Half Year results presentation

01 May 2012

Alison Cooper, Chief Executive, Bob Dyrbus, Finance Director

Good morning and welcome to our half year results presentation. I'm Alison Cooper, Chief Executive of Imperial, with me is Bob Dyrbus, our Finance Director and other members of the senior Imperial team including Matthew Phillips who will be appointed to the Board as Corporate Affairs Director in June. I'm pleased Matthew's joining the Board; his appointment reflects the importance of Corporate Affairs to our sales growth strategy.

After a brief overview of our first half performance, the team will take any questions.

Our Strategy

Our strategy continues to deliver sustainable returns to our shareholders and we remain focused on realising the potential of our assets.

Maximising Shareholder Returns

We maximise shareholder returns by driving sales, generating high margin profits and using our cash to reward investors and support the development of the business.

It's a growth model that continues to create significant value for our shareholders.

The four sales growth drivers are central to our success and I'll be talking more about them later.

HY12 Performance Highlights

Our focus on driving growth through our unique total tobacco portfolio, whilst effectively managing cost and cash, has delivered a number of highlights in the first half, and the sales momentum we're generating has been reflected in a strong performance in the second quarter, with tobacco net revenues up 8 per cent against the same period last year.

We delivered good first half growth from our key strategic brands Davidoff, Gauloises Blondes, West and JPS, with combined stick equivalent volumes up 5 per cent and brand net revenues up 12 per cent.

Fine cut tobacco volumes declined 1 per cent, driven by market weakness in Poland; excluding Poland, our volumes were up 3 per cent.

We improved volumes of our luxury Cuban cigars by 3 per cent and revenues by 8 per cent with strong growth in emerging markets, and we again delivered excellent results in smokeless, improving snus volumes by 74 per cent.

On a constant currency basis our portfolio gains resulted in growth in both tobacco net revenues and adjusted operating profits of 3.3 per cent.

We continue to invest in the business to build sustainable revenue growth whilst maintaining strong tobacco adjusted operating margins at around 43 per cent.

Adjusted earnings per share rose 5.1 per cent; we increased the interim dividend by 13 per cent and intend to continue growing annual dividends ahead of adjusted earnings per share growth.

In addition, we completed the £500 million share buy-back announced this time last year and the buy-back will continue at this annualised rate going forward.

Sales Growth Momentum - strong Q2 performance

On a half yearly basis, stick equivalent volumes were down 4 per cent.

The first quarter was challenging due to a number of specific external factors which clouded our true achievements.

Looking at the second quarter figures gives you a much better insight into the sales momentum we're generating.

We delivered a strong performance with volumes down just 1 per cent and tobacco net revenues up 8 per cent, and that's despite the impact of the Syria sanctions which we're still lapping.

Sales Growth Momentum – key strategic brands leading growth

Our second quarter growth reflects the success of our key strategic brands, with combined stick equivalent volumes up over 6 per cent and revenues up 15 per cent against the same period last year.

A very pleasing performance and we'll be building on this sales momentum in the remainder of the year.

So, that's an overview of 'what' we've achieved; I want to now focus on the 'how', how we're realising the potential of our assets to drive sales growth and deliver high quality sustainable earnings.

We have a winning mindset; a best in class reputation for managing costs and industry leading margins, and we're focused on delivering sales excellence across the business through our four sales growth drivers.

Sales Growth Drivers

These are portfolio management, innovation, customer engagement and pricing.

Applying consumer and customer insights across the four growth drivers is key to the work we're doing to drive sustainable sales.

We're enhancing our expertise in all these areas and I'm very pleased with the results.

Let's start by looking at portfolio management.

Portfolio Management - more consumers, more occasions

This is about capitalising on our portfolio strength; realising the potential of total tobacco to maximise our share of consumers and consumption – reaching more consumers on more occasions.

Portfolio Management - Davidoff

We've been very successful in achieving this with Davidoff, generating strong sales growth in emerging markets where disposable incomes and consumer preferences for luxury brands are increasing.

Half year volumes were up 2 per cent, with further gains in Asia and the Middle East, and we grew second quarter volumes by 5 per cent reflecting the brand's positive growth momentum.

In Eastern Europe we've put Davidoff into profitable high growth segments such as king size superslims and queen size, significantly increasing our volumes of these formats.

Davidoff growth was also strong in Asia-Pacific, where brand volumes were up 11 per cent, and there's much more to come; Davidoff has huge potential and we're currently finalising a number of key initiatives to fuel further growth in the second half and into next year.

Portfolio Management - Gauloises Blondes

Gauloises Blondes is our largest brand, with annual stick equivalent volumes of around 30 billion.

