Conference Title: Q1 Trading Statement Conference Call

Date: Thursday 11th February 2016

Operator: Good day and welcome to the Imperial Brands Q1 Trading Statement Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr Peter Durman. Please go ahead.

Peter: Good morning and thank you for joining us for today's call which accompanies the release of our Q1 Trading Statement earlier this morning, and is the first under our new name, Imperial Brands. I'm Peter Durman, Director of Investor Relations. I am joined by Alison Cooper, Chief Executive, Oliver Tant, Chief Financial Officer and Matt Phillips, Chief Development Officer. I will now hand over to Alison.

Alison: Good morning everyone. Before Oliver takes you through the detail, I'd like to share three key messages.

First, we are well placed to meet full year expectations and on track to deliver against the priorities we outlined for this year, including our commitment to dividend growth of at least ten per cent.

Secondly, we are continuing to improve the quality of our revenue growth. We have continued to make excellent progress with our simplification agenda – helped by the success of our brand migration programme, which is adding to the contribution from our Growth and Specialist Brands. We are actively prioritising brands and markets that drive profitable volume growth as we strengthen the business and enhance the quality of revenue growth.

Thirdly, since expanding our business in the US, the performance of ITG Brands has been excellent. We have successfully executed our retail and wholesale programmes and we are starting to see Winston and Kool gaining share. While it's still early days, this is a great start.

Overall, a good first quarter with continued progress with our strategic agenda. I'll now hand over to Oliver to take you through the detail.

Oliver: Thanks Alison and good morning everyone. Firstly, just a couple of points on our release. You'll have noticed that to aid transparency, we've provided metrics excluding the acquired brands in the US, giving you a clear view of our organic performance. In addition, as expected, we continue to see an impact from Iraq and Syria in the year on year metrics, particularly on our volumes.

The first quarter performance was in line with our guidance at the year-end results. As Alison said, we have continued to sharpen our focus on the quality of our revenue growth, simplification of the portfolio and the prioritisation of profitable volume growth.

Looking at the overall performance, our organic tobacco net revenue grew 2 per cent as a result of strong pricing. Excluding Iraq and Syria, revenue growth was 4 per cent. Our organic volumes were slightly better than expected with a 9 per cent decline, 4 percent of which was due to Iraq and Syria. The remainder is partly as a consequence of our brand strategy where we are prioritising profitable growth.

The US acquisition has significantly strengthened our footprint, we're delighted by the performance of ITG Brands. With over 150,000 stores now signed up, the sell-in of the new retail programme has been a huge success. Having introduced new promotional arrangements and improved in-store visibility, Winston and Kool market shares appear to be responding well, both growing in the last quarter. We've also delivered an encouraging performance in mass market cigars, reflecting the success of the work we are doing to strengthen the retail focus of the business.

Elsewhere, tobacco net revenues grew 7 per cent in Growth Markets excluding Iraq and Syria and was up slightly in Returns Markets.

Our Growth Markets have continued to be impacted by the conflict in Iraq and cessation of trading in Syria last year, which contributed to a decline of around 10 per cent in both volume and net revenue in the quarter. Excluding Iraq and Syria, Growth Market revenue was up 7%, with the majority of the increase coming from blu. We continue to focus on opportunities in key profit markets such as Russia, Saudi Arabia, Taiwan and Scandinavia, whilst refocusing our approach in markets with low quality volume such as Turkey. Price/mix remained strong at 21 per cent, supported by pricing gains in Russia.

Revenues in our Returns Markets were supported by strong year on year price gains, particularly in Germany and Australia, although performance has been affected by the ongoing competitive environment in the UK and more recently in Ukraine, as well as adverse mix and continued share loss in Morocco.

Significant deterioration in the economics and profitability of some geographies is also influencing our investment decisions including in the Ukraine, Azerbaijan, Turkey and in the Adriatics.

In terms of strengthening our portfolio, Growth Brand market share grew 100 basis points. Excluding Iraq & Syria, volumes were up 7 per cent supported by investment in consumer initiatives and the continued success of our migration programme. Since starting the programme, 23 migrations have been completed and a further 29 are underway. As part of our simplification agenda, we have ceded some share in our Portfolio Brands as we continue to prioritise our Growth Brands and improve the quality of revenue growth such that there was a decline in overall share of 40 basis points.

Specialist Brand organic net revenue was up by 4 per cent excluding Iraq and Syria, due to growth in Skruf in Scandinavia and our Premium Cigar brands. Reported net revenue, including the acquired brands of Kool and blu, was up 37%.

Fontem is successfully gaining traction with the blu brand, strengthening its market share in the US as we extended the distribution of blu plus supported by a new marketing campaign and pricing strategy. Blu has become the number 2 brand in the UK as a result of continued distribution gains. Fontem also continues to progress a range of patented technologies, including the licensing of its technology to a number of major e-vapour businesses.

Our focus on cost and capital continues. We're on track to deliver further savings of £55 million this year as part of our cost optimisation programme to reduce complexity and improve efficiency within the business. As part of our ongoing review of our manufacturing footprint, we recently announced the intended closure of the Logrono factory in Spain. This reflects a significant decline in production requirements at the site due to tough economic conditions, increasing levels of regulation and the rise of illicit trade over recent years.

We remain focused on embedding a culture of capital discipline and are continuing to target operating cash conversion of over 90 per cent. The strong cash flows will be used to reduce debt and fund our dividend commitment of at least 10 per cent growth in the medium term.

Looking now at foreign exchange… At our year-end results in November, we expected a translational currency headwind to earnings of around 2 per cent for this year, based on exchange rates at that time. However, recent exchange rate volatility, particularly with the strengthening of the Euro and the US Dollar against sterling, would suggest this impact to be now around a 1 per cent benefit to our full year earnings.

