Preliminary Results 2015

03 November 2015

Disclaimer

Alison Cooper

Good morning and welcome to our 2015 results presentation.   I'm joined by Oliver Tant, Chief Financial Officer, and a number of other members of the senior management team.

Our Priorities for 2015 – *what we said last year*

I'll start with a brief reminder of the priorities we set for last fiscal year.

They were about strengthening our portfolio by increasing the contribution from Growth and Specialist Brands, building momentum behind Fontem Ventures and developing our footprint though a focus on share and profit performance.

Our cost optimisation programme and stronger capital discipline were also key focus areas.

So, let me update you on our progress against these priorities.

Delivering on our priorities – *good progress against strategy*

It's been another good year with very positive progress with each of our priorities, improving the quality of our growth and continuing to strengthen the business.

We generated excellent results from our Growth Brands which - supported by our successful brand migration programme - outperformed the market again, growing volumes and share.

Together with our Specialist Brands, these now account for 57 per cent of Group revenues.

In addition, Fontem ended the year with an enhanced portfolio of assets – a great brand in blu, a stronger technology base and improving performances – both in the UK and USA.

From a footprint perspective, we delivered a positive performance from our Returns Markets and continued to realise opportunities in many of our Growth Markets.

Most significantly, we expanded our US footprint through this year's acquisition. The integration has gone very smoothly and the market shares of our US brands have held up well since completion. David Taylor CEO of ITG Brands will provide a brief update later in the presentation.

We delivered a further £85 million as part of our cost optimisation programme this year, at its heart is an extensive simplification agenda in respect of our brand portfolio, market focus, processes and ways of working.

Our continued focus on capital discipline is driving working capital benefits, with a further improvement in cash conversion to 97 per cent such that our net debt, before the acquisition cost, fell significantly – and we successfully refinanced $4.5bn of bank debt in the debt capital markets in July.

Our performance underscores our commitment to deliver sustainable returns to shareholders and this has been reflected in a further 10 per cent increase in the dividend.

People across Imperial have worked together to deliver these results, while continuing to successfully progress our transition agenda – many of them will be watching today. A great job and a big thank you.

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

Oliver Tant

Thank you Alison and good morning everyone.

Group Results – *delivering against the strategy*

The business has again performed well this year, making further progress against all aspects of our strategy with a good set of results from both a P&L and balance sheet perspective.

We grew tobacco operating profit by 3%, or 7% on a currency adjusted basis with growth in net revenue and further margin enhancement. Adjusted Group profits and EPS increased by 2% and 4% respectively, with growth in constant currency terms of 7% and 8%.

We've made further progress on working capital and cash conversion which contributed to another year of improved capital discipline. Before the cost of the US acquisition, we have reduced net debt by £1.1 billion. I will come on to talk in more depth about cash and debt shortly.

In line with our commitment to deliver returns to shareholders, we've announced a 10% increase in the dividend which will be 141 pence for the year

FY15 Volume – *maintaining overall market share*

Volumes for the year were 285bn stick equivalents, down 3% on a reported basis or 6% on an underlying basis.

Iraq & Syria accounted for around 10bn sticks, over half of our underlying volume decline, which also includes a 2% positive impact from the acquisition in the US, which added 5bn sticks.

The effect of last year's stock optimisation was a 3% benefit to volumes.

Overall like-for-like volumes declined by 4% in line with our market footprint with market share stable across the Group.

FY15 Net Revenue – *organic revenue growth of 1%*

The impact of Iraq & Syria on Group revenue has been less significant than on volume, given the lower relative sales value in those markets.

The US acquisition added around 4% to net revenue.

David will cover the US in more detail shortly and will talk you through the pleasing start we've made in the first few months.

The impact of a 4% volume decline has been more than offset by price/mix of 5% which, as expected, was stronger in the second half of the year.

Excluding Iraq and Syria, this resulted in organic revenue growth of 1% before currency translation.

FY15 EPS Growth – *constant currency EPS up 8%*

Adjusted EPS for the year was up over 8% in constant currency terms. This has been largely driven by the operating profit increase, with a small benefit from finance costs and a marginally lower rate of Group tax.

In FY16 we expect our average cost of debt to remain flat, with the tax charge coming down to nearer 20%.

