2023 Interim Results Script – 16 May 2023

Stefan

Slide – Half Year Results

Good morning everyone… and welcome to today's presentation on our half-year results.

It's great to see all of you who have joined us in-person today – thank you for coming.

And, of course, a warm welcome to those viewing online.

Slide – Disclaimer

I will just draw your attention to this disclaimer, before I introduce you to the rest of the team and outline the agenda.

Slide – Agenda

You will all know our Chief Financial Officer, Lukas Paravicini, and Peter Durman, Head of Investor Relations.

First, I will highlight the key achievements from today's results and the macro-trends influencing our performance.

Lukas will then discuss the financial outcomes for the first half and our outlook for the full year.

I will then return with some further detail on the actions we are taking to strengthen our performance and transform Imperial into a business that delivers sustainable growth.

Finally, we look forward to taking your questions.

Slide – Good Progress Against Our Five-Year Plan

I am pleased to report today's results are in line with the guidance we gave last year.

You will recall that we said that performance would be weighted to the second half – and we are exactly where we expected to be at this stage of the fiscal year.

The key headlines are these:

First. We are on track to deliver full-year results in line with our guidance.

Second, this confidence in our ability to deliver a meaningful uplift in performance is underpinned by another improvement in our benchmark measure of market share.

Aggregate combustible share for our top five markets rose by 20 basis points.

After several years of decline, we have now delivered four consecutive half-year periods of stable or growing share.

Third, we delivered this improvement in market share while <u>also</u> achieving strong price gains across <u>all</u> top five priority markets – and across our broader portfolio.

Though we never take anything for granted, our success in driving both share and pricing is further evidence we have now stabilised our core combustible business.

Our disciplined approach to raising prices has helped to offset the temporary increased pressure on volumes as the COVID effect on consumer buying patterns finally unwinds.

This disciplined approach also means, that despite cost inflation, we have delivered a like-for-like 30-basis point improvement in profit margins.

Fourth, in NGP, over the past six months we have moved confidently from the reboot phase to a broader roll-out across markets, products and categories.

This has driven a 35 per cent growth in NGP revenue in Europe, the region where we have been focusing our efforts.

Fifth. These results have been underpinned by continued progress in transforming our culture and ways of working.

I will say a little more about how we are building these capabilities later.

And finally, we continue to deliver on our ongoing programme of shareholder returns with the first £1 billion buy-back on course to be completed by the fiscal year end.

Slide – Resilient Underlying Consumer Demand

It is important to frame these results against the broader macro climate and explain how this underpins our confidence in second-half delivery.

There are two headwinds which have weighed on volumes in the first half – and these will both ease as we move into the second half.

First, while COVID is thankfully firmly in our rear-view mirror, it is important to remember that consumer buying patterns in the equivalent period last year were still affected by lockdown restrictions.

For example, as expected, market volumes in Northern Europe have been relatively weak, against a strong comparator.

It was this time last year, in markets like the UK, when people started to travel again en masse, which we are now annualising.

Lukas will provide further detail in a moment.

Second, these results are affected by our decision to exit Russia in April last year.

This has created a temporary drag on reported volumes and revenues.

But like the COVID effect, this pressure reduces as we move into the second half.

There are also two tailwinds that support our outlook for the second half and beyond.

First, as I mentioned, while delivering on our market share objectives, we have achieved strong pricing across many markets.

And this means that the effect of our pricing actions in the first half is already embedded in our second-half financial performance.

At the same time, though we have seen some downtrading, underlying consumer demand has generally remained robust across most of our markets.

Second, in NGP we expect to see the new products launched in the first half gaining greater traction with consumers during the second half.

And, while we continue to be disciplined in our approach, we also have further launches in the pipeline.

So, in summary, underlying consumer demand remains resilient.

We expect volume headwinds to ease, and we will benefit from strong embedded pricing.

And, as we scale up our potentially reduced risk portfolio, we will make meaningful progress towards the healthier future, which is at the heart of our purpose as a business.

I will now hand over to Lukas to take you through the financial results.

Lukas

Slide – Financial Review and Outlook

Thanks, Stefan, and good morning everyone.

Slide – Resilient Financial Delivery

Once again, I am pleased to show you a positive financial dashboard.