Our footprint bias give us a relatively limited exposure to emerging markets and so the effects of foreign exchange on local currency input costs have historically been immaterial to the Group. More recently, the significant volatility in some Eastern European countries has started to give rise to larger transaction FX impacts. At the year end, we saw a potential impact of about 1 percent on FY16 earnings, mainly from the Ukrainian Hryvnia, but the significant movement of the Russian Rouble in recent months is giving rise to a more material impact. Based on rates at the end of January, we estimate the transaction impact to our earnings this year to be around 3 per cent. So in summary, the 3 per cent positive swing on translation since early November is broadly offset by the 3 per cent transaction headwind.

To conclude, we've made a good start to the year continuing to deliver progress against our strategic agenda in the first quarter. Our overall outlook for the year is unchanged. We are performing well in the US and our results will benefit from a full year's contribution from ITG Brands. In Growth Markets, we will continue to target share and profit growth, while the headwind from Iraq and Syria will lessen during the second quarter. In Returns, we are benefiting from our price increases although we do expect some challenges from adverse mix, investment driven by EUTPD and the conclusion of the PMI distribution contract. These have been factored into our planning assumptions. As we highlighted in our results last year, we delivered a stronger volume performance in the first half coupled with a very positive price improvement in certain markets in the second half, whereas we expect the trends will be reversed this year. And so, the phasing of profit between the two halves is expected to be consistent with our historical average. Overall, we remain confident in delivery for the full year, including dividend growth of at least 10 per cent.

Peter: Thank you Oliver. That concludes the formal presentation and I would now like to open the call to Q&A.

Operator: Thank you. Ladies and gentlemen the question and answer session will be conducted electronically. If you would like to ask a question, please press the star or asterisk key followed by the digit 1 on your telephone keypad. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. We will take questions in the order received and we will take as many as time permits. If you find that your question has been answered you may remove yourself from the queue by pressing star 2. Again please press star 1 to ask a question. We will pause for just a moment to allow everyone to signal.

We will take our first question from Michael Lavery from CLSA. Please go ahead.

Michael Lavery: Thank you. Could you talk a little more about the United States and some of the investments that you're doing there, I believe you said you're reinvesting the savings and I would love a little more colour on what type of spending you're doing?

Alison Cooper: Good morning Michael. The focus on investment at the moment is really the area we highlighted at our full year results (excuse my voice everyone, I'm just shaking off a cold) and that's into the retail programme that we've been working on and coming into play now since the middle of November, so once we were allowed to start negotiating with the retailers getting our new contracts in place that's been the focus. We've now got, just to give you a feel, over 150,000 contracts signed up with retailers and that's now kicking in in terms of the visibility. Clearly point of sale is being improved significantly and also we're now in the throes of our buy down programme particularly behind Winston and Kool, in those outlets and so that's really the focus of our investment at the moment; it's around those retail contracts, it's around the buy down programme. We've got more in the pipeline as well, as we look at refreshing the brand equity and doing more in terms of the consumer offering, but at the moment it's still very much focused on wholesale; primarily on the retail programme that we're executing against.

Michael Lavery: And you say that the results are on plan and it looks from the data today and what we've seen in the scanner data that you haven't been able yet to have share gains or maybe even overall total portfolio stability. Is it right to assume that you can be successful without share gains?

Alison Cooper: We are not assuming success without share gains, we're very much looking, as we said at the time of the deal being announced, to grow our key focus brands, so that's around Kool, that's around Winston but also Maverick and USA Gold in the mix as well. We did also highlight that as we de-focused some of the portfolio brands, clearly they will continue to decline. We haven't got any particular plans for example for Salem that we acquired, and were assuming the continued trajectory of decline with Salem, but overall we are expecting growth from those key brands, and overall therefore taking our share forward in a measured way in the States in total and that's over time. I'll be very clear though, you can quickly fix share in the States by dropping price very rapidly but I'm not wanting to do that, what I'm wanting to do is build steady sustainable share growth in the market and that's something that takes time, takes investment, takes leg work and it's not something that happens overnight.

Michael Lavery: That's very helpful clarification, maybe two things related to that. Could you give a better sense of how you think about the total portfolio just given some of the drag from some of the brands like Salem that don't have any investment and then related to that what sort of timing you have in mind in terms of what some of your own share expectations might be?

Alison Cooper: Well as I think Oliver mentioned and I think I mentioned as well, Kool and Winston, we're seeing some good progress from already, but its early days so we don't want to make too much noise about that just right now. At the half year, it will be more appropriate to look at how our investment plans are doing, but in terms of the total portfolio, yes, the first target has got to be to stabilise the total share, improve the quality of that share by getting the growth in the brands that we want to see the growth in which is Winston and Kool and also USA Gold and Maverick. Winston and Kool is a priority in the first instance, so that's got to be the initial focus but then yes, we want to be doing enough to offset the declines in the portfolio brands as well but in the first instance it's around getting the share in the right brands. A little bit of growth going forward is what we're looking for, but steady growth, 10/20 basis points, not significantly stepping forward overnight.

Michael Lavery: Okay that's great thank you very much.

Operator: From Exane we will take our next question from James Bushnell, please go ahead.

James Bushnell: Hi, good morning.

Alison Cooper: Morning James.

James Bushnell: Morning, two questions please. The first one on Returns Markets, now the Q1 overall sales growth taking out M&A, Syria etc. looks very solid, Returns Markets though fractionally up, I just wondered if you could talk around maybe the North and the South parts of that, and the key dynamics that are dragging on, I assume what you would hope to be better growth than that?

Alison Cooper: I think Oliver highlighted most of them in his comments. Again we're focusing on the quality of growth we're generating here, most of the comments that we're making around the same factors that we talked about around the full year, so for example in the UK we've got to continue in a competitive environment, but I think you'll remember we highlighted last November that we took a decision last year to actually invest in getting our fair share of the sub-economy segment in the UK. You're going to see some of those effects lapping through in the numbers for this year as you see us getting that fair share of sub-economy which we did a lot of work through last year to do, so that's absolutely going to affect the overall mix from the UK perspective. Morocco has already been a feature that we've talked about for some time so that's still impacting the numbers from the Returns South perspective and I think you know the other factor in the mix at the moment probably to highlight is the Ukraine which Oliver mentioned. Clearly we've got various economic and profitability issues there because of the way the markets moved so we're making some very clear decisions in the market around how we want to compete and what we want to do there because it's very easy to lose a lot of money in the current environment, it's quite aggressive competitively as well, so that's another factor that's in the mix. In terms of Germany we're delivering some very solid performance, it's a very, very good market for us currently, so there's a mix of things in there but those will be the things that are holding it back if you want to focus on those.

