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Half Year Results 2016

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Alison Cooper – *Chief Executive*

Good morning and welcome to our 2016 half year results presentation.

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Our Priorities for FY16 – *What we said last year*

I'm going to start with a quick reminder of the 2016 priorities we shared in November.

These are captured within our four strategic priorities…

As part of our ongoing programme to simplify and strengthen our portfolio, we're building the contribution from our Growth and Specialist Brands. We are also investing in new consumer experiences through Fontem Ventures.

From a footprint perspective, the US is a clear focus as we invest behind the new portfolio. In our Growth Markets, our focus is on building momentum, whilst in Returns Markets we are driving profitability.

Effective cost and cash management continue to support our investment choices. We continue to instil a discipline on the use of capital, which underpins further debt reduction and supports our dividend growth commitment.

Our strategic agenda is building a stronger business… and we are making excellent progress to improve the consistency and quality of our performance… all supporting returns for shareholders.

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Delivering on our Priorities – *Good progress against strategy*

So, what progress have we made in these four areas in the first half?

We further improved the quality of revenue growth as our Growth Brands continued to outperform the market with volume and share growth and we further simplified the portfolio through our successful brand migration programme.

We prioritised quality volume in our footprint with positive momentum in many of our Growth Markets and further progress in our Returns Markets. And in the US, our enlarged business has had an excellent first half, finalising integration activity and building momentum behind the key brands.

Our cost optimisation programme is on track to save a further £55m this year, which will be reinvested to support our growth agenda. As part of this, we're implementing a new operating model to make us more agile and enable us to better respond to changing market conditions.

Our focus on capital discipline is improving our working capital position such that cash conversion was 105% and we delivered a £1.2bn like-for-like reduction in net debt. We also announced another 10% increase in the interim dividend.

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Improving Quality of Growth *– Clear footprint & portfolio choices*

We've made good progress against our objectives and I am pleased to report on some excellent financial results. There are a number of drivers behind the financials that we have highlighted to aid your understanding but let me step back for a moment and give you my perspective.

Our strategy is delivering and integral to our performance and our results reflect the investment decisions we are making to create sustainable value.

We decided to invest in the US last year and the business is firmly on track; a great addition to our footprint and portfolio but also a great addition to our capabilities.

And our organic growth momentum continues…

Focus is key in this VUCA world and we are making clear investment choices both now and for the future. Choices to grow and choices to defend… and choices to let go, particularly where quality growth isn't there and we are at best renting share.

Making these choices is an important discipline to ensure we generate the best returns for our shareholders on our assets.

And how are these strategic choices playing out in our footprint?

Most of our markets are on track and our investment choices are delivering against our strategy… Of these some are very much on course - such as Australia… and, as in any FMCG business, some are undergoing limited redirection - such as Germany.

There are a handful of markets where we have revised our investment choices as economic conditions and competitor focus on volume have diminished opportunities for quality growth… and where I believe we would be paying to rent share rather than building a sustainable position. I have lived through too many years of the Polish yo yo to want to play differently in markets like the Ukraine - hence our choice to deprioritise investment and volume in these markets.

If I were to headline one market where it's challenging currently to deliver against our strategy, it would be the UK…

Lots of regulatory change, combined with lots of competitor discounting means lots of churn in the market going forward… This creates risks as well as opportunities… We have invested in sub economy amongst other initiatives over the last 12 months or so and continue to focus on our sales growth drivers (portfolio, price & excise, innovation and customer engagement) and we will continue to manage the profit/share equation.

Overall a clear strategy and clear investment choices driving quality growth and sustainable returns.

Let me hand you over to Oliver to talk through the detail…

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Oliver Tant – *Chief Financial Officer*

Thank you Alison. Good morning.

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Group Adjusted Results – *Delivering against the strategy*

We delivered another strong financial performance in the first half, with good progress from both a P&L and balance sheet perspective.

Our results benefited from the US acquisition which made a very positive contribution to revenue and profit. On a constant currency basis revenue grew 17% while tobacco adjusted operating profit grew 21% leading to a 240 basis point improvement in margins to 46.4%.

