IMPERIAL BRANDS

Strengthening our Portfolio – Webinar Script – 27 June 2017

PETER

Good afternoon everyone… and thank you for joining us for today's webinar.

I'm Peter Durman, Director of Investor Relations.

I am joined by Alison Cooper, Chief Executive… Amal Pramanik, Divisional Director for our Growth Division and Marcus Diemer, Portfolio Strategy Director.

Welcome to the second of our IR webinar series. This is part of a programme of more regular communications exploring different aspects of the business. Our first webinar was in March and focused on our strategy and its context. The focus of today's session is on how we are strengthening our portfolio and how this is enhancing our revenue growth in line with our guidance and improving efficiencies. The slides and transcripts will be available on our website… We will not be providing an update or commenting on trading today.

[SLIDE 2 – Disclaimer]

I will just draw your attention to the disclaimer on slide 2 before I hand over to Alison to introduce today's webinar…

ALISON

[SLIDE 3 – Alison Cooper]

Good afternoon everyone.

[SLIDE 4 – Our Strategy]

I will start with a reminder of our strategy… You will be familiar with this slide and our four strategic objectives…

The focus of today's webinar is the first of these four objectives… to strengthen our portfolio.

It is at the core of how we are improving the quality of our growth, strengthening our portfolio by focusing on our strongest brand equities, with clear footprint choices, investing behind the brands and markets that matter.

At our webinar in March I outlined how, as a Board, we reviewed our strategy during 2016 and this review reaffirmed that we are focused on the right areas to deliver further revenue growth in line with our guidance and enhance returns for shareholders. However, the review also highlighted opportunities to drive even more focus on our strategic priorities.

We are further strengthening our portfolio through a radical simplification programme, enabling us to invest more effectively behind the brands that matter. This also reduces complexity, which delivers economies of scale that we can leverage across our manufacturing footprint and supply chain, supporting our cost optimisation programme and capital discipline agenda.

[SLIDE 5 – Market Repeatable Model]

As part of our review last year, we also affirmed the capabilities that enable us to win in market and enhance top-line growth. Based on our learnings from a range of markets, our Market Repeatable Model, provides a simple, effective and consistent operating framework that builds on the sales growth drivers we were already using in the business.

A "simple market-focused" portfolio is the <u>first</u> element of our "go to market" model… ensuring we have the right brands and SKUs in markets. This underpins all the other elements of our MRM.

[SLIDE 6 – Strengthening our Portfolio – Key Messages]

So what are the key messages from today's session?

As I have outlined already… Strengthening our portfolio by focusing on the right brands is absolutely core to our strategy and market approach.

This clear portfolio focus ensures stronger high quality growth enabling us to prioritise our investment more tightly behind fewer, bigger and stronger brands… An essential foundation for increased investment, improved revenues, while also supporting our cost optimisation programme.

We've made significant progress in reshaping our portfolio and have learned a lot, enabling us to improve our approach and identify further benefits.

And while we have made great progress there's still more to go for… reaffirming our confidence in delivering revenue growth of 1-4%.

I would now like to hand over to Amal – who runs our Growth Division and also has responsibility for our portfolio strategy – to outline the opportunity.

After that Peter will pose some of the key questions we hear from investors to Marcus who is our Portfolio Strategy Director – and also oversees the brand migration and SKU rationalisation programmes.

So first… Amal…

AMAL

[SLIDE 7 – Amal Pramanik – Divisional Director Growth Division]

Thanks Alison.

Marcus will talk about how we're strengthening our portfolio but first I'd like to give some context around the why - why are we doing this? Well, the answer lies in our history… and in our drive for top-line growth.

[SLIDE 8 – Multiple Complexity Drivers]

As a business, we became ever more complex over the years to 2010, driven by three main factors.

First, our M&A activity. Imperial was a very acquisitive company, completing a series of deals over the past 20 years that radically changed the make-up of the business.

This had a significant impact on our portfolio, which grew from 25 brands to more than 250.

Secondly, we had a decentralised operating model with each market independently managing its own local portfolio; there was no common framework for managing our brands and little alignment on the key global offerings.

Thirdly, like other FMCG companies – we had a launch mind-set: so while we did some housekeeping on the tail we added to the complexity with new launches, as opposed to really optimising the core portfolio.

This was the appropriate approach for us to take at the time while we were rapidly integrating acquisitions and increasing the scale of our operations.