James Bushnell: Okay and would you hope that sales growth in Returns Markets would improve as we go through the year?

Alison Cooper: Over the balance of the year yes, but just bear in mind that a little bit in terms of the front end part of the year.

James Bushnell: Okay, thank you and my second question, I think Oliver mentioned that most of the 7% growth in Growth Markets was from blu. I wondered if you could just tell us what it would have been without blu and maybe some colour around the growth of blu because you know some of the data we see from the US e-Cigarette category at least in the recent reads doesn't look quite so great, so maybe some colour on how you're seeing that at the moment as well?

Oliver Tant: Well I'll kick off with the first bit which is on the numbers and then pass over to Matt. The number excluding blu would be about 2.5%.

Matt Phillips: And from the performance of blu more generally, I'll put it into context. As you know our whole approach to this category is a very measured one and we're focusing on four markets and drawing the insights and the learnings from those markets in order to feed into the G3 and G4 so the third generation and fourth generation platforms which will be launched in due course, all focused on cracking the consumer experience. In the US specifically G2, so the second generation blu Plus was launched a few months ago, it's growing both volume and share and we've had a new marketing campaign whilst maintaining the sort of the premium price positioning of blu in that market, so we're very pleased with how it's going. I think maybe some of the confusing data that you see around the US is that I've talked before about some of the companies growing via a distribution push model primarily. A lot of the data that is quoted is into retail rather than consumer off state data, so from a volume perspective we're growing and as I say we're very pleased, we're not having to discount like others are which is affecting the value headlines that you're seeing and so I think it very much depends on the strategy and the approach of the various players in the market in terms of how it plays out on a headline level, but we're very pleased. From a UK perspective G2, the second generation products, blu Plus are going in this month, the business is growing and it's recently become number two in the market. Distribution continues to expand in the UK, we're very focused on the retail proposition, retailer margins, the margins, the historical margin structures trying to improve those, lots of learnings coming out of that market as well. And then finally, Italy and France which are primarily first generation markets, G1 markets where the learnings we're focusing on there are largely online retailing, online platforms and those sorts of things, so again lots of learnings coming out of all four markets which then goes into the G3 and G4 platforms for the next launches. And just one other point to make from a patent perspective you'll have seen that we've made really good progress licensing the G1, the first generation of technology to a growing number of eVapour companies, some of those have been announced, some of those haven't been and the terms are confidential but on a headline level we're looking at the licensing of the first generation and the exploitation of the second and following generations of products.

James Bushnell: Okay thanks very much, just as a quick follow up, is it possible to give any feel at all as to how significant those license revenues might be?

Matt Phillips: I'm having lots of heads shaken at me, no at this stage.

Alison Cooper: We'll have a think about that going forward James, but it’s very commercially confidential in terms of the terms. I think when we've got some more signed up it might be better to give an indication then rather than at this point in time.

James Bushnell: Okay, thank you very much.

Operator: We will now move to Erik Bloomquist from Haitong, please go ahead.

Erik Bloomquist: Hi good morning.

Alison Cooper: Morning Erik.

Erik Bloomquist: With respect to the price mix and how you see that evolving, it was very strong in Q1 as you noted. What are the drivers for that slowing through the course of the year and how do you anticipate that evolving as we go through fiscal 2016?

Oliver Tant: Erik thanks for the question, I'll pick up on this one. You're right to say it has been very strong for us in the first quarter if we look at it in an overall business context with 16.6% revenue growth and 3% volume decline. It suffered nearly 20% but one needs to bear in mind substantial proportion of that is as a result of bringing in the US assets and the impact they have on the average and that accounts for roughly 8.5% of that number and then there’s also the impact of Iraq, Syria which unwinds. We've always been pretty clear that we've had some unusual phasing of price mixes compared to our normal rather flatter profile and that we were very heavily back end loaded last year, so the first half comparative for us in the current financial year was relatively weak in terms of price mix. What we're expecting over the course of the rest of this year is that we will return in aggregate to levels that largely reflect our historic average and that as a consequence we remain on track for our full year numbers.

Erik Bloomquist: Okay and so that's back to the historic average including the benefit to the United States or is that excluding the benefit of the exclusion.

Oliver Tant: That's excluding the benefit of the US.

Erik Bloomquist: Okay, fine and then my second question is with respect to the migrations, it looks like those have increased, perhaps an additional 11 started in Q1. How far along in the migration process are you and can you talk a little bit about the benefits you're already seeing from that reduced complexity?

Alison Cooper: I think I highlighted at the full year we've still got a couple of years to go with this in terms of the overall programme but we do keep finding opportunities to accelerate migrations and where we do, and it makes sense to from a business perspective, that's what you see when you see sometimes some increasing numbers. I'm still incredibly pleased with how they're going, we're still getting very high consumer retention rates, well in excess of 90%, and they are very much improving the quality of the revenue line for us. But you're right, this isn't just about improving the quality of the revenue, it's the knock-ons in terms of the simplification of the portfolio and the opportunities to reduce complexity in the rest of the business that are also a benefit to us, and actually we've got a programme at the moment to look at that even further in terms of more opportunities to reduce complexity. I describe it as looking through both ends of the telescope so that we look at it from a market end, and say, from a market perspective, how can we reduce complexity, what can we do with the SKUs, what makes sense from a retailer perspective, from a consumer perspective. We're also driving that discussion as well through the other end of the telescope i.e. the manufacturing lens and getting them to really say well what are the things you like to lose that really add disproportionate complexity to your processes and therefore having that then quite robust internal debate to look at further complexity reduction opportunities, so it’s very live, very active agenda in Imperial at the moment not only as part of the migration programme but also as part of a broader agenda as well now to see where we can take complexity out because as markets get darker, it’s very important to have that agility with the consumer with the retailer, it helps with those retailer relationships and it’s very, very much core to our quality of growth agenda, both at the top line but also getting the cost base very agile and flexible in terms of delivering the bottom line as well.