Movements in foreign exchange translation had a 4% impact on the bottom line, with adjusted EPS for the year of 212.5 pence. Based on current rates of exchange, we expect a translational currency impact in FY16 of around 2%.

Strengthening Portfolio – *growing quality of revenue*

We've made further progress on strengthening our portfolio. Share of Growth Brands is up by over 100 basis points and they are demonstrating an improved volume trajectory on a like-for-like basis. Our strongest equity brands are also generating a higher proportion of the top line with Growth and Specialist Brand net revenue up to 57% of the total.

Volume and revenue from the new US brands for 2015 is all within Portfolio Brands which has had a 2% dilutive effect on the overall revenue bridge.

From FY16, Winston will be classified as a Growth Brand, replacing USA Gold, while Kool and blu have joined our Specialist Brands.

Our growth in Specialist Brand revenue, excluding the decline in Gitanes in Iraq and Syria, has been driven by Skruf, premium cigars and modern variants of Golden Virginia.

Developing Footprint: Growth – *building profit and Growth Brand share*

In our Growth Markets, our focus is on realising opportunities both now and for the longer term success of the business.

Excluding Iraq and Syria, our underlying revenue was up 5% and profits were up 8% reflecting positive momentum in the division, with particularly strong growth in Russia, Norway and Taiwan.

Our overall market share was slightly down with gains in Saudi, Italy and Japan offset by a decline in Vietnam.

The quality of our share improved with over half our share now represented by growth brands.

Developing Footprint: Returns – *revenue and profit growing*

We have continued to make positive progress in Returns markets where there have been some improved market volume declines albeit in some/many instances not reflected in improved market value.

In this context we have grown revenue and profit, benefiting from improved price/mix in the second half. Profit performances have been notably strong in Germany and Australia offsetting continued weakness in Morocco and the impact of investment decisions in the UK.

Market share reflects our Returns market strategy and is broadly stable with share gains in the North offsetting share loss in the South, mainly due to Morocco.

Again, the quality of growth improved with growth brands now over half our revenues in the division.

Developing Footprint: USA – *strong start for ITG Brands*

In the US, our strategy for USA Gold has continued to generate share growth in our focus states resulting in a stable national share. The acquired brands have also maintained share since completion and are performing as expected, contributing 5bn sticks and £242m net revenue in the three and half months since completion.

In mass market cigars the competitive environment shows no sign of abating so we have taken advantage of our new national distribution capability to revise our MMC strategy, an area David will share his thoughts on shortly.

We have taken the opportunity in the light of the reshaped US business to review stock levels resulting in a reduction to net revenue of just under £40m in the year.

As a reminder, we expect the US will represent more than 20% of Group profit on a fully annualised basis, further increasing the proportion of profits that we derive from markets with a better than average level of affordability.

Effectively Managing Cost – *funding investment, expanding margins*

We remain firmly on track to deliver our target of £300 million of annualised cost savings by 2018 with 60% delivered so far.

The evolution of a simpler business with more consistent processes is supporting cost efficiencies across the Group.

Many of these stem from streamlining our portfolio. Fewer SKUs, and a clearer brand hierarchy drives a more consistent investment approach across a focused Group of brands and markets.

This is enabling increased standardisation and a reduction in manufacturing complexity. This is turn supports a reduction in working capital, a tighter supplier base and economies of scale.

For example, we reduced our number of suppliers by 10% this year, aligning terms and leveraging our scale, which has driven an ongoing improvement in working capital.

Reduced complexity also improves effectiveness through smarter ways of working.

For example, the restructuring of our sales force and the use of bespoke customer relationship technology reduces time collecting data enabling enhanced customer engagement.

There are many other examples across the business helping to deliver our cost and cash objectives while also supporting top line investment and development of margin.

Greater Capital Discipline – *clear objectives for cash*

We have continued to place great emphasis on capital discipline, seeking to embed cash consciousness throughout every part of the business.

As well as focusing on working capital we continue to look closely at capital allocation to ensure we are maximising value from our assets.

As regards uses of cash, dividend growth of at least 10% over the medium term and continued deleverage of the balance sheet remain our priorities.

Higher Cash Conversion – *continued good progress*

Once again, cash conversion was strong at 97% for the year.

This continues to reflect improvements in inventory management, particularly leaf as we better align to market demand and realise the improvements to working capital from a simplified and more focused portfolio. We were also helped by the favourable working capital position within ITG Brands.