EPS grew 20% and the interim dividend increased 10% - in line with our commitment to deliver returns to shareholders.

Our strategic focus on capital discipline has delivered further working capital benefits and another period of strong cash conversion at 105%. The increased debt reflects the cost of the US acquisition and the effect of FX translation.

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HY16 Volume – *USA Acquisition adds 8.6bn SE*

Volumes for the period were 134bn sticks, down 3%.

Iraq and Syria accounted for around 4bn sticks, or 3% of the decline. We have now annualised the impact from Iraq and Syria and these markets now represent less than 3% of Group volume. The acquired US brands contributed almost 9bn sticks or 6%. The size of the markets in which we operate was slightly down on a 12 month average basis reflecting an improvement in year-on-year volume trends in some Western European markets and markets such as Turkey and Saudi Arabia.

In line with our Q1 announcement, like-for-like volumes declined almost 6%.

The significant deterioration in the economics and profitability of some geographies is influencing our investment decisions in markets such as Turkey, Ukraine, Azerbaijan and the Adriatic. Volumes declined 2% as result of these footprint choices.

Continued volume pressure in Morocco contributed another 1%. Price increases drove revenue and profit in Russia but volumes were down reflecting a temporary price disadvantage on Maxim. And there were share losses in markets including the UK and Germany which offset gains in markets such as Italy, Japan and Saudi Arabia.

Our overall market share improved 40 basis points with the benefit of the US acquisition. As part of our simplification agenda, and as we grow our Growth Brand market share, we have ceded some share in our Portfolio Brands. This resulted in a 50 basis point decline in our share excluding the benefit of the acquisition.

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HY16 Net Revenue – *Revenue Growth +2.5%*

The acquired US cigarette brands added around 16% to net revenue, taking ITG Brands' contribution to over 20%.

Alison will cover the US in more detail shortly and provide an update on the excellent progress we continue to make.

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

The impact of a 6% volume decline elsewhere in the business has been more than offset by strong price/mix of over 8% which, as we saw in Q1, has been particularly strong in the first half of the year.

This resulted in like-for-like organic revenue growth of 2.5%.

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HY16 EPS Growth – *Constant Currency EPS up 20.4%*

Adjusted EPS for the year was up over 20% in constant currency terms. This has been largely driven by the operating profit increase from the acquired US business.

This was offset by 3.7 pence of adverse transaction FX – I will come back to talk about the impact of currency on our results in a moment. EPS benefited from a lower tax charge but our interest charge was higher with the US acquisition debt and we had a lower contribution from minorities.

Currency translation was a small positive in the half resulting in adjusted EPS of 113 pence.

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Strengthening Portfolio – *Improving Quality*

We continue to make excellent progress in strengthening our portfolio.

We delivered continued momentum with our Growth Brands. Growth Brand market share improved by 80 basis points supported by investment in consumer initiatives and the continued success of our migration programme.

Our strongest equity brands are also generating a higher proportion of the top line, with Growth and Specialist Brand net revenue up to 59% of the total.

As a reminder… from the start of this financial year, Winston has been classified as a Growth Brand, replacing USA Gold, while Kool and blu have joined our Specialist Brands.

In addition to these portfolio changes, our growth in Specialist Brand revenue, excluding Iraq and Syria, has been driven by blu, Skruf, and premium cigars. We also delivered good performances with GV and Rizla.

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Developing Footprint: Growth Markets – *Growing Revenue*

In our Growth Markets…we focus on maximising long term growth opportunities.

Excluding Iraq and Syria, revenue was up almost 10% reflecting positive momentum. Price/mix was strong at 22.1% - reflecting the acquired contribution from blu and the benefit of patent royalty income as we leverage our e-vapour intellectual property. As a reminder, we include Fontem in our Growth Markets due to its growth potential.

Growth Brands as a percent of net revenue declined reflecting the impact of Iraq and Syria on Gauloises and the increased revenues from Fontem. Otherwise, Growth Brands increased their contribution to net revenues in the majority of our Growth Markets.

Our market share grew in Saudi Arabia, Italy and Japan but was offset by declines in Russia and Turkey.