Erik Bloomquist: Great, thank you.

Operator: We will take our next question from Vivien Azer from Cowen, please go ahead.

Vivien Azer: Hi, good morning.

Alison Cooper: Morning Vivien.

Vivien Azer: Thank you for taking the question. My first question also has to do with the United States, the syndicated data that we see does show clearly the improvement in Winston and Kool that you've noted. I am curious about your outlook for the US market, in particular the slightly better than historical volume environment, and how that informs the way that you think about your price gaps and the amount of discounting that you really need to do to stabilise the market share given the better trading environment?

Alison Cooper: It’s quite an active debate this one, even internally, because we have seen a very positive market in the US in recent times and yet I think most commentators externally, and also with our internal guys at ITG Brands are anticipating that will come off a bit later on this year. I think overall at the moment we're predicting probably nearer 2% decline for the full year in our internal estimates, and I've seen others they talk to reverting to normal declines of 2 – 3%, but at the moment it’s still holding up pretty well. I think, with this one, we've just got to keep monitoring given you know the consumer drivers of this, the disposable income, people talk about gas prices all of those sorts of things influencing this, so it's an ongoing monitoring. I think we've got a sensible assumption in our plans internally but we do keep monitoring it and debating it internally.

Let me maybe just briefly then talk to you about the pricing plans. In terms of our pricing plan we've done a huge amount of work on this. We did a lot of work on the optimal price points for the brands in the considerable amount of time we had leading up to the completion of the deal and also have done a lot of work subsequently leading up to mid-November, so we've got various levels of buy downs against Winston and Kool differing by different states and areas at the moment as well to try and get to the right level of buy down for the brand, to generate that steady sustainable share growth but also make sure it's very profitable and high quality growth as well in the market. That to my mind isn't particularly influenced by the market size, that's much more around source of business where you need to be competitively priced from a consumer perspective versus source of business and that's really where the focus is and that's what we continue to fine tune as we start seeing that share growth coming through from Kool and Winston and seek to maintain the momentum behind that. The guys are doing a fantastic job behind it and I'm really, really pleased with them, with how they've been performing in this first quarter.

Vivien Azer: That's very helpful thank you very much. My second question has to do with Russia which you called out as a focus from profitable growth, there are some differing estimates from some of your competitors about that outlook for the market environment given some of the questions around the macro backdrop so I'm curious to hear how you're viewing that trading environment for 2016 and what kind of market dynamics you're seeing in terms of trade down please? Thank you.

Alison Cooper: We're still seeing declines in the market coming through, there's a lot of price increases that we're achieving in the market, so we still see overall revenue growth and progression in the Russian market but yes, I do see continued declines in volumes, whether or not they are as high as the sort of 9%-10% we've seen, maybe they'll come in a little bit from that in 2016 but we still see reasonably high level of mid to high single digit volume declines in the market. I think pricing is sufficient to offset that from a revenue growth perspective, the other dynamic clearly is also down trading and we've seen opportunities with that in the market place and particularly big box formats that we've introduced, that's getting us more competitive at the moment but there's definitely down trading in the market as well.

Vivien Azer: Thank you very much.

Operator: We will now take our next question from Adam Spielman from Citi, please go ahead.

Adam Spielman: Thank you very much.

Alison Cooper: Morning Adam.

Adam Spielman: Good morning, I'm sorry about your cold.

Alison Cooper: Bad timing.

Adam Spielman: Well these things happen. A couple of questions if I can, first one really simple question. When are we going to get behind Iraq and Syria, when will that stop being an issue? Second question, talking about the rouble following on you know this isn't the first year the Rouble and the Ukrainian Hryvnia have fallen, why is this suddenly becoming a transaction issue now when it wasn't in fiscal '15? and then the final question is on Australia, I notice that Phillip Morris has said that it is taking a price, or announced a price increase, it may not be the same thing last week and I was just wondering if you can give us some sort of update on the trends there in terms of down trading to what it continues pricing in your market share in that market, thank you?

Alison Cooper: Thank you for the first two questions because I'm going to have a rest with my voice and let Oliver answer those for a few minutes Adam, and then I'll pick up on the last one.

Adam Spielman: Thank you.

Oliver Tant: I'll start with the transactional impact. You're right to say that we have experienced elements of weakness in those currencies in the past but to be honest with you not at the sort of the scale that we've seen over the last six months or so and whereas those items have impacted us they've been de minimis in the context of our overall numbers. What we've seen over the last six months is that those movements have become a little more material to us, such that we felt that they were over scale where we needed to call them out, so I think that's the response…

Adam Spielman: Can I very quickly ask, is that because your business has somehow changed in those markets, or is it that the movement has got so much bigger in the currencies?

Oliver Tant: Firstly, it's worthwhile noting its three currencies so it's; Azerbaijan, Ukraine and Russia as well. Where it principally emerges is because we have in a number of those markets, production facilities where we're buying in input costs in US dollars over relatively long lead in periods, so I think it's a combination of the continued downward trend in those currencies which has been relatively extreme over periods where we've been buying for example, leaf on contract over sort of 18 months lead in times into Russian and Ukrainian plants. It's a combination of things, it's also worthwhile noting that we have had this issue in the past, it's just been de minimis, it's been sort of below the 1% mark and in terms of impact on our profits and it's something that we've therefore not felt the need to call out. It's become a little bigger over the course of the last few months with continued pressure on those currencies and that's why they've been raised. There is an argument, I guess technically that you could conclude that these aren't transactional in nature, they're translational in nature because in practice the real issue is that the revenue stream emerging in the particular markets is now worth significantly less but to the Group the input costs haven't changed one iota, they were in dollars and it's really only the volatility against the dollar that's affecting the Group as a whole, but we're into a sort of technical accounting debate at that point in time and we've taken, I guess a relatively purist view in terms of how to account for them and reflected them and are calling them on the basis of what you heard during the course of this conversation and our announcement this morning.