Into FY16, we will continue to benefit from the working capital position in the US, although there may also be a temporary working capital impact from the implementation of EUTPD which will particularly affect H1.

Overall we still expect to maintain a level of cash conversion above 90%.

Strengthening Balance Sheet - *£1.1bn reduction in like-for-like debt*

Our strong operating cash performance supported a £1.1bn like-for-like reduction in net debt – before taking into account the cost of the US acquisition.

We successfully refinanced $4.8bn of our acquisition facilities with $4.5bn termed out across 4 tranches in the dollar markets at an average maturity of around 7 years. The remainder was refinanced with a bilateral term loan facility.

We are taking the opportunity to repay facilities as they come due and although we have € 2bn of bonds maturing in FY16, headroom created by our remaining bonds and bank facilities ensure that we do not have any further refinancing requirements over the medium term.

The average interest charge for the Group in FY15 was 4.3% and we don't anticipate a material deviation from this level in FY16.

Financial Summary and FY16 – *supporting dividend growth of at least 10%*

In summary the results we have achieved this year provide evidence of continued delivery against the strategy.

Revenue growth and improved margin have driven positive earnings momentum, while working capital management has supported enhanced cash conversion and a £1.1 billion reduction in like-for-like debt. These underpin a 10% increase in dividend.

Looking to the year ahead, we will continue to implement our new commercial and portfolio plans in the US. The expanded business is performing in line with our plans and we look forward to a full year's contribution.

In Returns, we see further pricing opportunities although there will be some challenges from negative mix, investment driven by EUTPD and the conclusion of the PMI distribution contract. These have all been factored into our planning assumptions.

In Growth Markets, we still expect a headwind from Iraq and Syria but this will start to lessen during the second quarter. Overall, we see continued portfolio and pricing opportunities in Growth Markets as we target share and profit growth.

Complexity reduction and simplified ways of working will continue to support our cost and cash objectives.

I should remind you that last financial year we delivered a stronger volume performance in the first half coupled with a very positive price improvement in the second half, whereas we expect the trends will be reversed this year. This trend will be particularly notable in the first quarter with volumes affected by the continued impact of Iraq and Syria and a strong comparator period.

Overall, we are well placed to meet expectations for the coming financial year.

Alison

Thanks Oliver.

A reminder of our strategy – *strengthening business, improving quality of growth*

Following on from Oliver's comments on cost optimisation and capital discipline, I will now focus on how we are strengthening our portfolio and developing our footprint.

Starting with the portfolio.

Strengthening our Portfolio – *further migrations success*

Our brand migration programme continues to play a key role in simplifying and strengthening our portfolio; it supports more targeted investment and is improving the quality of our sales growth.

Migrations accounted for the majority of our Growth Brand volume gains in the year, and we continue to retain close to 100 per cent of consumers across the programme so far – a fantastic endorsement of the quality of planning and execution that has gone into this.

We have now completed 21 migrations with Portfolio Brands being migrated into a range of Growth Brands including Parker & Simpson in Poland and Taiwan, JPS in Spain and the UK and News in France, which you can see here.

A further 20 migrations are underway and more are planned.

This has resulted in the market share of Growth Brands increasing in almost all of our markets, and the overall share of our Growth Brands increasing by 110 basis points in the last year.

Strengthening our Portfolio – *improved quality of revenue*

The brand migration strategy is enhancing the quality of our revenue growth. Growth and Specialist Brands now account for 57 per cent of Group revenues, compared to 50 per cent two years ago.

Migrations continue to be a key part of our strategy to remove complexity but there is more to go for. As we focus on reducing brands, SKUs and bills of materials, the objective is not only about reducing costs but more importantly driving more growth from our strongest equity assets.

Strengthening our Portfolio – *investing in fewer, bigger brands*

Migrations and organic growth are both supported by our marketing campaigns and new product initiatives. I have highlighted a few here.

West is the last of our key chassis campaigns to be finalised and this is being executed alongside a new pack rollout over the coming year.

The "*Vive le Moment*" campaign for Gauloises has improved awareness in Germany – scoring number one for brand relevance and number two for recall.

Davidoff sales in the Middle East are benefiting from the launch of a new Davidoff digital platform and a 'Fresh Lock' format. While Davidoff Absolute has exceeded our expectations since its launch in Taiwan in June.

