Q&A Transcript

Adam Spielman: Adam Spielman from Citi here, first just a couple of facts finding questions, you called out a couple of if you like, non-operating items in the results. So, I think there was an impact from a disposal in Logista. There was a pension change and I think some MPM adjustments in the US, I was wondering if you could quantify those? That would be my first question.

Second question, it seems to me that trends -- and I'm talking about market trends and hence your revenue trends, have got worse during the course of a year as it turned out not quite as good as you expected, and I was wondering if you could confirm that they sort of are deteriorating and how you expect them, you know, particularly the market trends to play out in the rest of the year? Do you think the adjustments to do with the tobacco products directive are basically also one off step downs or is there anything ongoing from that? Those would be my two questions for now. Thank you.

Alison Cooper: Okay, well I'll take up the second question first, and Oliver if you can pick up the one offs.

For a revenue trend perspective, I mean it's definitely been a tougher period, I think, for the industry that we're seeing currently. And that's two factors. One is in relation to some of the volume pressures, with regulatory changes and also excise changes.

And you mentioned the EUTPD, and I think in particular, I'd say for Germany, we anticipate a strong reaction to EUTPD in Germany given the lightness of the market and the impact of the packs. There's been a little bit more consumer reaction to that in Germany than anticipated. So, this year is slightly softer volumes overall, partly regulatory, but partly, as you know, from a strong volume position last year, which is probably slightly abnormal, given the historical trends for volume, so slightly soft from volumes.

From a pricing environment, I mean again this ebbs and flows, in terms of how pricing is looking. We've got a few markets at the moment that are quite competitive. I've called out the UK for a long time. And Russia's quite competitive at the moment as well. But in overall terms, a slightly weaker environment in the second half. But that's something that means, from a strategic perspective it is even more important that we focus on the markets with the brands with our investments in areas that we really see the growth opportunities going forward.

And that's exactly what the focus of the strategy has been; it's been reinforced in the first half with the additional investments and the increased focus behind those brands and markets.

So, for me, it reemphasizes what we're looking at as a business, but yes, some slightly weaker industry trends currently, rather than reading that across to anything further.

Oliver Tant: On the one offs, we've called out some -- the pension change, which was the curtailment essentially of a pension plan in the US. Broadly speaking, that was about 25 million dollars in our numbers. The Logista shares were substantially less than that, very small indeed. And I'm trying to recollect the MPM item--

Alison Cooper: There's a -- there's a working capital benefit in relation to MSA, is that maybe what you were alluding to?

Oliver Tant: If you can find an MPM adjustment that produced the one off credit, I'll be very happy to explore it with you, but the MSA adjustment is something slightly different. When we bought the US brands, we obviously had a time -- we had a timing difference on the payment of a -- of an MSA obligation. And this really plays just to our working capital, it doesn't have a P&L effect at all, because we make a payment at one point of time in the year, but we accrue the liability having collected essentially during our sales process up one point.

So, over a -- last year, we only accrued nine months with this into our half year numbers, because we bought the business nine years beforehand, this year, we have a full 12 month of numbers. So, our cash conversion benefited by an incremental three months from our norm of low 90s. In FY17 half year, it benefited to the tune of six months in the half year of '16.

I hope that it makes it clear, happy to take it offline as well.

Alison Cooper: But yes, it's working capital. It's not profit related.

Simon Hales: Yes, thanks. It's Simon Hales from Barclays. Could you talk a little bit more about the performance in the US? I mean Alison, you referenced the underperformance of some of the portfolio brands, in Maverick and what you're looking to do going forward to improve there -- just a bit more sort of colour on what's really happening with the share loss outside of Kool and Winston would be helpful, and how quickly should we hope to see some improvement in this.

Alison Cooper: Yes, I think it's partly down to the trends in the market at the moment in that we're seeing what are called premium discount brand in the States. That segment is performing fairly strongly, but also we got quite a growing and active deep discount segment in the US at the moment. So, the discount segment in itself is under a bit of pressure. Within that, I would -- I would call out Maverick more than USA Gold as the -- as the brand that's under some pressure.

So, we're looking at some different options for further investment behind Maverick to just activate it a bit more with consumers and just build its profile a bit more from a distribution perspective and markets as well. So, it is slightly weaker than we anticipated this year, but I think there are things we can do to address that. And as you say Winston and Kool are performing to plan. And the investments were putting behind the buy downs, but now increasingly around the equity activation and really looking, as you know, with Winston to shift the demographic and Kool to some degree as well, is an important part of what we're doing there. And that's really -- that's really coming through.