Adam Spielman: Thank you, that's very, very helpful and Iraq and Syria?

Oliver Tant: Iraq and Syria we expect a little more impact in Q2 but by the time we get to Q3 we will have lapped it.

Adam Spielman: Thank you.

Alison Cooper: We've got one on Australia. If I look at the Australian market, still a little bit soft in terms of market but from our perspective we continue to generate good revenue, profit growth and share growth actually from the market albeit we've been quite I think from our perspective in the market looking to slow that share growth a little bit. We've taken some disproportionate pricing moves in terms of how we've taken JPS forward to slow its growth in the market a little bit but the market's performing exceptionally well for us still and the portfolio continues to perform incredibly well and very high quality of growth clearly as well with them, with JPS being the lion's share of the share there but the dynamics for us are still very positive Adam.

Operator: We will take our next question from Chas Manso from SocGen, please go ahead.

Chas Manso: Yes, good morning.

Alison Cooper: Morning Chas.

Chas Manso: Morning, morning all. Okay in this release you seem to be highlighting your sharpening focus on quality growth so I was wondering whether you could talk about that a bit more, why sharpening now and on your volume decline ex everything you know ex Iraq and Syria, I think it was minus 4.7% this quarter. Could you tell us how much of that is down to this pruning of low quality, low margin stuff and how much more really is there to go and I guess the flip side of this is, should we expect some margin benefits if you're cutting out the low margin parts of the portfolio?

Oliver Tant: Well I'll pick up on that last point because I think we signalled that, to be honest with you, at the year-end Chas, where we said that one of the contributors to our upward momentum of gross margin where you may recall we'd gone above 46% at year end, whilst to some extent the fact that we were doing this and I think it's worthwhile noting that we're not making final calls in terms of our participation and segments of different markets, we're just being a little more flexible to respond where particular segments over periods of time become unattractive. You know we've talked about for example, the sort of currency related implications on performance in a number of eastern European markets and you can imagine actually pumping and growing volume and market share in those markets at this point in time looks less attractive to us than putting our investment behind stronger markets like Germany, so in the interests of improving quality growth we're making some of these dynamic decisions short term which ultimately as we move forward may well change based on opportunity at the time.

Alison Cooper: Maybe Chas, to put in the context of the quality of growth comments I was making earlier when I was talking I think to Erik around the simplification agenda, the calls we're making here are around really looking to focus behind a much smaller portfolio in terms of the brands and the SKUs that we're focused on and really putting our investment behind those and then getting the knock-on benefits not only through the efficiencies we can generate through the manufacturing and supply chain side but also there's marketing efficiencies and there's also, as we find as we discussed this more with retailers, you know retailers very much embrace this too, it makes a lot more sense to them in terms of working capital, how they can manage the portfolio with us and from our experience too you get more visibility and opportunity at point of sale with the brands that matter, so there's a lot of aspects to this agenda which is around, we highlight quality of growth that we are actually focusing on more, we are accelerating as well and I talked I think earlier at some length around how we're taking all of that forward and really driving that even harder through the business from a simplification perspective and focus and yet that goes hand in hand as Oliver mentioned with some markets where we're looking at it and going there's economic issues, there's profitability issues and yes, okay at the higher end of the market maybe there's some opportunities for us to do things but it is getting very competitive at the bottom end of the market and really you're losing money on a per stick basis, then some of those things just need backing off for the time being, so there's a number of things in that quality of growth agenda but the core of it is the piece I mentioned earlier and that's really around getting the right focus behind the right brands and portfolio in the markets going forward.

Chas Manso: Okay could I come back to the price mix questioning of earlier, so if you're accelerating the focus on quality revenue, shouldn't that have benefitted your price mix as you weed out the low price mix brands and you were saying earlier that although this quarter was strong in price mix over the year you would expect it to return to your historical average and yet this is in a period when you know other tobacco players are actually reporting above average price mix, so is there something that we're missing, some sort of negative mix aspect that is stronger than is obvious or are you being conservative here?

Oliver Tant: I don't think we're being conservative. We've got, just looking at some of the factors that are affecting it, we clearly in certain markets we're making investment decisions, in others we've got market mix criteria that are affecting the way in which overall price mix is impacting us, so I think there are a number of items that are contributing to it, obviously in overall terms our price mix will improve because we've got the impact for example of a higher US component within our numbers but price mix it's not just a question of positive pricing opportunity, it's also a question of mix in market as well.

Alison Cooper: It's market mix and product mix so there's an awful lot of factors in here, we've got now blu in the mix as well and that's going to influence. I highlighted one market earlier which is going to have more of a negative impact in terms of mix as we lap the investment in sub-economy in the UK that we put in place last year, so I think we've got to be careful when we're talking about this around the various drivers. Clearly our market footprint makes a difference as well versus the disposition of the market footprint of competitors and in some markets where you're seeing some of these, some of the economic pressures and some of the forex issues we've been talking about. You're actually seeing very significant price coming through which also tends to help offset some of those forex pressures for some of the competition and what they're looking at from a forex perspective, so there's a lot of things in the mix here Chas that would take a lot of time to unpick. Broadly we're fine with the levels of price mix we've achieved historically and we're managing that as we go forward. From a margin perspective though if you drop down to the bottom of the P&L, there are clearly opportunities here coming through as you take the whole cost equation to account as well through the simplification agenda.

Oliver Tant: I would say our lack of exposure to emerging markets and relatively high inflation currencies will obviously from a constant currency perspective maker our price mix numbers look relatively lower, but actually in reported terms they'll look significantly stronger and yet part of our whole strategy is focusing on some of these stronger environments where we feel that we have a greater opportunity to improve quality of growth, absent volatility that we're seeing in some of the emerging markets of late.

Chas Manso: Great thank you.

Operator: We will take our next question from Chris Wickham from Whitman Howard, please go ahead.

Chris Wickham: Hi guys, congratulations on a good quarter.

Alison Cooper: Thank you Chris.