Against a backdrop in increasing regulation and changing consumer demand, we saw a significant opportunity to strengthen the portfolio and enhance our organic revenue growth.

[SLIDE 9 – Opportunity to Focus]

We needed to tackle the complexity in the business. We had too many brands per market, which diluted our growth investments, as well as our presence at the retail level. In addition, engaging with retailers on our brands and products became overly complicated and harder to manage against increasing regulations.

As well as diluting growth, this complexity also impacts cost and productivity as a result of lower machine efficiency, higher manufacturing costs and reduced economies of scale across our supply chain and our sales processes.

Clearly, a business of our size is always going to have a degree of complexity but there was still huge scope for us to simplify the way we work – to simplify the portfolio to drive better focus and better results.

[SLIDE 10 – Portfolio Transformation]

In simplifying our portfolio, we're aiming to cut complexity by half, moving from 250 unique brands to 125…. and 5,000 SKUs to 2,500.

This is a significant shift but one that we're entirely comfortable in managing – the top 20 per cent of our portfolio already delivers over 90 per cent of Imperial's gross margin, so removing the bottom 50 per cent poses a considerably lower commercial risk than you might imagine.

[SLIDE 11 – Proven Approach for Growth Potential]

But the real opportunity is about revenue growth… And this is not exclusive to Imperial or even to tobacco… in fact a 'winning through simplicity' approach has been used to enhance organic growth in multiple other sectors and companies, to great success – as you can see in this slide.

Radical simplification provides considerable potential for both revenue growth and cost optimisation, and we're very excited about realising these opportunities. It requires discipline and focus, and we're embedding this in the business, optimising the portfolio and improving our quality of growth.

Let me now handover to Peter and Marcus to tell you more about the approach we're taking.

[SLIDE 12 – Peter Durman and Marcus Diemer]

Peter: Thanks Amal and thanks to Marcus for joining us today.

Marcus: My pleasure…and good afternoon everyone.

[SLIDE 13 – What's been our overall approach to simplification?]

Peter: Marcus, perhaps you could begin by explaining how we have approached our portfolio simplification programme?

[SLIDE 14 – Portfolio Transformation Journey]

Marcus: Sure.

Our portfolio transformation journey really started in 2012 … when we selected & validated our strongest equities, our Growth and Specialist Brands. These are the now the **key assets** in our portfolio.

From 2012, we **prioritised our investment** more aggressively behind these key assets … and designed a **global & disciplined approach - a strategic framework -** to managing and developing these brands.

Now our **brand migration programme** started in 2014, with a focus on migrating weaker Portfolio Brands into Growth Brands.

Amal said it before, portfolio brands are a legacy of our long acquisition track record. And yes... there are differences: some are strong enough to support our volume and revenue development … but some are not, so they are migrated or delisted.

Then in 2016, we took it a stage further or went deeper if you wish... beyond brand level... with a more radical SKU rationalisation programme.

And this year we started rolling this out across markets … in conjunction with our MRM…

[SLIDE 15 - Our 3 Principle Steps Approach]

Now our **Portfolio Transformation Approach** isn't rocket science, we are applying 3-steps... in all markets:

- First **Prioritise**: define Focus Brands and Brands we run for Cash
- Then **Simplify**: Migrate or Delist non-strategic or non-commercially relevant Brands & SKUs
- And **Leverage a simpler & stronger portfolio** using the MRM

How we best drive performance may evolve over time, but in principle .. these three steps have become our way of working.

[SLIDE 16 – How do you select and manage migrations]

Peter: So Marcus… we are often asked about how we actually do migrations… How do you select which brands you are going to migrate? And how do you manage the process?

[SLIDE 17 – Systematic Approach to Migration Success]

Marcus: Great question… Again we try to keep it simple with a four-step process….

First we identify brands that overlap – in other words, brands that have similar propositions and/or consumer bases

Then we check the numbers... go through **a rigorous commercial assessment** to ensure that a migration makes commercial sense and supports our quality growth agenda. Do you know that we are creating an individual Business Case for every single case? And we have done over 65 so far...