As Stefan mentioned, we have delivered gains in our aggregate share across our top-five combustible tobacco markets, at the same time achieving strong price gains.

In NGP, we have stepped up investment in Europe.

This has led to revenue growth in that region of 35 per cent.

This more than offsets the headwinds in the US caused by the uncertainty of the myblu Marketing Denial Order.

This resilient performance has meant that, at the half year, we're on track to deliver against plan as well as meet our capital allocation priorities.

Leverage remains within our 2.0-to-2.5 target range, and we will be at the lower end of this range by the end of this fiscal year.

We have made good progress with our initial £1 billion share buyback, which we're due to complete by the end of September.

Slide – Managing Volumes Despite Macro Headwinds

This chart really illustrates the point Stefan was making about the easing of Covid restrictions and so the impact on volume.

Between 2020 and the first half of 2022, COVID was a slight positive.

Movement restrictions and fiscal stimulus measures helped to increase consumer demand across many of our markets.

With the ending of pandemic restrictions last year, these positive volume effects have unwound, leading to a one-off volume decline compared to the strong COVID periods.

Looking to the second half, we expect the volume declines to moderate as the comparator periods start to look less challenging.

Slide – Strong Tobacco Pricing Across Footprint

We have offset these challenging volume headwinds – shown in blue on this chart – with strong pricing gains across our footprint – in orange.

Starting with the US, overall pricing increased 9 per cent, driven primarily by gains with our cigarette portfolio.

With volumes - it's important to differentiate between our cigarette portfolio, and our mass market cigars.

Cigarette volumes grew by 1% but these were more than offset by mass market cigar volumes resulting in an overall decline of 3%.

The cigar volume decline was mainly caused by wholesalers destocking following a contingency stock build in September ahead of Hurricane Ian.

Mainly because our cigar warehouse is based in Florida where the hurricane struck.

There was also some market-size and share pressures that Stefan will talk about later.

These volume declines in mass market cigars have also resulted in a negative mix of 7%.

This is because our cigars are relatively high value and low volume products - with a net revenue per stick 2.6 times that of a cigarette.

So, any movement in our cigar business – up or down – has an outsized impact on overall product mix.

This was compounded by some adverse product mix in the cigarette portfolio.

This effect was an outcome firstly of our successful capture of the KT&G share following their exit in December 2022.

And secondly, it was thanks to the strong performance of our deep discount brands, Crowns and Sonoma.

Moving to Europe, you can see that again strong pricing has partially mitigated the effect of volume declines.

In AAACE, excluding Russia, we have seen very strong pricing right across the footprint – up 12% - more than offsetting volume declines of 6%.

On a Group basis, excluding Russia, constant currency tobacco net revenue is flat.

Strong pricing has offset volume declines, driven by Europe, and adverse mix, driven by the US.

Slide – Resilient Adjusted Operating Profit

Excluding Russia, adjusted operating profit grew by 1.2 per cent at constant currency.

As you can see here, it was driven by an improved performance in tobacco and Logista.

Profitability in tobacco benefited from strong pricing across our key markets, and, excluding Russia, we grew tobacco operating margins by 30 basis points.

In NGP, as expected, losses increased by £14m, in line with our plans to invest in new products and markets.

And, in the second half, we will further increase investment.

We continue to operate with discipline, focusing only on products and markets where we have the right to win.

And, importantly, we remain on course to break even by the end of our five-year plan.

Logista also made a strong contribution with robust underlying performance helped by pricing and recent M&A.

We have been supporting Logista in its successful diversification strategy, which, you can see, is enhancing the financials.

Slide – EPS Delivery in Line With Plan

Our adjusted EPS is broadly in line with our expectations.

As we have said, our interest costs have increased with higher interest rates and new debt issues.

We've mitigated the impact of rising interest rates, by fixing around 85% of our interest cost this year. More detail in the Appendix.

The strong first half performance of Logista resulted in an increase in minority interests.

Our adjusted effective tax rate is slightly higher than last year at 22.4% – and we are now guiding for the rate to be around 22 to 23% for the full year, slightly higher than originally expected.

We continue to expect some upward pressure over the medium term.

Our share buyback has begun to reduce the number of shares.

And the full benefit to the weighted average share count will flow through with next year's buyback.