A new marketing campaign and pack execution has been rolled out across the JPF footprint – and is supporting key brand migrations in Spain and Poland.

A new pack design and equity campaign for Golden Virginia called "*Rock and Roll*" will also go live in the UK shortly.

In 2016 our focus is on supporting further migrations whilst building momentum behind our key equities in our key markets.

Strengthening our Portfolio – *developing new consumer experiences*

As you know we are also strengthening our portfolio by investing in new consumer experiences.

Following the US acquisition, we have integrated the blu team with Fontem Ventures and are working on further developing the blu brand and e-vapour technology.

We have a great set of assets in the e-vapour space, a strong equity in blu, enhanced technical know-how to complement our current intellectual property and are building a presence in the current four key e-vapour markets globally. A strong platform from which we will continue to develop new opportunities for growth in 2016 and beyond.

Developing our Footprint – *building presence in Growth Markets*

We are investing for future growth both in e-vapour and in our growth markets.

I have summarised here some of our key market performances in 2015. We are not only building our presence in these markets but we are doing so with our strongest brand equities - our Growth Brands.

In Russia, consumer choices continue to be influenced by the economy and the evolution of excise and regulation. Positive pricing has been beneficial but we've also led the market with portfolio initiatives, enabling us to capture our predicted increase in down trading. We have been successful with Big box and queen size propositions in

Maxim in particular, such that our share is stable with a strong improvement in revenue and profit.

In Taiwan we grew profit, driven by the success of Davidoff, supported by the new Hunters campaign and new launches such as Absolute. West held back our overall share but we have new initiatives over the coming months to address this.

Norway - and Scandinavia overall – keeps improving. Skruf slims is adding to our share gains & strong profit growth.

In Japan our investment is focused on growing our sales capabilities and distribution and we are making share gains in West. Italy is similarly progressing, but with share gains in JPS which is our priority brand.

I also want to mention Saudi Arabia where our investment in Davidoff as well as contributions from West and Gauloises are driving positive financial results and supporting share growth in one of the few growing tobacco markets in the world.

Developing our Footprint – *positive performance in Returns Markets*

In Returns Markets, the quality of our market share continues to improve with over 50% of net revenue in Growth Brands. As Oliver mentioned earlier, share gains in Returns North were offset by a decline in the South, particularly due to further market share erosion in Morocco, largely due to illicit trade.

It's a highly competitive environment in the UK and we have invested to gain our fair share in the growing sub-economy segment which has helped stabilise our cigarette share with a focus too on improving our portfolio - now more concentrated in our JPS & Lambert & Butler brand families.

Our Australian team has had another great year, with further improving profitability, growing share and now the proud parents of the number one brands in both cigarettes with JPS & fine cut with Champion.

Germany has had another successful year with excellent financial results in what continues to be a pretty stable volume environment with good pricing opportunities. We have ceded a bit of share during the year but have plans to redress the share/profit balance with JPS & Gauloises initiatives.

Finally in Spain, 2015 has been a big year for migrations with high conversion rates. Our profit delivery improved against a background of slower industry volume declines.

Our US acquisition has been a major part of our footprint development story this year and I would now like to introduce David Taylor, Chief Executive of ITG Brands who's going to give a brief update.

David Taylor

Alison. Thank you.

Developing our Footprint – *strong start for ITG Brands*

I am delighted to join you here this morning, and I am also pleased to say that the start to Imperial's newly enlarged US presence is all going to plan.

The acquired brands - Winston, Salem, Kool and Maverick - performed well in the fourth quarter, maintaining stable market shares since completion in June.

You may know that Reynolds made some changes to their promotional programmes for Winston and Kool in late 2014 and early 2015 which were aimed at stemming share losses for those brands. We have made no substantial changes to those programmes since closing and, combined with the efforts to protect retail visibility as provided in the route-to-market agreement with Reynolds, market shares for the acquired brands have stabilised.

Remember that these brands had suffered declining market shares for many years. In addition, overall market share for USA Gold held steady during fiscal 2015, while gaining nearly 20 basis points in focus states which is an encouraging trend.

Developing our Footprint – *focused portfolio investment*

Looking forward, we will implement our new portfolio strategy based primarily on four brands – Winston, Kool, Maverick and USA Gold.