We achieved profit growth in many of our Growth Markets, although overall profit was affected by Iraq and Syria and transaction FX in Russia.

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Developing Footprint: USA Market – *Strong Results from ITG Brands*

We have been very pleased by the performance of our expanded US business. Our acquired brands contributed 8.6bn sticks and £468m revenue in the first half.

Our focus brands Winston and Kool have responded well to the new promotional arrangements introduced through the successful sell-in of our retailer programme. Alison will give more detail on their performance shortly.

Investment will increase behind brand activation in the second half but overall, we are on track to deliver our plans for the year.

The expanded US business is performing strongly and is proving to be a great addition to the business – further increasing the proportion of profits that we derive from markets with better than average affordability.

Turning to Returns markets…

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Developing Footprint: Returns Markets – *Increased contribution from Growth Brands*

We continued to focus on quality growth opportunities in our Returns Markets. Price/mix of 4% helped offset the volume declines.

Results in Returns South benefited from strong performances in markets such as Algeria and Portugal which mitigated the on-going challenges in Morocco. While in France and Spain, improved market size coupled with the benefit of our actions to enhance performance have started to deliver a more positive trend.

In Returns North, markets such as Australia and Poland delivered good growth in revenue and profit. In Germany, we grew profit and focused on improving share particularly with JPS and Gauloises. The UK remains a competitive market so we continued to invest in the sub economy segment – as we balance our share and profit. In Ukraine, we deprioritised our investment activities in a market where the profit opportunity has been affected by currency devaluation and competitor price discounting.

Our Growth Brands performed well with the proportion of net revenue up 280 basis points, supported by successful migrations across a number of markets such as France, Spain and Germany.

We achieved good profit increases in markets such as Australia, Germany and Spain which offset a transaction FX impact caused by currency devaluation in Ukraine. Excluding this adverse transaction FX, operating profit grew 2.4%.

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Driving Cost Optimisation – *Funding Investment*

In keeping with our strategic priorities we continue to work hard on improving our cost effectiveness and are focusing on driving a strong culture to embed capital discipline.

Our cost programme is aligned with our portfolio and footprint priorities, and continues to provide efficiencies in two core areas: product cost and overheads.

Our portfolio priorities help us increase efficiency by reducing complexity and product cost, optimising overheads, and targeting our investment more effectively.

In addition, we continue to review our manufacturing capacity and are rolling out global procurement to new areas to reduce cost.

We are on track to deliver £55m of savings this year in line with our target, and the programme objective of £300m by 2018.

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Cash Conversion – *Continued Good Progress*

Our cash conversion rate over the 12 month period to March was 105%. This was driven by a strong working capital performance, boosted by a timing difference in the payment of the Master Settlement Agreement creditor which relates to the acquired US brands. This represented 9%, or £270m.

Even after stripping this out, we delivered improvements across all our key levers including aged debtors, supplier payment optimisation and lower capex. We continue to target operating cash conversion in the low 90's for the full year.

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Foreign Exchange – *Translation benefit, transaction headwind*

Foreign exchange translation was broadly neutral on reported revenue and profit.

The recent volatility in currencies is likely to continue – particularly with the impact of the EU referendum on sterling – which makes it difficult to provide guidance for the rest of the year. Based on rates at the end of April, the strengthening of the Euro and the US Dollar against sterling would result in a 2-3% benefit to our full year earnings.

In line with our comments at Q1, the recent devaluation of various Eastern European currencies has resulted in a transactional currency impact of 4% on first half earnings with a 3% headwind estimated for the full year. So no change to our transaction FX outlook.

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Strengthening Balance Sheet – *£1.2bn reduction before FX and acquisition*

Our strong operating cash performance supported a £1.2 billion reduction in net debt – before taking into account the £4.6bn cost of the US acquisition and £1.2bn of adverse currency translation due to recent sterling volatility.

We are taking the opportunity to repay facilities as they come due and we repaid around £1.5 billion of bonds in the first half. The headroom created by our remaining bonds and bank facilities ensures that we do not have any further refinancing requirements over the medium term.

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Financial Summary & FY16 – *Supporting dividend growth of at least 10%*

In summary, these results are further evidence of continued delivery against the strategy.