Chris Wickham: Just a couple of questions from me. I was wondering, I know it's a blunt instrument, but just do a cross check on market share in your five largest markets by revenue outside the US. Are you gaining market share in three or four of those, or five? What's the situation? and then the second one, I was just wondering if we have an update on Australia and regulation? how much more pressure are they still coming at you for different things or now we've got plain packs there is life just a little bit easier and a bit more normal?

Peter Durman: I think in terms of the market share point we have lost some market share in Russia. I think some of the markets around, for example, where we've seen timing of pricing increases, so where markets like the UK, Germany etc. where we pushed prices ahead a bit ahead of the competition, we've seen a little bit of price, a bit of share erosion there and the one that Alison referred to earlier, Morocco, we've seen some continued share erosion in that market as well. I think I would also return back to more generally what Alison said earlier about obviously we've taken some deliberate decisions in certain markets, particularly in Eastern Europe which obviously not necessarily sort of big markets but in the context of the overall group but markets like Turkey, Ukraine etc. where again we've deliberately decided to cede some share in the context of trying to obviously improve while protect profitability in the longer term.

Alison Cooper: And you'll remember the context of this Chris is that in Returns Markets it's not about share growth per se, it's about broadly holding share and we've talked about some of those strategic moves we've made in places like the UK with our investment in sub-economy to really address the share in the UK but also it's right to highlight that some of these markets are the decisions that we've mentioned around Turkey for example where, yes the quality share but not some of the cheaper loss making share in the market and we've restructured operations accordingly to address that as well.

Chris Wickham: Yeah and what about France and Spain in that context?

Alison Cooper: France's base has still got the ongoing pressure from brunes; the brunes segment that tends to pull our share down in both of those markets. Spain from a domestic perspective again it's in a similar position in terms of Returns Market, it's very slightly off at the moment but the blonde share is looking fine. France we have the continuing issues with the portfolio in France that we've highlighted previously so it's the brunes issue largely, a little bit of pressure on Gauloise but this is performing well for us.

Chris Wickham: Okay out of those 8 all of those 8 we should really be saying that it's sort of deliberate but managed losses?

Alison Cooper: It's in line with the return strategy for the returns market although some things to address at the moment, again I've highlighted the UK and what we've been doing over the last twelve months on that and we are seeing growth in other markets where we're investing to grow but clearly our big profit pools are largely on Returns Markets and really that sits in line with our strategy for those markets.

Chris Wickham: And Australia?

Matt Phillips: In relation to Australia, at a headline level I would say that it's the environment is nowhere near as aggressive as it was a few years ago. Clearly you've got the fourth of the four excise escalators coming in September but we're hopeful that the excise approach going forward will be a more measured one. Certainly the Australian government's focus on illicit trade and the volumes of smuggled product that's coming in to Australia, they've made it one of the key objectives of the Australian border authorities, there's a few senators who are now starting to talk about looking at this whole lifestyle regulation and nanny state approach, so I think Australia by nature will always be a hostile attitudinally towards tobacco but my sense is that it's less hostile because there's a better understanding and awareness of the broader picture than there was a couple of years ago.

Chris Wickham: And when you say better understanding, are there any learnings that they've made from the whole sort of plain pack thing, perhaps to surprise them or that's led to that understanding or how is that…

Matt Phillips: As you know or you may recall that the Australian government promised a year ago or more that they would publish the results of the plain packaging experiment as I still call it. 12 – 18 months on they still haven't done that which I think you can read between the lines, there are probably reasons why that hasn't happened but meanwhile the illicit trade, the smuggled products coming into the market have continued to increase and is now being noticed because the seizure levels have gone up and so that's why it's a broader perspective I think, some of the things that we were saying before plain packaging would be likely to happen that this wouldn't accelerate the rates of people stopping smoking, it would trigger down trading, it would cause illicit trade etc. is what we see has happened in the Australian market.

Chris Wickham: Yeah, okay, that's very helpful thank you very much.

Operator: We will now move to Jon Leinster from Berenberg, please go ahead.

Jon Leinster: Thank you, good morning.

Alison Cooper: Morning Jon.

Jon Leinster: Morning, couple of questions, first of all do you think the fact that PMI has moved to its own distribution, is that likely to have any impact in the UK, are they going to launch a series of sort of lower level brands and possible be disruptive, secondly when blu was a standalone business and you could see the figures within Reynolds, or sorry Lorillard, it was quite unprofitable, is that margin structure going to change a lot with blu Plus or is that just because of the overhead allocations that we're sort of putting in with Lorillard and lastly in the US market I get the impression that Kool has moved off the agenda, originally you were talking about volume growth for Winston and sort of holding market share for Kool and US Gold and Maverick and it sounds much more like that you're now looking for sort of volume growth from Kool, is that impression correct or is that just sort of nuances?

Alison Cooper: Let’s kick off with PMI, PMI in the UK are already very active with Chesterfield right at the bottom end of the market so they’re already very active with that and they’ve been quite active in the market over recent years even when we were distributing for them. That’s very much a focus for them currently, although given the pack change to 20s coming up there’s going to be quite interesting churn I think in the market when that happens because a lot of the cheaper offerings at the bottom end of the market are in 17s/18s packs at the moment so they’re going to need to move up potentially quite significantly once it’s 20s that are the minimum size that’s allowed but more generally. Our sales force I think is almost benefiting from the fact that we don’t have to distribute for Philip Morris products anymore, we get more focus around London and the south east in particular with our portfolio. I also think from the blu brand perspective it is particularly helpful and almost timely that our sales force have more space now to deal with the blu brand across the market as well. So I think from our perspective and focus in the UK going into, whether it’s an EUTPD plain packaging environment still to be seen, I think it’s been a good move as well from our perspective and our business although acknowledging there’s a loss to the top line and profits this year in terms of the lack of that distribution agreement but I think their focus will be, I'm sure, in building their own retail presence although still very small compared to ours in the UK and Chesterfield clearly already very active in the market.