Jon Leinster: Jon Leinster from Berenberg – on the growth brands a couple of things; the volume growth rate is about 3.2%, how much of that was due to migrations? And secondly, given you did have volume growth of 3.2%. Why are net revenues at constant currency down 2.5%? Price mix of minus 6 seems quite aggressive, can you explain exactly what happened?

Alison Cooper: It's a mix. We still have the benefit clearly of migrations coming through, but we're seeing some very good organic growth actually, from all brands, apart from Gauloises, at the moment actually, which we've got some specific -- some specific share actions that we're addressing in the second half in Germany, but it continues to grow in Algeria, so there's organic growth coming through across the -- across the growth brand portfolios.

From a volume revenue perspective, I mean that's just the direct read across to the investments that we've been talking about. So in the US, there's a lot of investment going behind buy downs, as we normalize the overall buy down level full year effect run rate in the -- in the US following acquisition.

And also there's investment going in the UK as well from an always on price strategy and making sure that we're competitive in the sub economy segment, in particular in the US, which again, we flagged at the full year. So, some of those actions clearly have an impact on the overall revenue performance currently, but as that investment plays out over the coming years, and that will be helpful to the overall revenue trajectory, but it does -- you know, provide a quite an aggressive price mix number currently in the first half.

Fulvio Cazzol: Fulvio Cazzol from Goldman Sachs, there seems to be a lot of focus right now on NGPs across the industry, and we hear from your competitors more excitement on heat not burn and you've highlighted continued investments in vapour with the third generation coming out later this year, can you also highlight what you're doing behind the scenes to prepare for heat not burn if that proves to be an exciting category, even in Europe one day? Thanks.

Matthew Phillips: It's easy -- I mean it's easy to forget in all the excitement that the whole next generation products area -- and I mean by that heated tobacco and E-Vapour outside Japan is still pretty -- still pretty nascent. I would also -- you know, reconfirm our -- our belief is that the opportunity in E-Vapour remains bigger than the opportunity in heated tobacco. But I've also said that -- you know, I think there is a place for both. I'm -- yet to see the kind of traction outside Japan that would make me change that view and start following a heated tobacco strategy more proactively. But we have been looking at a variety of options for a while within heated tobacco.

I think it's fair to say that technology has moved on quite a lot, because of all of the investment in a variety of markets like E-Vapour, but also the marijuana market in the US. Technology has moved in different directions, which don't require a heated tobacco product to necessarily be in the format that it's currently -- is currently offered. So, we are looking at a variety of things. I've also said if we had to -- if we had to change our mind because it did start getting traction, we would be able to follow with an offering within a number of months. And that's still -- that's still the position.

Carl Walton: Carl Walton, UBS just wanted to follow up on the brand migrations, looking at the -- couple of markets where you finished, you've done maybe two thirds for brand migrations, is that specific to France and Russia where there was just more opportunity or should we think that the overall opportunity being a bit bigger than the original target? And if so, how does that impact how we should think about volume performance and margin going forward?

Alison Cooper: There's two key aspects to our portfolio recognized as the migrations piece where I mentioned we've done roughly now 65 migrations, 95% have on average consumer retention, which is very high. And that's really been spread across the globe, in terms of that migration activity, so it's not been isolated to France or Russia as being a cross market to consolidate the portfolio behind the strongest equities.

The second phase now, which is a more radical approach to looking at portfolios and markets was piloted in Russia and France. And as you can see we piloted roughly a 50% cut, we've achieved more than that as we've rolled out, extended nationally across those markets. So, it's now really driving a very much more simplified optimal portfolio.

And across the two of these, these are very key elements that support our cost optimization programs, because you know, as we get the right portfolio, that has knock-ons across the supply chain in terms of cost and efficiencies, but also more broadly within the business as well from a sales force focus perspective, and clearly from a trade perspective as well. As I highlighted, it really helps the engagement with the trade. They absolutely love it. So it's a two phase, I suppose, programme, but then also with our ongoing housekeeping bits for it to make sure that we -- we'll make that distinct as well over time.

We're just briefly talking about Russia, in particular, Amal, in terms of how the migration -- sorry the SKU rationalization program is being received there by the -- by the market just for a bit of colour.

Amal Pramanik: Yes, maybe just a couple of comments so it's -- like Alison said, there are two things, one is migration and another one is be distinct. So, we have quite a lot of be distinct that we have done, so that is the SKU rationalisation that Alison has talked about. And it is improving distribution and visibility, because some of those very slow moving SKUs were taking up space on the shelf and working capital improvement for the retailers as well, and that's why they're so happy. And even with all those changes in Russia, we have done around our share performance, so it's still not growing, but definitely a much better trend than in the historic past. Thank you.