We have a strong balance sheet that supports our strategic agenda as well as returns for shareholders and deleveraging.

Looking to the year ahead, we will continue to implement our new commercial and portfolio plans in the US, with a step-up in investment supporting our plan delivery.

In Growth Markets, we focus on profitable share opportunities to drive performance and will lose the impact from Iraq and Syria in the second half. In Returns Markets, we continue to balance share and profit. As we have highlighted before, our results will benefit from embedded price increases, although we will see some negative mix, additional investment to support EUTPD and some impact from the conclusion of the PMI contracts.

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

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Events Update

Before I hand back to Alison… I want to update you on our IR programme. We're hosting an investor day on the 8th June at our head office in Bristol. This will be an opportunity to give you a more detailed update on our strategy and how we are changing the operating model through new ways of working. It will focus around three themes: improving the quality of growth, building agility into our business model and our disciplined approach to cost and capital allocation.

I would also like to update you on our plans for quarterly reporting. Since the requirements to publish an Interim Management Statement were dropped, we have received a number of requests from investors to stop these updates. So, we plan to issue a brief pre-close update in September instead of the Q3 update in August. And this will mark the end of our quarterly updates.

In addition, we are keen to provide better quality engagement for investors and are planning to introduce an investor seminar series during our next financial year. These will provide additional opportunities to look into the business in greater detail to help investor understanding.

I'll now hand back to Alison…..

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Alison Cooper – *Chief Executive*

Thank you Oliver.

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Delivering on our Priorities – *Good progress against strategy*

Let's now focus on how we are improving the quality of growth through strengthening our portfolio and developing the footprint.

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Strengthening our Portfolio – *Simplification focus*

A key element of our strategy is the work we are doing to strengthen our portfolio. We are targeting to have at least 75% of our revenue from our strongest brands over the next few years.

A key activity is our brand migration programme. This is migrating consumers from our Portfolio Brands to our Growth Brands, focusing our investment resources behind fewer, bigger, better brands.

Migrations represented the majority of our Growth Brand volume gains as we continued to achieve an excellent consumer retention rate of over 95%.

We have now completed 35 migrations with multiple markets transitioning to JPS, West and Parker & Simpson. There are a further 20 migrations under way, with more planned over the next couple of years.

As a result of migrations and organic growth initiatives, we increased Growth Brand market share by 80 basis points over last year.

At the same time, we are now piloting the next phase of our simplification agenda through deeper SKU rationalisation in order to 'cut the tail' and drive efficiencies whilst delivering further revenue growth opportunities, i.e. 'growing the head' with our strongest brand equities. It's an exciting next phase!

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Strengthening our Portfolio – *Migration in Spain*

As an example of the value we are creating with migrations, I'd like to give an update on one that we've mentioned to you before….Brooklyn to West in Spain.

Two years ago, Brooklyn held a share of 2.1% and West just 0.1%.

When we transitioned consumers across to West, it gave retailers a talking point and new consumers were added to the brand. This customer advocacy helped us achieve a consumer retention rate of over 100%. We have successfully grown our brand share 90 basis points in under 2 years to over 3% - supported by investment in the 'Hi' campaign for West.

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Strengthening our Portfolio – *Investing in our brands*

We also continue to invest behind the organic growth of the brands through targeted marketing campaigns and new product initiatives.

Here are some examples of recent product introductions…

JPS Triple Flow has just been launched in the UK and brings together a number of developments including a premium tobacco blend, a mineral filter and easy draw channels to offer a smooth smoking experience.

We've also added further Crushball extensions to the product range of a number of our Growth Brands including West, L&B, Players and most recently JPS.

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Strengthening our Portfolio – *Investing in our brands*

The launch of Gauloises L'Autre in the lights segment in Algeria has driven share growth with Gauloises now becoming the No. 1 brand in the market.

And since launching West Queen Size Compact+ with a recessed filter in Kazakhstan, we've seen an improving trend in our market share.

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Strengthening our Portfolio – *Investing in our brands*

A new Fresh Box pack for Davidoff that helps preserve the freshness of cigarettes has added to our share in the UAE since its launch three months ago and has now been launched in Saudi Arabia alongside a new digital platform.