And once the business case is signed off, we get into **detailed executional planning** before moving on to the final 'launch and learn' stage... which essentially means going-live, tracking progress and capturing learnings, which is critical to adjust and improve

[SLIDE 18 – Tailored for Building Asset Scale]

As said, we have done 65 migrations so far - and yes all migrations are slightly different - but the majority can be grouped into three different types…

- Migrations that give us national brand scale, good example is France where we combined two strong regional brands……
- Migrations that shift local Portfolio Brands into international Growth Brands, such as Brooklyn to West in Spain…
- And migrations that support a portfolio clean-up, to drive focus & improve our economies of scale… the example on the slide is Poland where we migrated multiple brands to P&S … successfully
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[SLIDE 19 – How do you execute and track migrations?]

Peter: Understood – but how do you execute a migration….and things must go wrong sometimes… so how do you mitigate those risks? And have you ever had any migrations that have failed?

[SLIDE 20 – Robust Repeatable Model]

Marcus: Actually no, we haven't had any migrations that failed … but clearly there are always learnings and capturing these is absolutely key.

In terms of risk mitigation, we first identify where the risk lies … and how big it is.

Preparation is key. When we're looking at migration candidates, we make a detailed consumer assessment … as set out on the left hand side of the slide.

We look at consumer groups and their buying motivations…..we also assess brand awareness and the product itself: blend, formats and price. These elements need to be consistent between source and destination brand… in cases where they are significantly different we do some harmonisation work upfront... which helps to mitigate risk

We also do a commercial assessment… to quantify opportunities and risks and the overall benefit, which informs GO/NO-GO decision...

The commercial benefit is significant if we manage to migrate a consumer from a tail brand that is declining faster than the average… to a Growth Brand that can outperform – as shown by the chart on the right … But this is theory… it only works if we ensure a smooth consumer transition…

Peter: But Marcus… before we go on… are the Growth Brands at a higher price point and therefore… should we expect to realise a positive mix benefit as a result of migrations?

Marcus: No… because typically we are migrating brands at the same price points – so it's not about a mix benefit but there are lots of other benefits…

[SLIDE 21 – Smooth Consumer Transition]

…but let me quickly come back to the smooth consumer transition...

I have an example from the Ukraine, where we migrated Classic to P&S.

You can see different steps... and each requires detailed choices around pack design & communication…and of course we validate all of this with consumers … conducting rounds of intensive research.

Peter: And how do you track migration results?

[SLIDE 22 – Robust Success Tracking]

Marcus: Tracking is centred on the **'critical phase'** of the migration... when the destination brand name takes over. As you can see in this Spanish example, we added the West to Brooklyn in PHASE 1, and in PHASE 2 West becomes dominant... that's the critical phase... before Brooklyn disappears completely.

In terms of **metrics**, we measure volume and market share six months before and after the critical phase… and this gives us our success rate. Our average success rate

is 95 per cent – I think this is pretty good... well above the 80 per cent benchmark for other FMCG companies.

Peter: Marcus…How long does a typical migration take? And will the success rate of 95% fall in future – because you've done all the easy migrations first, leaving all the difficult ones left to do?

Marcus: We usually complete them within 12 months – depending on the case.

And no, we haven't done the easy ones first. We have done a wide range of migrations …very large ones like Balkan Star to P&S in Russia …and tricky ones like Fortuna to News in France – still delivering 95% retention on average.

[SLIDE 23 – Why more radical SKU reduction and what is your approach?]

PETER: Thanks, Marcus. Can we now move onto SKUs? What's the rationale and approach to the more radical reduction here?

MARCUS: Well, the rationale's simple: we have too many!

[SLIDE 24 – Creating the Optimal Assortment]

Amal talked about this before: at one point we had 5,000 SKUs – this makes its just harder for us to sell... and for our consumers to shop... particularly in dark markets where we cannot activate or were we have a display ban... which unfortunately is the case in more and more markets ..

There is also limitations to shelf space. I have seen markets where shelf space has become clogged with weak and low performing SKUs, again diluting focus & visibility of our core assortment … which results in lost sales and unnecessary complexity – a pain for us and our retail partners.

Peter: So what do you do about it Marcus?

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Marcus: In essence we replace low performing SKUs with higher performing ones - removing SKUs we don't need... in some cases we can't fit them all on shelf anyway…

BUILD

…and this drives distribution behind our optimal assortment… and enables higher levels of quality revenue growth despite the cut in SKUs.