Alison Cooper: We were talking about France and how that -- that's helping from a plain packaging perspective to--

Dominic Brisby: Yes, I mean say France we had a lot of SKUs really taking up quite a lot of space, so we deliberately migrated some of the weaker ones into our stronger -- into our stronger brands and concurrently, have also delisted a number of SKUs, which were rotating slowly. And particularly, as we go into plain packaging, which is a time of great, great turbulence for retailers, they really value this very much as they can reduce the number of SKUs they're keeping on the shelves.

Now, if you look at our performance within this in France, the notion of having the simple market focus portfolio, which looks at through the lens of the MRM is quite an important key to our competitive advantage there, has allowed us to grow particularly News very significantly.

Previously if you looked at Imperial's business in France, we -- whilst we had quite a significant market share, we had a large number of small SKUs, now migrating brands into News, and taking a lot of quite decisive action to grow News has meant that as we enter this plain packaging environment, we think we're in quite good shape to grow this brand further, just as we grew JPS so significantly in Australia, following the implementation of plain packaging.

Alison Cooper: Thank you.

Though we are boring about all the work that we do on portfolio, but it was very necessary for Imperial given the very complex portfolio we've had. And I think as a business, we just see the benefits of it across the board. And it is -- you know, it's clearly good for margin, but it's also good for stickier top line growth as well, going forward. And the more we get our portfolio into those brands -- into those brands, the better. And I think we're planning a webinar later in the year if you want to hear even more about what we're doing on portfolio, we'll talk to you about it even further. But it underpins everything we do.

Adam Spielman: In the past we used to obsess about plain packaging, we've now had it implemented more or less in France and in the UK as well as Australia. There's obviously a lot of down trading in the UK and Australia, you're gaining from one and I guess you're suffering a little bit in the UK, what's your overall view on the impact to plain packaging now it's come to so many markets -- or a reasonable number?

Matthew Phillips: We've only got Australia really, to be able to use because the transition in France and the UK is not through, you've still got branded packaging on the shelves. And excise still is a bigger factor in terms of driving the dynamics and in our view. I mean there is down trading in these markets anyway, and to segregate out and some kind of acceleration being linked to plain packaging is very difficult.

Consumers still do make brand choices. The brands are still relevant to the consumer. They're still relevant to the retailers. One has to find different ways of being able to operate in that environment clearly, which is a lot of the thinking that sits behind our MRM. So, it does change the way one plays in a market, but it's the excise dynamic, which I think is the bigger immediate impact on consumer affordability.

Adam Spielman: And then in terms of -- it seems to me that any company that has still got branded packs in a market, probably has an advantage just at the moment. Is that true? And if so, who has the advantage in France and the UK?

Alison Cooper: Yes, the learnings from this are that yes if you have longer stocks of the branded packs, interestingly enough, the -- we're not -- we're not sure whether or not if you -- if stretch it out too far, there's got to be a freshness concern in the market. But the learning is that if you switch -- if you switch too quickly at times, then you can lose share.

The other learning is actually the minute everybody else switches, it comes back very quickly. On the whole in most markets, we've planned quite good stock durations for most of our -- most of our products through the EUTPD. I think there was one example in France where we didn't plan such long durations due to capacity issues and whatever else, because you know, we need capacity left right and centre, but we have literally seen a drop off initially but some very rapid feedback up now that the competitors SKUs have shifted as well. So, yes it's been a key aspect of our management through EUTPD in particular.

Chris Wickham: Thanks, yes -- Chris Wickham, Whitman Howard, just going back to that slide 23 in an earlier question on vaping and then next generation products, I mean what are the M&A opportunities looking like there, either in terms of type of products or route to market? And is it possible that it's just simply that we don't have the big players dominating the route to market, where they can get the maximum amount of education in terms of product development, and that sort of tangibility that's perhaps holding this sector back?

Matthew Phillips: Yes, I mean the point I made a minute ago about it being a nascent market I think is the case. And so, if you take the US market as an example, with the possible exception of one participant in that market, it's largely been led by heavily discounting products and widely distributing through a single channel. And the consumer is -- you know, is different to that.

The vaping consumer, which I would contrast with the heated tobacco consumer, the vaping consumer, I think is more the sort of the millennial sort of consumer, whereas the heated tobacco consumer tends to have a -- to have an older profile, and therefore the shopping habits of those consumers is different.