And Davidoff Absolute has been launched in Taiwan… a new pure 100% tobacco variant that is stimulating new interest in the brand.

So some examples of the drumbeat of initiatives behind our Growth Brands that are building brand equity and share.

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Strengthening our Portfolio – *Building blu*

We are also investing in new consumer experiences in e-vapour and our revenues have benefited from the acquisition of blu, which is fully integrated within Fontem.

blu PLUS+, our second generation technology – and we believe the best closed system vaping experience currently out there – is growing as we continue to extend distribution in our target markets. These include the US and UK where blu is the number two brand.

We are investing in our technology platform to support the next generation product launch that will further improve the consumer experience, whilst also leveraging our intellectual property by licensing our first generation technology to other e-vapour providers.

blu is about technology but it's also about a broader consumer experience and brand equity and we launched a new print and TV campaign last month. Overall, it is a strong platform from which we can drive further growth opportunities.

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Developing our Footprint – *Momentum in Growth Markets*

Turning now to our Growth Markets where we continue to focus on maximising growth opportunities…

Let's start with Russia where Growth Brand share improved with the launch of Parker & Simpson in the value for money segment, which is also benefiting from the migration of Balkan Star. We experienced a temporary price disadvantage on Maxim but its share is now stabilising and helping our overall share. With price increases, despite the market volume declines, we delivered double digit revenue growth.

In Taiwan, our results were driven by Davidoff including success with Davidoff Absolute, and we are addressing recent share pressure on West through the launch of new pack formats.

Norway continues to be a fantastic story for snus, with further share gains and profit delivery… and Skruf is now the number one brand in the market. New innovations are supporting the performance including the recent launch of Skruf super slims.

We are continuing to grow our market share in Japan with West, supported by ongoing brand development and an expansion of our sales force with a focus on increasing our distribution.

And in Saudi Arabia, the launch of Davidoff Fresh Box is expected to stimulate demand following success in other lower Gulf markets. We are also achieving a good performance with West with share gains supporting our overall share growth.

JPS continues to gain share in Italy supported by the successful migration of Fortuna. We've improved our distribution infrastructure, and with Davidoff, we have adopted a city focused growth strategy to raise the brand profile with our target consumers.

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Developing our Footprint – *Positive performance in Returns Markets*

Looking now at our Returns Markets where we continued to focus on quality growth, managing market share and profit for the long term.

I'll start with the UK which continues to be one of our more challenging markets with ongoing competitor discounting. We are continuing to invest behind our share of sub economy, with Players now the leading brand in the segment. We are also achieving good momentum with L&B and creating new interest in both L&B and JPS with crushball extensions and other new products.

Australia remains a strong performer with positive metrics on all fronts. We continue to build the equity of JPS which is delivering continued share, revenue and profit growth, albeit at a slightly slower rate, given our sizeable share position.

Algeria is another market that has delivered excellent results, with the success of Gauloises driving strong share, volume and revenue growth.

In Germany, Gauloises is performing well supported by the successful 'Vive le Moment' campaign. We have taken steps to address the pressure on JPS share, which is already showing some improvement. And profits are up, with more to come in the second half as phasing has been affected by a price increase in April.

In Spain, trends are improving and, as you saw earlier, we achieved further share growth in West following the Brooklyn migration… and continued to progress the migration of Ducados to JPS. Price/mix also improved as did our profits.

In France, our overall trends are improving as a result of our actions combined with a better market size development. News has performed well following the migration from Fortuna last year and has significantly increased its position in the market both in cigarette and fine cut tobacco. The regulatory environment continues be challenging with the risk of plain packaging and some interesting recent pronouncements regarding brand names.

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Preparing for EUTPD II and plain packaging *– A cross functional approach*

On that note… I thought I would give a brief update on our preparations for EUTPD II and plain packaging…

This has been a major programme over the last three years, working across nearly all aspects of our business from manufacturing to marketing through to our customer and consumer-facing sales teams – with a focus on both complying and opportunities to win.

It has been important to learn from the implementation of plain packaging in Australia and our approach has therefore been focused around our sales growth drivers… portfolio, pricing and excise, innovation and customer engagement.