Sounds counterintuitive I know, but let me explain in a bit more detail…

[SLIDE 25 – Disciplined SKU Rationalisation Approach]

Again, we have a simple four-step process to manage SKU reduction.. and we have successfully piloted in two of our most important and difficult markets: Russia and France

- So in STEP 1 we select strategically and commercially important SKUs.. this is what we call the optimal assortment..
- Then we estimate the potential downside of taking out non optimal SKUs, we are looking at volume and gross margin impact..
- In step three we do the opposite: we quantify at the potential upside, with a focus on calculating Share & revenue benefits…..
- before moving onto the final stage of the process, assessing the manufacturing and marketing cost savings.

And as with migrations, we create a business case... to make an informed decision about whether to go ahead or not.

And to set KPIs for tracking results.

[SLIDE 26 – What were the results in France and Russia?]

Peter: So can you give us a bit more detail of the actions you took with the pilots in France and Russia? And what were the results in those markets?

[SLIDE 27 – France – Market Context]

Marcus: Sure, let me start with France…

As you know, France is a tough market, highly regulated and very competitive.

We were losing share and had a very complex and fragmented portfolio……and this complexity really started to dilute our brand strategy and investment prioritisation.

So, we needed to take action... to prioritise, simplify and eventually leverage.

[SLIDE 28 – France: Radical Simplification]

Prioritising and simplifying was done at both a brand and SKU level…. we ended up reducing complexity by around 60%, going from 22 brands and 143 SKUs to 9 brands and 51 SKUs.

And we shifted focus and directed 90% of our marketing investment on the Growth Brands: News and JPS. In addition, we did a migration… News to Fortuna…..

But let me quickly demonstrate how we simplify SKUs to drive growth … I have the French example... it's interesting because it's based on <u>real</u> market data...

[SLIDE 29 – Example of Significantly Reduced Tail]

We started with defining our optimal assortment... lower performing SKUs which didn't make the cut were migrated or delisted – as you can see on the slide – each of the plots an individual SKU…

[SLIDE 30 – Example of Significantly Reduced Tail]

This freed up shelf space and resources to focus on our top performers… resulting in a higher weighted distribution behind our optimal assortment and improved availability. As shown here… we're left with a cleaner, simpler portfolio – that is better placed to drive quality growth.

[SLIDE 31 – Radical Simplification: Optimal Assortment driving better share trajectory]

And we successfully did a big migration. Fortuna to News – creating a #3 player brand in the market... As a result, we have stabilised overall share and improved momentum behind NEWS & JPS.

If we now go over to **Russia**…

[SLIDE 32 – Russia – Market Context]

A large and attractive profit pool that also has its challenges … with a tough economic backdrop, increased downtrading and a growing regulation. In addition, we had a VERY complex and regionally fragmented portfolio, lacking the focus and scale to compete effectively.

A great case for portfolio transformation…

[SLIDE 33 – Russia Radical Simplification]

So we identified 5 key brands to focus, 4 brands to migrate and 5 brands to delist…. Shifting from 14 brands and 112 SKUs to 5 brands and 34 SKUs... which is massive…

This helped to rollout P&S - to meet increasing consumer demand for international brands. We reallocated 60% of our marketing investment behind P&S and increased our average volume per SKU by 70%.

[SLIDE 34 – Russia Market Share Stabilised]

As in France, this has helped us to stabilise our overall market share and drive growth in P&S by 30 basis points – beyond the boost from migration. Really a great story... if I would have told you we are taking out 70% SKUs without any share impact I guess you wouldn't have believed it – in fact we have actually improved our share momentum.

Dior and Oliver, General Managers from France and Russia, had their doubts as well... but let's hear how they now think about portfolio transformation…

[VIDEO]

[SLIDE 35 – Extending Simplification across Markets]

These two pilots have been really good examples of how portfolio simplification kick-starts all the other elements of the MRM… specifically with the core range everywhere and our relationship with customers… building on our strength in these areas.

And now we are implementing this in other key markets such as Spain, Germany and Italy – where we are basically applying the same principles... but adapting to individual market context and needs.

Now it's fair to say that the scale of opportunity varies … for example, in Spain there are typically less constraints on shelf space... and distribution is already high, so we decided to do optimise rather than radically simplify, but even this has delivered benefits... both in terms of costs and focus. In Italy on the other hand, the portfolio was again complex & fragmented...

Different markets... different opportunities. But clearly a simplified portfolios helps all to drive improved market share trends and to leverage MRM... so we are rolling this programme out across 20 markets this year.

[SLIDE 36 – So what are the benefits for the business overall?]

Peter: Alison talked earlier about this being a core part of your strategy… can you give some evidence of the benefits that this has driven for the business overall?