It's a brand that's well-positioned in the EU and growing fast in Africa and the Middle East.

The success of Gauloises Blondes is driven by its iconic branding, emphasising "freedom" and "joie de vivre". We're currently rolling out a new global campaign called 'Light Up Your Life', which highlights the brand's sense of free spirit.

These initiatives are designed to build on what was a great first half performance from Gauloises Blondes - volumes were up 11 per cent, driven by strong gains in Africa and the Middle East where volumes increased by 20 per cent.

We've also extended the franchise with Gauloises Tactil, a new cigarette blend in an innovative GlideTec pack. Tactil has just been launched in France and the initial response has been excellent.

Portfolio Management - West

Overall volumes of West were flat but we're achieving gains in numerous emerging markets in Eastern Europe and Asia, with Taiwan up 35 per cent and further growth in Russia and Ukraine.

Consumer demand for innovation remains strong in Eastern Europe; the launch of queen size West Compact in Ukraine and West Duo, with a crushball filter, in Russia is supporting our ability to capitalise on these growing trends.

Portfolio Management - JPS

JPS has been a star performer for several years. By making JPS increasingly relevant to value seeking consumers and creating a total tobacco brand franchise, we've transformed its performance.

Annual volumes reached 25 billion stick equivalents in the year to March and we've continued to build on the JPS success story.

We increased volumes by over 4 per cent in the first half, achieving growth in a number of markets with strong results in the UK and Australia.

There's further untapped potential in JPS and we recently completed a major rejuvenation project aimed at reinforcing the brand credentials.

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Portfolio Management - fine cut tobacco

We're world leaders in fine cut tobacco and we've been reinforcing this position by strategically managing share and profits to maximise returns.

Overall volumes were down due to a weaker market in Poland, compounded by destocking, although we increased our share.

We're focused on driving profitable growth in the make your own category in a number of European markets through JPS, Ducados and News.

Our leadership in fine cut tobacco is supported by our ongoing success in papers and tubes; volumes were up 5 per cent and 10 per cent respectively in the first half.

Portfolio Management - Habanos

We delivered another very strong performance with our luxury Habanos cigars, particularly in emerging markets.

Growth is being supported by limited editions, such as the Cohiba Behike line.

We increased overall volumes by 3 per cent and sales were up 8 per cent, with emerging market volumes up 12 per cent and sales climbing 17 per cent as a result of excellent gains in China, Russia and the Middle East.

Portfolio Management - Smokeless

Our smokeless tobacco business continues to go from strength to strength in Scandinavia, where we've developed a dynamic snus portfolio that's in tune with what consumers want.

The portfolio's well placed to reach more consumers on more occasions, with a strong presence in both premium and value.

The new factory's enabling us to keep pace with the growing demand for our brands; in the first half we improved volumes by an impressive 74 per cent and increased market shares in Sweden and Norway.

We've further strengthened our position in Sweden by launching a new brand to compete in the value segment. Smalands Snus is named after the region where our factory's based and will further enhance our ability to maximise growth opportunities.

Innovation - new consumer choices

I gave a flavour of our innovation work earlier; it's an important driver of growth and we're making great strides in building a bigger pipeline of scalable innovations based on consumer insights.

These consumer-led innovations are expanding our total tobacco portfolio; they're focused on giving consumers what they want and we're applying innovation to brands, products and markets in a way that will be margin accretive.

Innovation – GlideTec reinforcing brand differentiation

Pack innovations provide smokers with choice and reinforce brand differentiation. Branded tobacco packaging enables smokers to distinguish one brand from another, which drives effective competition between tobacco companies.

Through GlideTec we've developed an industry leading pack innovation built around consumer insights into the sociability of smoking.

It's an innovation that's strengthened Lambert & Butler's performance in the UK; we expect Tactil to do the same for Gauloises in France.

Innovation – Fortuna GlideTec launched in Spain

And Fortuna GlideTec to deliver similar results in Spain, following its launch last week.

Capacity investment is supporting GlideTec's international roll out, with a number of other brand and market launches to follow.

Innovation – high growth segments

Setting the pace for innovation and being first to market is important, we're also focused on gaining share in high growth segments; I highlighted some of these earlier, here you can see other examples.

We've been active with crushball filter technology; West Duo's also been launched in Russia and Poland and we have a Fortuna version in France.

Lambert & Butler Fresh Burst has just gone into the UK and there'll be further crushball launches in other markets.

We're also introducing queen size variants across many territories, including the current launch of L&B Profile in the UK.

More initiatives are underway as we continue to focus on building a pipeline of fewer, bigger, better innovations that are scalable and will deliver high returns.