Our portfolio simplification through brand migrations and SKU reduction has been prioritised in those markets preparing for EUTPD. This promotes simplicity for retailers and enables us to ensure we have the right brands at the right price points. The objective is to ensure we optimise the distribution and availability of our core SKUs – aligning with our strategy to improve the quality of revenue growth.

Customer engagement has also been a key focus. Our sales teams have been trained to work alongside retailers and have been equipped with various toolkits to support stock ordering, customer education, shelf layouts and compliance.

We have also been working on innovations around the new pack formats to stimulate consumer interest – we will give further details on these as they are launched.

Supporting all these changes have been our supply chain and manufacturing teams managing a complex cut over process.

As Oliver indicated, we are incurring some additional costs to support the transition over the next couple of years, which have been factored into our plans.

This is a major programme exacerbated by a lack of implementation clarity from many member states but all being excellently managed by our internal team.

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Developing our Footprint *– ITG Brands performing strongly*

Turning now to ITG Brands…

I am delighted with how the business is performing. Since the standstill agreement concluded in mid-November, we have rolled out new retailer agreements. These are now in place with more than 160,000 stores – more than the old Lorillard universe – covering around 80% of national volumes. Our programme is designed to make it "retailer-friendly" - simple, with achievable requirements, and attractive for our retail partners. Enlisting the retail community so that we grow together is critical to our success, and so far the response from retailers has been very encouraging.

The integration is largely complete with the synergies being reinvested into the brands in line with our plans.

The transition of manufacturing with Reynolds is continuing ahead of plan and the reciprocal manufacturing arrangement is working well. The equipment migration process will be complete by the end of June this year and we are evaluating options to optimise our US cigarette manufacturing arrangements once all the equipment moves are complete.

Our new approach for mass market cigars is also gaining traction – and I will come back to this in a moment.

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Developing our Footprint *– Investing in Focus Brands*

Our portfolio strategy is focused on four brands – our priorities are our premium brands, Winston and Kool, followed by Maverick and USA Gold as our discount offerings.

The new retailer programme is focused on promotional pricing and better in-store visibility and for Winston, this means investment across all states – while we have a more state focused approach for our other brands.

In addition, we are finalising plans to further build the brand equity of Winston over the medium-term. This will involve a refreshed pack design and advertising and be supported by direct mail and a new digital platform to improve awareness. We will provide further details as these are launched over the next twelve months.

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Developing our Footprint – *Positive share trends*

The focus brands have got off to a great start – with share gains since the acquisition completed. Winston has led the share gains with a 20 basis point increase since June and you can see on the chart how the brand has responded to the increased investment through our retailer programmes launched in November.

Kool is also gaining share in key states, such that our total focus brand share has increased by 30 basis points.

It's early days but this is a very pleasing development in a few months given the years of neglect.

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Developing our Footprint – *Progress in mass market cigar*

Our mass market cigar business has undergone significant change in the past six months as we changed our route to market strategy to a consumer 'pull' model. This aligns to our cigarette model and has resulted in the integration of the two sales teams.

We are focusing on our primary brands, Dutch Masters, Dutch and Backwoods, and are strengthening the consumer appeal of those brands.

In February, we launched a consumer events programme to raise awareness of these brands and new campaigns were placed in store last month and on-line. Our innovation programme is being revitalised around Dutch Masters and Backwoods.

We have also launched a number of other initiatives aimed at reducing cost and complexity while improving net revenue and operating profit.

In summary, great delivery in the US. We have a great team in place making great progress with both our cigarette, mass market cigar brands and blu.

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Our Priorities for FY16 – *On track to deliver*

So to conclude… it's been a strong first half and we remain on track to meet full year expectations.

Our strategy is about focus… focus on the right brands and consumer experiences, the right markets, the right ways of working, the right investment and the right capabilities.

The team at Imperial Brands have done a great job delivering against these in the first half and will do the same in the full year – delivering today's returns whilst strengthening the business to deliver tomorrow's.

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Half Year Results 2016

Thank you. That concludes today's presentation and we'll now take any questions you may have.