[SLIDE 37 – Migrations Providing Asset Scale]

Marcus: OK… so let's start with our migration programme…

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We have completed 65 migrations so far … with an average consumer retention rate of 95% …So we are good at this… and we have continued to learn and refine our migration skills.

We are moving consumers from our local tail brands that are declining faster than the market to our Growth Brands that are outperforming… and we are not finished yet..

Peter: Marcus…so with all this portfolio change, have your migrations and SKU delistings been a drag on volume performance?

Marcus: There can be an initial top-line drag, particularly from delistings – but first of all this is not significant… and in markets where we have done our rationalisation program we were able to more than compensate initial volume losses over time - with better distribution and availability - resulting in higher rate of sales behind the optimal assortment.

And with migrations, a success rate of 95% means we don't take all our consumers with us but we can show an improved trajectory… a result of greater focus & spend behind destination Growth Brands.

[SLIDE 38 - Significant Portfolio Transformation]

Overall, we've already delivered significant changes to the shape of our portfolio since 2013 … reducing our brand and SKU count by around a third... against our original target of 50%... with plenty more still to go for.

Peter: Marcus... I know the transformation journey started 2013. So how much longer will this take?

Marcus: We still have another 2-3 years of migrations and SKU rationalisation… but yes, we are driving this transformation to support an improvement in the overall revenue growth…

As a result, we have a stronger portfolio with fewer, bigger and stronger brands, and this delivers benefits in two areas: "grow the head" and "cut the tail"… both of these help to reinforce our growth agenda.

"Grow the head" is all about effectiveness, it's about the strength of our portfolio. We are not doing simplification for the sake of simplification, we know that a simple and more focused portfolio enables quality growth.

[SLIDE 39 – Grow the Head. Strengthening our Portfolio]

The right portfolio focus helps us to prioritise our marketing investment more effectively … away from our Portfolio Brands now spending behind Asset Brands, they now receive nearly 80% of the investment compared with 54% in 2013… And 80% of

new product initiatives are on Asset brands... all to build brand equity to support future pricing capability and top-line quality revenue growth…

[SLIDE 40 – Grow the Head. Strengthening our Portfolio – Increasing Quality]

…with 60% of our revenue now coming from our Asset Brands... against our target of 75%.

Peter: So why do you not aim for 100% from Assets?…

Marcus: Because some local Portfolio Brands are good to keep as they play a valuable role in their specific market.

But specifically our Growth Brands are doing well... with strong revenue growth…

[SLIDE 41 – Grow the Head – Strengthening our Portfolio – Increasing Share]

And outperforming with consistent share gains over recent years. Even if we strip out the benefit of migrations, our Growth Brands have gained market share.

Peter: Can you explain what we mean by “cut the tail”?

Marcus: With **“cut the tail”**, we generate efficiencies through our manufacturing and supply chain to supports growth. Essentially we generate the oxygen we need to reinvest into top line growth.

[SLIDE 42 Cut the Tail: Complexity Reduction]

Let me start with **procurement.** Efficiencies are most evident in our “Non Tobacco Material” costs... or NTMs. These account for roughly a third of our cost of goods sold.

Printed items are a large part of these costs … and the unit cost is highly dependent on volumes due to set up times at our printers. This means scale or volume is a key

driver of cost or savings … cost for our smaller volume SKUs for instance is more than double vs the average.

Now we still have a lot of small volume SKUs and… some are perfectly OK, for instance new launched initiatives, but there is still opportunity for further simplification.

We also continue to cut down manufacturing complexity. We standardise component parts across brands and SKUs. All this adds scale to our purchasing power with lower cost as a result.

[SLIDE 43 – Cut the Tail: Complexity Reduction]

And cutting SKUs has driven a 30% increase in average volume per SKU over the past three years… which has helped to bring NTM cost down, with a 9% real improvement despite overall volume declines.

Peter: And what have you been able to achieve on conversion costs – because I believe these represent about another third of the cost of goods?

[SLIDE 44 – Cut the Tail: Complexity Reduction]

Marcus: Machine efficiency across Europe has improved by 10% over the past three years… fewer SKUs means fewer changeovers in our factories. And to give you some idea of the impact on production… a typical changeover can take around an hour – resulting in 1.2m sticks of lost production.

So this is also key to simplify our factory footprint… which in turn, improves plant utilisation... by 15 percentage points since 2013.