Slide – On Track With Capital Allocation Priorities

Turning to cash and capital allocation… we remain focused on cash generation and being really disciplined in how we allocate capital.

Operating cash conversion for the period was 77% on a 12-month basis, against a strong comparator of 102%.

A key element of the lower operating cash conversion has been a change in working capital outflow of around £900m, which reflects a number of factors:

Firstly, we have had a planned increase of around £0.5bn in pre-production stock as a result of the strong pricing achieved across our footprint.

We expect this to unwind in the second half and so drop through to profit.

Secondly, last year we benefited from the repayment of 250 million euros of deferred consideration for the disposal of Premium Cigars which did not repeat this year.

And thirdly, we saw a similar increase in working capital at Logista driven by the strong pricing, as well as additional working capital from their recent acquisitions.

Capital allocation remains a key part of our strategy.

Our first priority is to invest in the business.

Leverage at the half year is flat year-on-year at 2.4 times and our year-end leverage will be at the lower end of our range 2-2.5 times.

Our recent bond issue supports the strong balance sheet and extends weighted average maturities.

The bond issue was over-subscribed showing continued demand in the debt capital markets.

We have announced a dividend increase of 1.5% and we will complete our £1bn share buyback by the end of September.

Slide – On Track To Deliver Full Year Guidance

We remain on track to deliver our full-year guidance.

And we will generate improving returns in line with our five-year strategy.

As Stefan said earlier, our confidence in the second half is partly underpinned by our action on pricing taken in this first half.

And, as the COVID and Russia impacts unwind, we expect the volume headwinds to ease.

Top-line performance continues to be supported by strong operational gearing.

And over the second half, we will realise the remainder of the cost savings from our restructuring initiatives.

These positive drivers will be partially offset – as we have previously guided – by higher NGP investment.

And, of course like all businesses, we still face cost inflation.

For the full year, we continue to expect constant currency net revenue to grow in the low single digits.

Constant currency adjusted operating profit will grow at the lower end of our mid-single-digit range.

At current rates, we expect foreign exchange translation to be a 3 to 4% tailwind.
As usual, there is a slide in the appendices with guidance on specific items.

Our strategic transformation and our disciplined capital allocation means we are well placed to generate long-term value for shareholders.

Thank you.

I'll now hand back to Stefan, who will provide an update on our operational progress.

Stefan

Slide – Transforming Imperial Brands

Thank you, Lukas.

I will now update you on how we are delivering on our strategy and how this is translating into operational progress.

Slide – Our Purpose, Vision and Strategy

I first introduced this strategy wheel almost two and half years ago.

So that means, for our five-year plan, we are now approaching the half-time whistle.

And, as the coach for “Imperial FC”, I am proud of the team’s achievements.

We have combined great external signings with the best home-grown talent – and I am pleased with how the players have gelled.

As a smaller “club”, we won’t outspend our bigger rivals, but we can outperform with the right approach.

And this is where our challenger vision matters.

By getting closer to the consumer, innovating fast and executing well, we know we can win.

And win in the right way.

The behaviours listed across the bottom are, if you like, the Imperial playbook, which we are embedding throughout the organisation.

This year, I have continued to visit our markets and seen some more great examples of this challenger mindset in action.

In Taiwan, our largest Asian market, I saw how the team is turning around market share in a highly competitive environment.

In the Canary Islands, an important travel retail market, I saw how our brand ambassadors have been making the most of the opportunities created by the easing of Covid restrictions

And in the US, I spent some more time with our sales reps seeing how focused execution is enabling us to punch above our weight.

Slide – Transforming Imperial Brands

Our colleagues on the front line are being enabled to perform more effectively through new consumer capabilities, a more performance-driven culture, and more effective ways of working.

First on consumer capabilities, we continue to build our skills in insights, marketing and sales.

The most concrete example of progress in the first half has been the opening of our consumer innovation hub in Liverpool, which brings together consumers, our product development teams and third-party partners in the same collaborative space.

Further consumer centres will open in Hamburg and Greensboro – as well as an innovation hub in Shenzen.

Facilities like these will help us accelerate our distinctive approach to innovation, which is based on deep partnerships.

We will give more insights into these new consumer capabilities and how they are driving operational progress at an investor event in New York on 27 June.

I hope you will join us in-person or virtually.

