from the outset that the commercial rationale lies in the inherent brand equity and opportunity to grow sales. We've developed trade marketing, A&P and pricing strategies and reflected in our plans the material uplift in investment we believe is required to drive a turnaround in share. That investment will be primarily directed towards Winston, which is still the sixth largest brand in the US in spite of having had no focus and little or no support for a number of years. We will also increase the investment behind Kool and Maverick, whilst broadly maintaining investment in USA Gold. Stability in our overall US market share is our first objective, and this will be achieved through all aspects of our sales and marketing activities to develop sustainable and profitable market share.

In line with the original terms of our agreement, both Reynolds and ourselves are working through a structured route-to-market approach. This allows for a transparent and orderly transition of ownership, with the re-merchandising of brands, alignment of shelf space and introduction of new commercial terms being phased across the next five months.

We are excited to be welcoming the blu team on board and combining a fantastic e-vapor brand, Silicon Valley know-how with the technical expertise and IP from Fontem. As you're probably aware, we are already distributing blu under licence in the UK, and this is reinforcing our view that blu is a brand with strong potential. The management changes we announced in our release are indicative of the level of commitment we have in e-vapor and the ongoing development of new consumer experiences.

Although the assets did not formally become ours until last week, integration planning started several months ago. Dedicated teams across both Imperial and Lorillard have been working together to cover all areas of the business in readiness for completion. Post-completion integration is now fully underway. As we've already announced, David Taylor, the former CFO of Lorillard, has been appointed to run ITG Brands. David brings with him a huge amount of experience and in-depth knowledge of the sector and David, perhaps you'd like to say a few words at this stage.

### David Taylor

Thank you, Alison. I am delighted to be leading ITG Brands and it is a pleasure to be joining you on today's call. As you mentioned, we've made a great deal of progress on our integration efforts, our operational readiness and our brand plans for ITG Brands newly expanded portfolio of tobacco products. I suppose that is one of the hidden benefits to have waited so long for the required regulatory and legal approvals to close the transaction. We've had more than ample time to create a robust transition.

This is truly an exciting opportunity for us at ITG Brands to build value based on a diversified portfolio of brands across menthol and non-menthol segments of the US cigarette market, combined with market-leading brands in the mass market cigar and e-vapor categories. In the cigarette market, our vision is to restore the brands acquired from Reynolds by leveraging the high name recognition of these brands, primarily Winston and Kool, with significant investment and increased visibility at retail, professionally executed by what I believe to be the best combined sales and marketing teams in the industry. This will be our absolute focus at ITG Brands. This will of course be complemented by our leading mass market cigar brands Dutch Masters and Backwoods, as well as blu, one of the leading consumer propositions in the e-vapor space.

Our portfolio strategy is designed to balance market share and profitability, and as Alison said, we have a long-term perspective that will be driven by consistent investment over the long term to drive sustainable, profitable market share. Our strategy and tactics will not seek quick wins but will be focused on delivering meaningful results over time. That is how Lorillard won in the US marketplace in the past and that is how my former Lorillard colleagues as well as our new Commonwealth Altadis team members are positioning ITG Brands for success in the future. Lorillard's sales and management teams have widely been regarded as best in class in the US, and the additional talent from Commonwealth Altadis makes the team better and brings special expertise in other tobacco categories and to our new organisation. ITG Brands brings together the best elements of Lorillard and Commonwealth and we are supported by Imperial's extensive global team. It is truly a powerful combination and we are all very eager to get to work.

I look forward to sharing our future successes with you as we continue to build our US business. For now I'll turn it back over to Alison. Thank you.

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### Alison Cooper

Thank you, David. Culture is something which I feel is often overlooked in integrations. David talked there about bringing teams together across Lorillard, Commonwealth and the wider Imperial Tobacco Group. The formal monitoring we've carried out over the past few months reads very positively: the collaborative and can-do attitudes demonstrated by the integration team from Commonwealth and Lorillard has been evidenced throughout the planning process, and they've put us in a great place to hit the ground running. Over the past months, this team has addressed over 1000 integration activities covering finance, sales and marketing, manufacturing and supply chain, systems, HR, regulation. All of these have been critical to our day one readiness and I'm delighted that the process has gone so smoothly. On the manufacturing side, we have an agreement in place with Reynolds which allows the reciprocal manufacturing of our respective brands and the gradual transition of Newport production from Greensboro to their facility at Tobaccoville and vice versa for Winston, Kool and Salem. I don't intend to go into the nuts and bolts of that arrangement but what I will say is that the planning is at a granular level to ensure continued supply to our customers and the full transition of manufacturing between ITG Brands and Reynolds.

From a customer perspective, we began preparing them for the changes several weeks ago, with correspondence covering the new organisation, sales setup and brand portfolio. We're now actively managing the customer engagement process within the phased route-to-market approach I mentioned earlier.

I'll now hand over to Oliver, who will take you through some of the broader financials before we move on to take your questions.

### Oliver Tant

Thanks, Alison. Let me start by talking through where we stand on financing. Consideration of $7.1 billion has been fully settled, drawing against the US dollar-denominated bank facilities put in place before we announced the deal in July last year. It is likely that we will refinance part, if not all, of these facilities in the debt markets. While the date of any issuance has yet to be agreed, it is likely to be sooner rather than later. At current market rates, we would expect to achieve a rate of approximately 4% across a blend of maturities. In the short term, the impact on the overall Group cost of debt is likely to be a nominal reduction. We consulted all three ratings agencies – Standard & Poor's, Moody's and Fitch – before the deal was announced last July and have maintained regular contact with them since. All three remain comfortable with our post-completion financial parameters, which are as expected.

The financials in our plans are attractive, with strong earnings accretion in year one. As Alison mentioned earlier, however, the compelling deal rationale is the longer-term opportunity to reinvigorate an attractive portfolio in a stable and profitable market. In order to achieve that, we will significantly upscale and maintain investment in those brands, in part funding that through the reinvestment of all deal-related synergies.

As I've said before, the circular can be used as a good proxy for financials relating to the incremental US business in FY '16, in particular the profit that we expect to be generated from these acquired assets. Just to remind you, the amortisation of US intangibles which are expected to be around $6.4 billion, are tax-deductible and will generate a real post-tax saving of $170 million per annum over 15 years. Taking this into account, we do not expect our overall Group effective adjusted tax rate to change materially, remaining at around 21%.

Finally, we expect one-off deal-related charged to be approximately £100 million in total across FY ’15 and FY ’16.

Thank you, and now back to Alison.

### Alison Cooper

Thanks. Before taking your questions, I’d like to finish with the slide we closed with when we announced the deal back in July. These assets materially enhance our portfolio, our scale and our capability in the US. With a share of nearly 10%, we’ll be a stronger competitor in a market with a growing profit pool, which benefits from relative affordability, regulatory stability and improving near-term fundamentals. We’ve acquired these assets at a financially attractive price with a cash-generative earnings stream which further strengthens our ability to generate returns for our shareholders.