Customer Engagement - availability and advocacy

Customer engagement is about maximising the availability and advocacy of our brands and products at the point of sale – leveraging our strong retailer partnerships to grow our share of consumers and consumption.

We've a great reputation for customer engagement and we're focused on enhancing our expertise in this area even further.

Customer Engagement – availability and advocacy

Customer engagement is a key focus area across our markets and is particularly important in a product display ban environment.

We've made great strides in Australia, where our strong trade relationships have supported excellent share and volume gains.

In the UK we've been working with large retailers in the run up to the first stage of display restrictions, which came into effect last month.

We've also extended our UK sales force coverage and are increasing the frequency of our visits to independent retailers, reducing their working capital requirements and rewarding availability and advocacy.

This activity is strengthening our position in the UK and is a key element to get consumer traction with innovations such as Lambert & Butler GlideTec, Profile and Fresh Burst.

Pricing - maximising revenue growth

The fourth sales growth driver is pricing – maximising revenue growth by taking a strategic approach to pricing opportunities by brand, pack size and sales channel.

This is about detailed pricing analysis and modelling across our footprint, as well as further enhancing our approach to engagement with authorities on excise matters.

Pricing - Fortuna in Spain

Our pricing strategy for the Fortuna brand franchise in Spain is a good example of how we're applying this thinking.

We offer consumers choice and value through differentiated Fortuna variants, and when we raised our prices last July we positioned the Fortuna family at various price points to reach a broader range of consumers.

This has helped us to get Fortuna back on a growth trend and drive brand share higher.

We're implementing the same strategy in other markets focused on maximising share and revenue growth.

From a Group perspective, we've already achieved over 80 per cent of our pricing assumptions for this financial year.

Positive Market Share Momentum

Applying all four growth drivers across our footprint is key to building sustainable sales and is delivering positive results across our regions.

This slide shows the recent upward trend of our cigarette and fine cut tobacco shares.

In the EU we continue to focus on balancing share and profit to maximise returns.

Some shares have been under pressure but we're addressing this through the growth drivers. We generated positive results in our cigarette and fine cut tobacco shares in most of our major markets in the second quarter compared to the first quarter of this year, including Spain, the UK, Germany and France.

Outside the EU, our US share has been under pressure in what remains a very competitive market, while in our Rest of the World region there's growth in value and "premium and above" products.

We're capitalising on key consumer growth segments through the success of our key strategic brands and our strong portfolio of local and regional brands, achieving particularly good results in Asia-Pacific and Africa & Middle East.

This reflects the strong second quarter momentum we generated across our regions and we'll be building on this in the second half.

I'll now hand over to Bob to take you through the financials.

Bob Dyrbus, Finance Director

Group Results

Thanks Alison and good morning everyone.

I'll start with an overview of the results.

This table includes a reconciliation between reported and constant currency numbers. I'll be focusing on constant currency adjusted numbers for all of my comments. Results have been adjusted and presented on our usual basis, with details in the appendices.

Tobacco net revenues were up 3.3 per cent with positive price/mix offsetting volume declines, whilst Logistics distribution fees declined 1.8 per cent, a robust performance given the economic climate.

Tobacco operating profits increased 3.3 per cent and Logistics operating profits decreased 3.8 per cent giving combined growth at a Group level of 3 per cent. We continue to invest in the business to drive long-term growth whilst generating high margins of around 43 per cent.

After tax being charged at an effective rate of 24.5 per cent, which remains our guidance for the full year, earnings per share grew by 5.1 per cent.

EU Adjusted Operating Results

In the EU, I'll start with the UK where our financial performance benefited from a favourable comparative due to the timing of price increases - revenues were up over 12 per cent and operating profit up more than 9 per cent.

In Germany, both revenues and profits were up over 3 per cent, in Spain revenues declined 4 per cent and profits 2 per cent as a result of further weakness in market volumes.

In our Rest of EU region we grew revenues by 4 per cent and profits by over 5 per cent.

Non-EU Adjusted Operating Results

In the Americas, and principally the US, our profits and revenues declined in a competitive market partly impacted by shipment timings ahead of our price increase last year, while in our Rest of World region, revenues increased by over 6 per cent, with profits up over 5 per cent.

Volumes in Eastern Europe declined 9 per cent, impacted by conditions in Ukraine where there was distributor de-stocking and market softness following a tax increase. This was partially offset by growth in Russia.

Eastern Europe remains a key strategic growth region for the Group and we're continuing to invest to support our portfolio and strengthen our competitive position.

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We continue to make excellent progress in Asia-Pacific, growing volumes over 4 per cent and gaining share in most of our key markets. Revenue increased 16 per cent benefitting from improved mix, and profits were up over 23 per cent.