In summary, we have held conversion costs flat despite inflation and declining volumes over the last few years… great achievement by our manufacturing colleagues.

And these factory and supply chain cost initiatives contribute to our cost optimisation programme to deliver £600m of savings by the end of 2020 – freeing up resources so we can reinvest in top-line growth initiatives.

[SLIDE 45 – Key Messages]

Peter: Thanks Marcus.

So the key conclusions that I take from this are that the portfolio transformation is central to our strategy – and to how we win in market – and most importantly about how we drive enhanced top-line growth in line with our 1-4% revenue guidance.

We are strengthening our portfolio through brand migrations and more radical SKU rationalisation. This is driving a higher proportion of our revenue from our Growth Brands – our strongest brand assets. These brands continue to outperform with consistent share gains – even excluding migrations – driving a stronger quality growth.

But this is also making it easier to manage the portfolio enabling us to prioritise our investment behind fewer, bigger, stronger brands to drive better pricing power… and also to manage them more effectively within an increasingly complex regulatory environment.

I know that many investors often see portfolio simplification just as a cost cutting exercise – and while there are clear economies of scale that underpin our cost saving initiatives – this is really about improving the quality of our top-line growth and driving more of it.

Marcus: Absolutely. Ultimately, this is building a better business… one that's generating a higher quality of growth and creating a stronger platform for delivering sustainable returns to shareholders.

[

SLIDE 46 – LOGO]

PETER

Thank you Marcus, Alison and Amal… We would now like to open the call to Q&A.

Q&A

Peter Durman: Thank you, Marcus, Alison, and Amal. We'd now like to open the call to Q&A.

We have question registered on-line from John Fell, and he asks that we've nearly had five years now, where the group has generated no organic revenue growth, in which the company has been going through change programs, and while the regulatory environment has been challenging, when we will get to a point where the company will generate growth again?

Alison Cooper: Thank you John. I know you're all familiar that we've had a strong focus on quality of top line growth, for a number of years now, and you've heard this afternoon about a number of the initiatives that we've been working on, in order to really reshape our portfolio, and strengthen our portfolio, to drive growth going forward.

And despite a number of external factors, which you're familiar with those for the last few years, we've made very good progress with that quality growth agenda.

And at the point when we were reassessing the strategy in 16, we very much concluded that we had the foundations in place to really add to the investment behind that portfolio, to really look to reinforce our growth potential and drive more from the top line, going forward, than we had historically.

So, the initiatives that we've been going through today are really at the heart of our focus and our confidence on driving revenue growth within our 1 to 4 percent guidance range, going forward, and adding to the growth potential of the group, and reinforcing further returns, and a dividend commitment of imperial.

So this is very much the focus on how we are taking the group forward, to deliver more against those objectives.

Operator: Excuse me, we have a question from the telephone lines, and it comes from the line of Michael Lavery. Your line is open.

Michael Lavery: Thank you. I just was curious about some of the execution costs of the transitions, is that still rising? or now with a lot of these transitions behind you, is it starting to fall? How does that fit in to sort of – what kind of run rate does that have?

Alison Cooper: Is there a particular slide you're referring to Michael? Because we weren't really talking about the execution cost of the transitions.

There is a cost associated with them, but they're not particularly significant in the context of the group, clearly there's things like managing the non-tobacco material changeovers, making sure we don't end up with write offs as we switch between packs going through the migration program.

Those sort of aspects are important to manage, but I mean in terms of the group, the costs are not particularly significant.

Michael Lavery : Well, yes, it wasn't a specific slide, I suppose. But that's actually more helpful then, to just know that it's not material, and so it's in terms of just executing it's pretty modest prices or costs as far as playing it out?

Alison Cooper: Right and on that I think the intense planning we go through, for every migration, in particular, it's to make sure, and the SKU actualization, right, so we minimize those costs in terms of how we manage that rollout.

Michael Lavery : OK, great. Thanks.

Operator: Thank you. And the next questions comes from the line of Adam Spielman. Your line is open.

Adam Spielman: Hello, thank you very much. First of all thank you for the seminar it is more detail than previous and that is appreciated. So, clearly what you're doing is sensible, but I wonder where you think your complexity of the company will end up in Europe? So, this is your European footprint relative to your peers.

It strikes me that (P.M.) and (J.T.) had much more simple portfolios to begin with. They'll probably still end up more simple but you're closing the gap substantially with them? Would you said that's a fair categorization?