And therefore, I think there are opportunities for different players, theoretically to be able to play in E-Vapour. But what you're seeing is the regulatory burden and continues to increase. And therefore, the costs of being able to play in the market is going up, and people are starting to struggle. You know, they're in a window in the US at the moment of having a period of being allowed to stay on the market before they have to comply with the FDA regulations. As we approach the deadline for that, you're going to start seeing people disappearing from the market.

You're seeing regulatory initiatives in the US trying to get the dealing date changed, because they recognize what's going to happen to a lot of players in the US market. So, to answer your question, there are inevitably going to be -- there are already lots of E-Vapour acquisition opportunities, but there are lots of people who just ripped off other people's ideas. Finding the ones who are actually genuinely additive to the knowledge base is the -- is the trick. But we -- we're talking to those people for our licensing programs and the like anyway, so I expect there will be M&A, yes. It's a very long answer.

Chris Wickham: And also -- and just as a follow up for that -- thanks what about route to market, I mean is that -- is that -- is that a barrier where you're just not getting control of that, that distribution?

Matthew Phillips: It's unproven. So Vape stores come and go. They're also under pressure in various markets and -- you know, if one takes a look at what has happened in the heated tobacco collect space, owning that consumer experience or trying to shape that consumer experience through flagship stores and what have you, is something that has worked in certain markets. But I think retail and the influencing of the experience and the reduction of retail margins is an important factor that the industry still needs to solve for.

Alison Cooper: There's no doubt either E-Vapour will be partly around some of the traditional tobacco distribution and partly not, and that's an important aspect in capability building.

Chas Manso: Chas Manso from Soc Gen. On the market share, you're saying across your footprint now down 30 basis points, could you remind us what it was last year, I think it was around minus 50? Could you -- I mean people are clearly looking for the signs of the turnaround and sustainability of the turnaround, could you perhaps talk us through -- you know, what's taken the minus 50 to minus 30? How much of that is the SKU reduction?

How much of it is stuff like -- you know, less price competition in the Ukraine which is sort of outside your turnaround plan? And maybe like an exit market share rate to give us some confidence about -- you know, the second half? And you know, do you expect to get to -- sort of breakeven to flat market share at some point in the not too distant future? So, that's the market share question.

The second question's on margin, and I think the margin is down about 130 bps at the group level, but if you take the investments out, it looks as if the margin was up substantially, something like 500 basis points. That doesn't sound sustainable, but I mean could you again, talk us through how much of that is some temporary cost reductions to manage your way through this period and how much of that 500 is kind of the benefits of everything you're doing on simplification and therefore is more sustainable?

Alison Cooper: I'll get Oliver to pick up the margin question in a second. First of all market share, on market share, you know what our volumes are doing, and we tell you what the market volumes are doing. And therefore, there's a sequitur to that, which is what our aggregate market share is doing, therefore we're transparent about the fact that our market share overall is down 30 basis points, and compared to 60 basis points last year.

It is not a key metric per se that we drive as a business, to be clear, in that we give an aggregate, and if we really just wanted to drive an aggregate share, then as you know, from things I've said previously, you go for big volume markets with lower margins, you can drive some volume and drive some aggregate market share, and that's the way to do it.

So, I'm very -- again clear that what we focus on is the markets where we want to either grow or stabilize market share from where we've been, and our investments are very much focused on those. So, for example, actually Ukraine has rebounded a bit this year, so that's helped a little bit. We said that will come back once the price war has settled down. But the real drivers of the improvement behind the market share are the markets we're investing in.

So Germany's on an improving trend, big market. UK's on an improving trend, we're very much -- you know, regaining a -- leadership momentum in the market. We've got Russia stabilizing that has big impact on the overall share position. US currently, because of my comments on Maverick and some of the portfolio brands, clearly is having a bit of a drag on the overall market share, given size the market and the -- and the impact on the aggregate share number.

But our focus is on the markets where ewe see growth opportunities going forward, tried to highlight that in the context of Adam's question earlier around looking at the broader industry context. You need to be selective. You need to be sharply focused on where you see the opportunities for growth going forward.

And that's where we're looking to either address the share or grow the share more as we look -- as we look out. And therefore I'm not saying well, I'm desperate to fix the overall aggregate share of the group. What I do want to see is the share in the right places with the right brands. And that's what we're going to continue to focus on and see in the second half.