I'm going to pick up on the US one on Kool briefly and then Matt do you want to pick up on the blu profitability? In the US I think you're right there is a very slight shift I would say from probably when the deal was first talked about. I wouldn’t say from the time of the deal completion as we worked further on the brands during the time of deal completion, discussing more with the Lorillard guys at the time, we saw more opportunity for Kool. I wouldn't say it's a big pendulum swing in terms of our views on Kool but I think we've got more and more positive about it as time's gone by and therefore very interested to see how the buy down programmes are put in behind that brand and how it responds at the moment. It's got some very good equity with consumers, we knew that but I think where we're pushing it from a retail perspective now, I think it's got some real opportunity for us and again, I continue to be impressed by the team in the US and what they're doing and they are really helping drive that performance, very capable, absolutely delighted with the retail contracts we've got lined up and that clearly gives us opportunities both with Winston and Kool going forward. On blu Matt?

Matt Phillips: On blu the overhead allocation that Lorillard undertook was slightly odd but you know we did say from the beginning that it was a loss making business and that we are focused on the profitability of that business and that's through a variety of mechanisms really, there's the cost of goods savings that comes from scale and improved technology and there is the increasing ability to use online platforms rather than going through the retail channels which Lorillard were very focused on retail rather than online and one of the opportunities that that presents is the retailer margins historically in this category have been very high, because you've had poor technology, unknown brands and therefore high margins being paid to retailers in order to get them onto shelf so as the brand grows and becomes more important to those retailers the margins that they can demand comes down, so I think it's a combination of those things which gives us the opportunity to improve the profitability of the business going forward.

Jon Leinster: Do you think the blu Plus, has the sort of gross margins you receive on that, is that significantly different from the traditional blu is that a game changer or not really?

Matt Phillips: Not necessarily, it does from the cost of goods and what have you, it does improve as you get scale and what have you but I think the big change that it has enabled us to do in the US is to maintain the premium price positioning of the brand while others who have got lesser technology have had to discount in order to maintain distribution and I think that's something that we've been able to avoid.

Alison Cooper: We wouldn't claim the blu Plus is game changer technology yet but I have to say it is significant improvement in the technology and what it delivers consumers and the feedback from consumers is absolutely excellent.

Jon Leinster: Okay, thank you very much.

Operator: We will take our next question from Fulvio Cazzol from Goldman Sachs, please go ahead.

Fulvio Cazzol: Yes, good morning everyone, just a couple of questions from me. The first one was on the UK, I was just wondering following the investments that you've been making in the sub-economy brands, do you think that now you have the right brand mix ahead of plain packaging regulations in May and what are you hoping to see from a corporate share standpoint over the course of the next twelve months please?

Alison Cooper: In the UK we're very much focused on two brands, or two brand families I suppose in the UK which is the Lambert & Butler brand family which is part of the West chassis from overall group perspective and the JPS Players brand chassis effectively, so those are the two key focus areas that we've been working on. That's not what we're working on now, we've been working on over the last few years to get appropriately positioned ahead of regulatory changes in the marketplace and similarly we've been working on the fine cut portfolio as well with the focus on Golden Virginia and also on Gold Leaf, so all of those are important in terms of our portfolio focus in the UK and we're very much on track with what we were trying to achieve from a portfolio perspective. At the moment I would say making predictions on short term share in terms of where it goes in the UK is probably slightly hazardous for any competitor because there are going to be so many changes in the market that are on track for the coming months and to be honest, eighteen months, as the market shifts with all the changes around EUTPD with the pack sizes going up to 20, similarly on fine cut increased size of weights that you have to buy with the minimum of 30 grams, so there's going to be a lot of churn in the marketplace. All I can tell you at this moment in time is we've looked to position our portfolio in the best place to achieve our strategic agenda in the UK and clearly that's got share in mind in terms of how we look to maintain our share in this market at least which is in line with our Returns Market strategies.

Fulvio Cazzol: Okay, thank you and then my other question was on pricing in Russia I know that you called out the transactional currency headwinds which obviously suggests that FX has worked out worse than what you would have anticipated at the full year, but I was just wondering from a pricing perspective, given the significant tax increase and one of your competitors already raising prices by 10 Roubles a pack since November, I was just wondering has this come out a bit better than what you would have hoped for back in November?

Alison Cooper: Yeah the pricing we put through in recent months is broadly in line with our plans for the year it's probably just a smidge better, but only a smidge better, it's broadly in line with what we've built into our plans at the beginning of the year.

Fulvio Cazzol: Okay, no problem, thanks a lot.

Operator: We will now take our next question from Stephanie D'Ath from Bank of America, please go ahead.

Stephanie D'Ath: Hi most of my questions were answered but I just wanted to know regarding France and plain packaging did you already put in place a team like you did in the UK and is that the same team that would likely deal with the strategy in France once plain packaging is introduced? Thank you.

Alison Cooper: Again in each of our markets we are looking at these things a long way out, one of our learnings from Australia was that you don't actually start planning for plain packaging once it looks like it's going to become a reality. You have to start several years out thinking about plain packaging and what you do with the portfolio, what you're doing from a customer engagement perspective, all of those aspects in the market, so this is very much the local market teams taking ownership for that. We share learnings around the Group, clearly we've got some great experience from Australia and some learnings from there but we also need to look at the specific market throws being implemented and understand what it might mean in the context of those specific markets and the people best placed to do that are the people in those markets, so we very much share the learnings across the Group but the local market teams take it forward and that's what they've been doing in the UK.

Stephanie D'Ath: So didn't you move your Australian strategy team from Australia to the UK?

Alison Cooper: No we didn't, we happened to have the General Manager in the UK who used to be the General Manager in Australia but it's not a question of moving, we don't have strategy teams like that that move around, what we do do at Imperial, and I think we're great at it as a business, is really make sure we keep open lines for sharing the learnings between markets, getting people collaborating with each other and helping each other out with those learnings and therefore a very active dialogue goes on around this as it does around EUTPD implementation at the moment which affects, clearly, all markets in the EU but on plain packaging clearly the market's in focus at the moment of France, UK and also Ireland as well.

Stephanie D'Ath: And would it be fair to say that altogether they account for around 30% of your earnings? Those countries entering plain packaging?