Winston and Kool will form the pillars of our premium brand offering in the non-menthol and menthol categories, respectively, and Maverick and USA Gold will provide our discount offerings.

Our marketing and promotional strategy will concentrate on revitalising the historical brand strength of Winston and Kool, and will involve competitive promotional price activity and appropriate merchandising at retail.

In that regard, our newly designed ITG Brands retail merchandising programme is currently being presented to retail outlets and is being well received.

Our goals in designing our programme were to make it "retailer-friendly" - simple, with achievable requirements, and attractive for our retail partners. We believe that enlisting the retail community in a collaborative fashion to grow together is critical to our success.

Of course, the standstill provisions of the Reynolds deal mean that in-store implementation of these new merchandising plans will not begin until mid-November.

Our mass market cigar business is undergoing significant change – moving to a business model that more closely aligns with our cigarette model than has historically been the case. We are focusing on our primary brands, Dutch Masters and Backwoods, and are strengthening the consumer appeal of those brands with appropriate support.

This will involve changes to our wholesale and retail programs, as well as a host of other initiatives aimed at reducing cost and complexity while improving profitability. This revised approach will likely take several quarters to begin yielding results.

Developing our Footprint – *all integration activities on track*

As we have previously indicated, the ITG Brands organisation was built upon the strong backbone of the former Lorillard organisation and then supplemented by talent from Commonwealth-Altadis.

The combination and reorganisation of our sales forces is complete, along with the requisite training for all sales associates. Virtually all sales territories in the United States were redefined from scratch, and a number of people were relocated and reassigned to fit the geographic coverage requirements of the new portfolio.

We currently expect that the wind-down of the former Commonwealth-Altadis headquarters in Florida will be largely complete by March of next year, when all the back office functions have migrated to North Carolina.

The transition of manufacturing with Reynolds is continuing according to plan and the reciprocal manufacturing arrangements is working well. The equipment migration process will be complete by the end of calendar year 2016 and we are currently evaluating options for optimizing our US cigarette manufacturing footprint once all the equipment moves are complete.

In summary, we are off to a great start. There is still much to do, but we are confident that we have the right team in place and we are all committed to restoring the glory of our brands. It will take time, patience, and discipline, but we believe we can build a strong tobacco competitor in the United States, and one that will make Imperial's decision to invest here a wise one.

Alison Cooper

Thank you David. I am delighted with how well the US is performing. We have an excellent team on the case and an exciting year ahead of us.

Evolving our operating model – *embedding new ways of working*

There are some key themes that run through today's presentation.

We talk a lot about simplification. Simplification of the portfolio, of SKUs, of bills of materials and our processes.

And we've talked about focus. Our investment focus behind our key brand equities, a clear strategic focus across our footprint, on cost allocation and on cash & capital discipline.

And the reason that simplification and focus are talked about at length in Imperial is that we are committed to becoming even more effective across our operations, further improving the returns we are generating from our assets.

We are changing our ways of working and getting more effective throughout the value chain. We are generating savings from increased global procurement, driving consistent operational excellence across our factory footprint, realising the benefits of market clustering, and continuing to implement a differentiated approach to customer engagement. These are examples amongst many other initiatives – so we will take some time next year at an investor day to take you through in more detail.

Our Priorities for FY16

These themes are captured within the four strategic priorities and it will therefore be no surprise that our focus for the coming year will follow the same four priorities.

We'll continue to build the contribution from our Growth and Specialist Brands. This will be supported by further migrations, which in turn, supports our ongoing programme of portfolio simplification. We will also continue to develop opportunities for Fontem Ventures.

From a footprint perspective, the focus is on building momentum across our Growth Markets, whilst driving profitability in Returns Markets. The US will clearly be a key feature as we progress our plans for the ITG Brands portfolio.

Effective cost and cash management support our investment choices and margin progression and a key element will be the further roll-out of our operating model.

We have made excellent progress on cash conversion, instilling a greater discipline on the use of capital and this will remain a key focus to underpin further debt reduction and our dividend growth commitment.

We are building a stronger business. We have the right strategic agenda and we are making excellent progress to improve the consistency and quality of our performance, all supporting high returns for shareholders.

Preliminary Results 2015

Thank you. That concludes today's presentation and 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. May I have your first question.