Oliver Tant: On the margin point -- the margin's down about 150 basis points, of which 290, broadly speaking is the impact of the investment activity that we've undertaken, so you -- you've got basically 140 absent that.

Most of that is driven by performance in the US, and I sort of referred to the pension curtailment item but we've also been through, and are continuing to deliver on a whole series of cost savings within the US following the acquisition, which are also driving that improvement in performance -- which I think is about 420 basis point improvement in margin across the US. There are also some mixed factors that will be influencing that as increasingly the core brands within that portfolio, are becoming a more prolific component of our overall business in the US.

I think as we look through to the rest of the year, I mean we would expect the slightly better revenue performance in the second half to have an impact in the context of our overall margin development. And I would expect it to be weaker than last year, but significantly better that it is at the half year.

Jon Fell: Hi, Jon Fell at Ash Park, a couple of things, one technical one, when you do delistings, does that have an impact on the volumes and revenue and profit that you report in a negative way? And just more broadly, can you remind us what mid to long term kind of model we should be -- or you're aiming at for revenues and profit growth for Imperial? And has a combination of what you've done in the first have and how your markets have developed increased or decreased your confidence in getting there?

Alison Cooper: Okay, so first of all, in terms of delisting, in the short term, there will always be an impact when you delist, so that will impact your revenue, profit, volumes, and similarly actually, even though we've achieved a very high level of consumer retention in migrations, initially you'll get a bit of a dip from that as well, but then -- you know, we do it because we then want to generate more growth in the brand that's been migrated into where the delisting you're trying to navigate the consumer to -- so we do it because we do see benefit from doing it. But in the short term, you will have a bit of an impact from those activities, absolutely you will.

In terms of the overall -- the -- sort of the grow the model for the business, we saw 1 to 4% of the revenue line of the revenue line, 4 to 8% at the -- at the earnings line. The investments we're putting in the business is looking to move that up and try and deliver the lower end of that. I would say the second half of this year, as we were talking about earlier has got some more pressures I think from an industry context perspective at the moment. But I wouldn't necessarily roll that forward at this point in time. I think that's currently how we see the world. And I think you know, we've got to see how some of these developments you know, pace out over the coming months.

We clearly keep an eye on where our competitors are, where their pressures are in terms of what they need to deliver, and that's been very informative to our thinking and strategies as well, if I can put it like that.

Mirco Badocco: Hi, Mirco at RBS and if I look at your growth trends, they account for 58% of group volumes in a much lower proportion of revenue, which implies a lower price index, and of course you have also the specialist brands in the mix. So, I wonder if you can give some more colour on the relative of pricing mix of growth brands and portfolio brands and what is driving that?

Alison Cooper: There's a -- there's a whole mix of factors, but one of the key ones in relation to portfolio brands is we quite often price them up to manage them over a period of time, out of the market, effectively. So, effectively a milking strategy for some of portfolio brands.

And that will clearly impact the overall price mix position of those brands. But it will also include some of the -- some of the higher priced brands within that, so I take for example, the Brunes portfolio is staying in France for example, which is very highly priced, very highly profitable sitting in our portfolio brands and it's been declining in volume terms for a very long period of time.

Oliver Tant: I think there's also the issue that obviously from a volume perspective, we can only do it in things where we can measure wide stick equivalents. Whereas there are some products that we sell from a value perspective, which we can measure, so papers as an example, would be products that we can include--

Alison Cooper: And premium cigars.

Oliver Tant: -- and premium cigars, in the -- in the -- in the value equation, but we can't include them in the volume equation, because there isn't a reference point in terms of the ability to translate into sticks, so necessarily, the volume will be a higher percentage, because we're measuring it against a slightly smaller population of our business.

Jamie Norman: Good morning, Jamie Norman from SocGen, to what extent has the tailwind from the sterling's devaluation in a sense, emboldened you to take some tough decisions, to invest more significant in your business than otherwise might have been the case? Put another way, is -- has sterling's weakness brought you closer to the end of your journey than otherwise might be the case? And if sterling does a -- continues to be weak through Brexit, will that continue to be a nice cushion for you to get to the ultimate nirvana?

Alison Cooper: I heard forex and I thought that would be and Oliver question, but it's not -- no is the answer. We were putting our plans together in relation to the investments and yes, it has sat conterminously with a year where we got -- we got favourable forex environment, but that wasn't a determinant of the investment program.

And looking forward, I think I've already said we may find some opportunities for some smaller increments of investment but not for the scale of the program that we announced in November.

Okay. Well, thank you, everyone, for joining us today. And have a good rest of the day. Thank you.