Alison Cooper: Well there's no doubt that some of our competitors start with simpler portfolios than we do. And most notably clearly Phillip Morris, but what we've very much looking to do is make sure that we do have that optimum portfolio as you can see from our (MRM) or marketing repeatable model

we are really looking to make sure that we have the right assortment for the consumers in the market for the demand shifts in the market.

And really therefore, model the assortment based on those dynamics and therefore, we're bound to have brands at different price points for different consumer propositions.

But I wouldn't have thought that the destination would be too dissimilar although we'll be more likely use specific brands in specific segments rather than to do brand extensions in some areas.

But clearly we see this as an opportunity and we continue to take this forward to really make sure we strengthen our quality of growth going forward.

Adam Spielman: Thank you.

Operator: Thank you and the last question comes from the telephone lines comes from the line of John Buckland. Your line is open.

John Buckland: Good afternoon, thanks. I was struggling to get through actually but anyway. The simple questions is, why do you need to growth target? I mean you have so many brands and so many SKUs I mean, could you not have a fantastically profitable business just getting a little bit smaller?

I mean, and this ambition of halving stills seems to leave you with a very complex business. I mean, can you not go much further, much faster?

Alison Cooper: I'd love to I mean, maybe Marcus can comment in a minute. But we have clearly tried to get the pace of this program right and balance it also with the consumer proportion that we need in market. And yes you could go very fast.

But I would argue that the degree of risk you take, if you go too fast its considerable in terms of you know, the profitability of these brands and what they contribute if you go too quickly.

So, I think it's important if you take the consumer with you and therefore, (as for the) pace we put in here would continue challenging ourselves on the pace. But we've got to keep at the correct pace balancing your opportunities and the risk.

Marcus Diemer: I think it's important to in alignment with the end markets as well and clearly that is something that has been absolutely critical for our success that we have generated. , you have always the markets on side. That's one element I wanted to say and then clearly. I mean you better show some successes before you roll out across the other markets.

So we are very clear on doing a pilot, taking the learnings seriously, defining our model. Be very serious about what we're doing and then go at the right pace. I think critical as well that we do that sustainably, and we are talking just about taking things out but it's important that they're not coming back in.

Because otherwise we have done all the exercise very much for the sake of it. I can clearly say that Amal showed a number of 350 SKUs coming in per year. This has now come significantly down, we are now talking around 125. Actually we are not just changing our portfolio, we are changing mind set. This is critical.

John Buckland: At the beginning of the presentation you said, 20 percent of your portfolio delivered 90 percent of your gross margin. So when you get to this halving what's that ratio relative to this 20/90?

Alison Cooper: I don't think we have specifically calculated that ratio. I mean clearly it's going to be you know, we're going to be generating 90+ percent or more from those key brands. But those key brands also need to include a few of our local hero brands as well.

Because there are some of those that we are still not sure that we will ultimately migrate into the assets brands. So we've got some very important brands in our portfolio that sit along-side the growth assets.

But clearly the more we go down this journey then it's going to be minimal that's going to be derived from anything we don't want to have in the portfolio. But we do need to pace our way there.

John Buckland: Can you give us any clues how this is changing returns on capital and the margins, etc, etc there's a lot about growth and reducing costs. But what do they mean in financial measures?

Alison Cooper: It's good for our margin, going forward it gives us opportunities not only to really keep pushing on the quality growth, the top line growth.

These are brands as well that are strong equities in markets in terms of positions they can hold. But then also as Marcus outlined significant cost opportunities which very much underpin our margin development going forward as well and continue to add to our bottom line as well as the overall approach adding to our top line opportunities.

John Buckland: But you can't actually put a figure on it? In pounds, or percent of sales or whatever?

Alison Cooper: We haven't put specific targets on it. We've just highlighted that those incremental margin increases give us opportunities over time.

John Buckland: OK thank you.

Operator: Thank you we don't have any further questions from the telephone lines. Over to you.

Peter Durman: We may have another just on line…

Alison Cooper: There's no one on the telephone line, you got a few more email questions.

Peter Durman: We have some more coming through on email yes, so Charles Mills has commented, can you offer more on the profit benefit of migration? Maybe how many basis points higher on margin post migration being completed versus the combined margin pre-migration of the 2 brands concerned.

Alison Cooper: In terms of the, looking at the specific individual brands on migration benefits, all the opportunities we've been highlighting around the manufacturing costs. But we tend to capture that in aggregate in the business those costs savings are part of our 2, 300 million pounds cost saving programs.