Alison Cooper: Including the US it will be less than that, but clearly…

Stephanie D'Ath: The US is not considering plain packaging right?

Alison Cooper: No, far from it.

Matt Phillips: You have to look it more broadly, there are lots of countries that are considering plain packaging, we've talked about three…

Stephanie D'Ath: But just UK, France and Ireland are close to 30% of your earnings, no?

Oliver Tant: No they're not they're a smaller proportion of our total earnings than that.

Stephanie D'Ath: Okay, thank you very much.

Operator: We'll take our next question from Martin Deboo from Jefferies, please go ahead.

Martin Deboo: Morning everybody, thanks for taking the question.

Alison Cooper: Morning Martin.

Martin Deboo: Morning, sorry to have to put you through the mill again. I'll keep it brief. It relates to Jon Leinster's question and some things you said Alison, it was just a very straightforward mechanical question. Is the loss of PMI distribution in the UK material to volume, revenue or profit in the way that you would want to call that out or is it de minimis to use Oliver's term?

Alison Cooper: I think it's worth, for the full year, people understanding the impact from the UK perspective. We've already talked about I think the profit number which is around £30 million in terms of the impact so that's about a percent of growth, already factored into our plans for this year. The top line perspective is roughly £50-£60 million if I remember rightly, so I'm quite happy to be transparent about the numbers. That's around the impact.

Martin Deboo: Okay, that's very clear, if I missed that earlier sorry, but thank you.

Alison Cooper: Okay, thanks.

Operator: We will now move to Owen Bennett from Nomura, please go ahead.

Owen Bennett: Morning guys.

Alison Cooper: Good morning.

Owen Bennett: Three questions please, firstly just on your goal to improve the quality of the mix could you give the percentage of the group net revenue made up of the growth and specialist brands versus prior year when stripping out Iraq and Syria because I know that's obviously probably weighing on that number somewhat. Secondly you gave the contribution earlier of blu to revenue growth, could you possibly give the contribution of blu to the volume growth and then thirdly I was hoping maybe you could be a bit more specific on the share trends of Winston and Kool and what is the share versus prior year and also versus the previous quarter, thanks very much.

Peter Durman: I think some of those I'll pick up, if it's okay with you, offline because certainly in terms of things like the percentage of Growth and Specialist Brands on a comparative basis, I need to check the numbers on that and things like blu for example there's no volume. Because there is no stick equivalent volume associated with that, for example so it's a quick and easy one but if I pick up on the other ones with you offline if that's okay. Thanks.

Owen Bennett: Sure. Thanks a lot.

Operator: As a reminder to ask a question in today's question and answer session please press star 1, please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. We will take our next question from Michael Lavery from CLSA, please go ahead.

Michael Lavery: Yeah thanks for the follow up I just had a question back on the United States, is Kool getting any different amount of attention just given some of the uncertainty around the FDA approval with packaging changes and what your options might be for a Winston menthol in terms of looking like it's limited under their current guidelines?

Alison Cooper: That's not a driver of how we're thinking about it, we've done it very much from the equities that Winston and Kool represent and as we've continued to do work on the equities with consumers, we very much continue to see some great opportunities with Winston, but Winston is very firmly in terms of its source of business in the first instance in full flavour, non-menthol, that's absolutely where Winston sits and that's where we've got to focus in the first instance and clearly Kool sits very firmly from a consumer perspective in the full flavour menthol. Therefore, at the moment I think in terms of our first area of focus for these brands, that's what we've got to focus on so I'm not fretting over can I sort out a Winston menthol or do something different with Kool or whatever else because we've got a core sort of opportunity with these brands that we've got to focus on in the first instance and there's no point in diluting that focus, again the US is about quality of growth, it's about growth in the right brands and it's about getting the sales force focused behind a small but a small focus portfolio to drive the share growth.

Michael Lavery: Okay thank you, that's helpful, one last one on plain packaging. Just at a high level, certainly you have learnings from Australia but every market is a bit different, just in terms of what the potential competitive implications might be on your go to market strategy, do you expect any changes that would come from it and do you think your portfolio might be better positioned than peers?

Alison Cooper: We look at it through the same lenses when we look at markets because there are certain things that we focus on to drive growth, so we look at it through our sales growth drivers and probably the most important sales growth drivers around the portfolio and pricing and that was a key area for us in Australia to look at where the price areas were that consumers would be interested in, what the key portfolio areas were that we could use therefore to support the consumer proposition and then the other aspect is customer engagement and I think what was very important to our success in Australia was the fact that the customers, the retailers are very significantly affected by these sort of changes and therefore the more we can understand things from their perspective and actually help them through that transition, the more we can work with them and find some win/wins for our portfolio and also with the things that impact their business and those principles are things that we focus on are the same in any market and you can take the learnings from plain packaging into that, but yes you've got to adapt how you address that given your pre-existing portfolio in the market and the current market dynamics, so we're not complacent to think you can copy, paste but the principles of the things we work on in a plain packaging ought to be successful in a plain packaging environment are the same.

Michael Lavery: Great thanks very much.

Operator: Our final question today will come from James Bushnell from Exane, please go ahead.

James Bushnell: Hi yes, sorry just a very quick follow up. Is there any seasonality to think about in your US business, just noticing that your Q1 revenues were above your Q4 revenues and if we should build that into our thoughts going forward? Thanks.

Alison Cooper: There is not strong seasonality in the US business, there's a little bit of the impact of the MMC destock we did at the end of Q4 that would have provided a little bit of a boost to Q1 in total US terms, that's not acquired brands, I don't think there's any significant seasonality, you've got clearly timing of price increases will impact the numbers a bit.

James Bushnell: Okay, understood, thanks very much.

Operator: That will conclude today's question and answer session. I would now like to turn the call back to Peter Durman for any additional or closing remarks.

Peter Durman: Thank you. I'd just like to thank everyone for joining our call today, the IR team will be around for the rest of the day should you have any sort of follow up questions and thanks very much for joining and goodbye, thank you.

Operator: That will conclude today's conference call. Thank you for your participation ladies and gentlemen.