In Africa and the Middle East we increased volumes, revenue and profit despite the impact of Syria driven by a number of strong global and regional brand performances.

Logistics

In Logistics profits declined 3.8 per cent, a robust result given the difficult operating environment.

In Tobacco logistics, growth in cigars and fine cut tobacco has helped offset the decline in cigarette volumes. While in other logistics our transport operations performed well, we grew our market share in our pharma division and in our Lottery business we have added new points of sales to the network.

Our ongoing cost saving programme continues to focus on maximising profitability.

Financing and Cost of Debt

Our average all-in cost of net debt was stable at 5.5 per cent; we expect this to be slightly higher, at around 5.7 per cent, for the full year.

The net interest charge was stable given our normal first half working capital outflow, the final dividend payment and buybacks.

The appendices contain further detail on our debt maturities.

HY12 Adjusted Net Debt

Turning to the financing of the business.

Our closing adjusted net debt for this half was 9.9 billion pounds.

Working capital followed its normal pattern with a significant outflow in the first half of just over a billion pounds, due to a number of factors including pre-production ahead of January and February duty increases.

Net capital expenditure was 152 million pounds, and our cash conversion declined as a result of the higher working capital outflow this half year. The impact of foreign exchange movements was minimal.

FY12 Financial Outlook – investing for growth

As you've seen from the second quarter there's strong sales momentum in the business, we want to maintain this over the long-term and will continue investing in our products and portfolio, our sales force and other areas of the business to support our sales growth agenda.

As we've previously stated, we envisage net capex of around 400 million pounds in 2012 reflecting our investment in capacity to meet demand in consumer growth segments and to continue building our innovation pipeline.

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FY12 Operational Outlook

Our focus for the remainder of the year is to continue applying our sales growth drivers to further enhance sales and profit momentum.

This is supported by our work on the key enablers, particularly when it comes to managing regulation and tackling illicit trade.

We'll continue to vigorously challenge extreme regulatory proposals such as plain packaging which are not based on credible evidence and will only serve to further fuel the illegal trade in tobacco.

We expect the outcome of the court hearing in Australia to be announced later in the year and will make a comprehensive submission to the UK Government's consultation.

From a footprint perspective, we expect EU consumers to remain focussed on value and we'll be capitalising on this dynamic with our total tobacco portfolio.

In the UK we expect further market volume declines and we'll continue to focus on reinforcing our leadership position.

The market remains buoyant in Germany and we'll be seeking to capitalise on growth in fine cut tobacco and improve our cigarette share.

Spain remains challenging but as you've seen we're improving our performance across our total tobacco portfolio.

Outside the EU we see significant opportunities across our portfolio in value and in "premium and above" and will build on the excellent results we've delivered through, Davidoff, Gauloises Blondes, West and our luxury Cuban cigar portfolio.

The USA remains challenging and highly competitive and our new management team are focused on improving the performance of our core brands through the sales growth drivers, with the benefit of critical mass from the combined cigarette and mass cigar business.

And finally in Logistics we'll continue to identify opportunities to grow the business whilst maintaining our cost discipline.

Thank you. I'll now hand you back to Alison.

Alison Cooper, Chief Executive

Total Tobacco Portfolio - driving sales growth

We're generating momentum behind the topline through our strategic brands and total tobacco focus; you've seen that from our second quarter performance and our priority is to drive sales further through our focus on the four sales growth drivers.

Our portfolio has never been in better shape; we've been very active across our brands and products and have a number of exciting initiatives in hand that will further fuel growth.

One major development involves accelerating Davidoff sales; this will be launched in the second half and represents a key milestone in realising Davidoff's global potential.

Our Total tobacco portfolio, combined with our focus on consumer-led innovation, gives Imperial unique opportunities. As well as driving growth of our key strategic brands, we'll be enhancing our fine cut tobacco performance and maximising the growth potential of Habanos and our high performance snus business.

The work we're doing in customer engagement and pricing is integral to our overall sales focus.

All four drivers need to work together to maximise returns and our people are embedding this approach across the business.

Our Values

It's the people at Imperial - and the values they demonstrate – that are making the difference, bringing our growth strategy to life on a daily basis throughout the organisation.

Their talent and their relentless focus on sales, cost and cash management gives me great confidence for the future.

Maximising Shareholder Returns

The external environment is tough in some areas but we have consistently demonstrated our ability to grow the business in this environment.

We're generating good sales and profit momentum and the remainder of the year is all about building on this performance.

The combination of our highly energised people and our unique total tobacco portfolio puts us in a strong position to maximise growth and further reward our shareholders.

Thank you; we'll now take any questions you may have.

The presentation is being recorded so please wait for a microphone and give your name and organisation before asking your question.