And as I mentioned with the previous question, will give it incremental margin opportunities over time, but clearly these aren't not the only dynamics that drive margin in any particular market. There is also the pricing environment and other costs I have as well.

Peter Durman: Charles Mills has asked another one. How far through the brand migration process are you? How many brands still to do and when do you see yourselves being finished?

Alison Cooper: Marcus do you want to take this?

Marcus Diemer: We have set ourselves a target of 50 percent as I have outlined before and we have delivered now 33 percent reduction. Now as I have said, I believe that we are done potentially in two to three years but clearly it's all sort of active portfolio management. It needs to become part of our ongoing business and it has been. So I mean in two to three years, I think we are going to be done with that.

Peter Durman: And can you give us an idea what upside there is on the working capital perspective from those migrations and the SKU rationalization process? That's from Alberto Lopez from JP Morgan.

Alison Cooper: Again, this within a number of other initiatives that supports our working capital improvements. But clearly as we combine a number of the aspects in terms of the purchasing of the non-tobacco materials or the opportunities from a blend perspective, this all helps our working capital programs.

And helps us generate you know, the level of cash and cash conversion that we've been delivering over the last few years. All very supportive to our working capital and our cash agenda.

Peter Durman: A question here from Rowan Marron. What do you achieve the initial target of getting 50 percent of reduction and do you see an opportunity to take that beyond that to a further range of portfolio itemization?

Alison Cooper: I think that links to previous questions and it's our initial target, but we will continue to look at opportunity to optimize, to drive more focus behind the the growth brands. And you have seen they're outperforming the markets.

And more, we drive into those growth brands, the more we add to our top line potential.

Peter Durman: We've had one or two questions asking about next generation products. These are not the focus of today's presentation which has been about how we're strengthening our portfolio in our tobacco business. Those will be the subject of another webinar at another time when we'll talk about what we're doing on NGP.

And I think we've had a question here about the headwind from brand migrations, but I think we dealt with that one already. I think that probably largely covers the ones we've had online. Are there any other questions on the phone at all?

Operator: We don't have any further questions from the telephone line sir.

Peter Durman: As well as market by market.

Alison Cooper: I think Marcus can comment on the business cases. As you said we do them individually for every single migration. And we also look at business cases clearly from SKU rationalization as well and they are — they're detailed, they're detailed business cases.

Marcus Diemer: Absolutely and what we are looking at ultimately is to generate a positive five year NPV. And we are looking specifically at one; success rate, two; trajectory changes and three; any impact on transfer cost or strengthens.

And all of that actually combined gives us a net present value. As a third, maybe look at that over the five year period. And we go ahead if it's positive.

Peter Durman: I also have a question about your confidence about hitting our one to four per cent target in the future? I think we covered that I the presentation but, that whole presentation is really focused around...

Alison Cooper: Yes, I mean all of the initiatives are around really continuing to improve the quality of growth we generate as I highlighted in November. It's about more of that quality growth.

And we are very much focused on the markets and brands that matter, and really driving the growth in those areas, so that we can sustainably grow the top line within our guidance range. And therefore support the, the EPS and the dividends delivery.

Peter Durman: We've got one question from John Leinster. Having rationalized Germany, France and Spain, should we expect the same significant SKU rationalization to take place in the UK and in the US in the coming two to three years?

Alison Cooper: Well our priority markets are clearly the first priority at looking at these opportunities. And we'll continue to work on the portfolios in those markets. I think as Marcus highlighted it's not a one-time initiative.

It's something that we'll keep on top of in terms of the optimal SKU portfolio. As I introduced this Webinar,that very much drives the whole of our market repeatable model, drive that quality shares focus in those markets and very much supports our growth agenda.

Peter Durman: And we've also been asked, can we disclose the portion of tobacco volumes migrates since FY13?

Marcus Diemer: Yes, we can. If you're looking at the close of FY16, we have migrated around about 30 billion sticks.

Peter Durman: OK. At this moment that's the end of the questions that we've got online. Any other questions on the phone at all?

In which case, I'd like to thank everyone for joining the call today at the webinar. And I apologize for the technical problems and if that made it a bit more difficult for a few of you.

But hopefully you found it useful. If you have any further questions, don't hesitate to contact one of the IR team. I look forward to you joining future webinars again in the future. Thanks so much. Goodbye.

END