Second, we are continuing to embed the performance-driven culture I have spoken about at previous results presentations.

Recent developments have included a new, more rigorous performance review system and a comprehensive coaching programme for our top 300 leaders – including myself, Lukas and Peter!

Third, for a business that was built through acquisition, we have plenty of opportunities to simplify how we work.

In the first half, we continued to build out our new centralised shared service centres and develop the design of our new global ERP, which will replace 60 legacy systems.

At the same time, we are on track to deliver the £150 million of savings we had promised.

Slide – Good Progress Against ESG Priorities

Similarly, we have continued to make good progress with our ESG priorities.

Internally, we have launched our "triple zero" campaign to build the movement among our colleagues to deliver three key ambitions: zero injuries, zero waste to landfill and net zero across our value chain by 2040.

Externally, our progress has been recognised by organisations including the Carbon Disclosure Project, MSCI and the others listed here.

We continue to strive to drive further improvements across our eight priority areas and look forward to providing you with further updates.

So, turning now to our three strategic pillars and starting with our focus on the priority combustible markets…

Slide – Stabilising our Priority Market Share

Over the past two years, we have revitalised our five priority markets by focusing on tailored growth initiatives for each market.

And I am pleased to report we have increased our aggregate market share by 20 basis points, following several years where we have been the number one share donor.

And, as I said earlier, we have achieved this while maintaining our pricing discipline.

As a reminder… our objective is to stabilise our share, and to no longer be the number one share donor.

We are realistic in our assumptions.

We do not expect to grow share in aggregate every year – nor do we expect growth in all five markets in any given year.

We manage these markets as a portfolio and we are pleased with the encouraging outperformance so far.

But we recognise these are highly competitive markets and so our planning assumption is that we will hold our full-year share flat on last year.

Let's now review our performance in our priority markets starting with the US…

Slide – Americas: Positive FMC Market Share Growth

We delivered a strong cigarette performance in the US, with market share up 95 basis points, against a challenging market dynamic with market volumes down around 9% year on year.

We grew share in each of the three cigarette price segments where we focus and achieved pricing across all our key price points.

Brand equity investment and innovative retailer initiatives behind Winston and Kool supported continued share performance in the premium value price segment.

We also performed strongly in the fast-growing deep discount price segment, where Sonoma and Crowns performed well.

Slide – Americas: COVID Unwind Normalising Volume

As Lukas mentioned earlier, the performance of mass market cigars has weighed on the overall US results.

There are three reasons for this:

First, we felt the impact of the destocking which followed an earlier move last September by wholesalers, worried about potential supply disruption, to increase inventories ahead of Hurricane Ian.

Second, at the category level, we have continued to see volumes decline following a period of strong growth which had benefited from COVID.

And third, we have lost share as competitors resolved their supply issues and we experienced some greater price competition.

We continue to believe this category remains attractive and our iconic brands like Backwoods are well-positioned.

Slide – Strong Pricing Gains Across Priority Markets

In the other four priority markets we have made clear choices around balancing market share with the delivery of pricing and value.

In the UK, we increased prices in November. Given the structure of the market, we anticipated this would impact on our share in the short term, but it was the right decision for value creation.

We expect some share recovery in the second half of the year, as investments in local jewel brands, such as Embassy and Regal, continue to gain traction.

In Spain, we raised prices for the second year, after years of price stability.

At the same time, we achieved modest share gains driven again by our local jewel brand initiatives, such as a new super slim format for Nobel.

In Australia, we again achieved pricing gains early in the period, while managing our overall market share delivery.

In Germany, after more than a decade of share losses, we continued to experience a further decline in the first half.

We remain confident that patient investment in building brand equity and sales force effectiveness will lead to stabilisation.

But, as we have said before, this will take some time to achieve.

Slide – Driving Value from Our Broader Market Portfolio

The second pillar of our strategy is to drive value from our broader market portfolio.

Here, a clearly defined role for each of our markets has meant a greater focus for some clusters like Africa and Central and Eastern Europe…

We have decided to leverage the capabilities we have been building in our "Triple A" region to manage these smaller markets more effectively by transferring our Central and Eastern Europe cluster into this region.

Strong pricing in these markets drove robust revenue growth.

Similarly, in our African portfolio of markets, strong pricing more than offset weaker volumes.

We continued to focus on increased customer engagement tailoring our portfolio of local jewel and key international brands to meet local consumer demand.

Slide – Challenger Mindset and Step-Up in NGP Innovation

Our third strategic pillar is to build a targeted NGP business – and in this period we made a step-change in the pace of innovation, with new product and market launches.

That said, we continue to adopt the same disciplined approach.

We only launch products in markets where, first, there is already a clear consumer demand and, second, we have well-established routes to market through our combustible business.

Consumers are expressing different preferences in different markets, and that is why we are pursuing a multi-category approach.

Vaping is the clear choice for consumers in the UK, France and much of western Europe.

And over the past six months, we have introduced new products including the blu 2.0 pod system and our disposable blu bar in eight markets.

Heated tobacco is the number one NGP in much of central, eastern and southern Europe.

Having validated our proposition, Pulze and iD, in the Czech Republic and Greece, we are now in a total of seven markets, five of which were launched in the last six months.

And we are continuing to build our modern oral brands, including Zone X, through new flavour launches in markets, particularly the Nordics, where this is the preferred category.

So turning to each category in more detail…

Slide – Vapour: Encouraging Market Share Growth

In vapour, we have seen positive market share growth following the successful launch of blu 2.0 and blu bar.

Our blu vaping brand is differentiated in the way it is targeted at “next steppers”, more mature consumers who are making a broader lifestyle shift.

We took feedback from these consumers to develop our new blu 2.0 device, improving product design, pod performance and battery life.

This was the first product to be delivered from our refocused innovation pipeline.

Following city trials in France last year, we launched blu 2.0 nationally in the UK, France and Spain, where it has been positively received by consumers, as demonstrated by these national market shares.

And we recently launched in <u>five</u> further markets.

Following extensive adult consumer research, we broadened the blu brand with a disposable vaping product, blu bar, and have seen early progress following its launch in the UK, France and Spain, with more recent launches in <u>four</u> additional markets.

As you would expect, blu bar was brought to market within a responsible launch framework targeting adult consumers and work is underway to improve the product’s life cycle.

Slide – Heated Tobacco: Successful Launches in Seven Markets

In heated tobacco, consumer feedback from our initial market launches fed into our product innovation with the development of Pulze 2.0, our newest device.

This device, with its compact all-in-one design and 25 or more sessions from a single charge, appeals to consumers who appreciate the simplicity and convenience of not having to recharge.

The new device has been supplemented by new tobacco and flavour editions of our iD sticks and we are seeing some encouraging initial share gains.

Following <u>five</u> new market launches in the period, our heated tobacco proposition, Pulze and iD, is now available in <u>seven</u> European markets.

This means we are now present in more than 60 per cent of the addressable market in Europe.

These are still early days and we take nothing for granted.

Competitors are, of course, innovating with new propositions of their own.

But we are receiving positive feedback from consumers and customers, and we see an opportunity to carve out our fair share in this category.

Slide – OND: Strong Performance in Modern Oral Nicotine

In modern oral nicotine, the footprint of our Zone X product is focused on the Nordics and other European markets with a heritage of snus tobacco.

Here too we are building a distinctive proposition with innovative flavours designed to attract and retain consumers, who want to migrate from traditional snus and other tobacco products.

And we delivered another step up in revenue growth in line with our expectations.

So, I hope you can see we are gaining real momentum with NGP in Europe across all categories.

And it is worth noting that NGP now represents 7% of our European sales, and growing.

Slide – Transformation of Imperial on Track

So, to conclude…

Half-way through our five-year strategy, we are exactly where we hoped we would be.

We have navigated some challenging macro-headwinds to land a resilient first-half performance.

As these headwinds start to ease in the second half, we are confident in our ability to deliver a full-year performance in line with our guidance.

More broadly, we are well on the way to building a business which is more consumer-centric, more performance driven, and more effective in how it operates.

We have secured the stabilisation of our core combustible business.

And, with the disciplined expansion of our NGP operations, we are moving towards the healthier future which is at the heart of our purpose.

All of this means that, while the future is always uncertain, we remain on track to transform Imperial into a business that can deliver growth year in, year out and create highly consistent value for shareholders.

Thank you again for joining us today…

We would now like to take your questions.