2022 Pre-Close Trading Statement Transcript – 6 October 2022

Stefan

Good morning everyone… and thank you for joining us for the announcement of our pre-close trading update.

Before we start, I will draw your attention to the disclaimer set out in our trading update, which also applies to the remarks we make on this call.

I am joined by our Chief Financial Officer Lukas Paravicini and Peter Durman, Head of Investor Relations.

I am first going to cover the news about our share buyback before coming onto the trading update, where, as we announced earlier today, we continue to trade in line with expectations.

So first, the buyback, which represents an important milestone in the delivery of our five-year strategy.

You will recall that the first two-year phase of our plan has focused on strengthening the business – investing to build the foundations for the next three-year phase of our plan.

This first phase has also been about strengthening our balance sheet, managing towards a clearly defined leverage target to underpin our commitment to an investment grade credit rating.

Capital allocation is an integral part of our strategy and a key value lever for shareholders.

I am delighted to announce that, having now reached our target leverage at the end of September, we are now able today to announce a £1 billion share buyback to be implemented over the next twelve months.

It also complements our existing progressive dividend policy.

Total capital returns in fiscal year 2023, including ordinary dividends and share buybacks, are expected to exceed £2.3 billion.

This represents around 13% of current market capitalisation, based on last night's share price.

Furthermore, our confidence in the future and the highly cash-generative nature of this business mean that we are today able to commit to an ongoing, multi-year buyback programme.

So Imperial has the potential to meaningfully and systematically reduce its capital base over time.

This buyback is also possible because of the continued progress we are making with our strategy to transform Imperial Brands.

I am pleased to report that trading for the year has continued in line with expectations with constant currency net revenue and adjusted operating profit growing at around 1 per cent.

The key headlines are:

First, our targeted investments have driven a further improvement in aggregate market share in our top-five markets. This is another important piece of evidence confirming that we have now stabilised our core combustible business, following a long period of relative decline.

As expected, we have delivered an improved price mix in the second half, which has helped offset an anticipated increase in volume declines as borders have reopened and there is a return to pre-COVID purchasing patterns.

Second, we continue to make good progress in implementing our refreshed NGP strategy. We have achieved further share gains with Pulze and iD, our heated tobacco offering, in Greece and the Czech Republic.

This good progress validates our new, more consumer-centric approach, and has given us the confidence to launch the proposition in Italy, Europe's largest heated tobacco market. I recently attended the launch event and it was great to the see the team there using the learnings we've gathered from our two pilot markets.

And, our consumer trial of blu 2.0, a new pod-based vapour device, in selected cities in France has been well received by consumers and the trade.

This is further consumer endorsement of our NGP launches and has strengthened our confidence in our NGP strategy as we prepare for a broader roll-out of our new propositions. We look forward to updating you on progress as they occur.

And finally we remain on track to deliver an acceleration in performance for the next three-year phase of our plan.

The additional investment and the actions we have taken during the initial two-year strengthening phase have built strong foundations and enhanced our resilience as we face a more challenging macro-economic environment.

Over the next three-year phase of our plan, we continue to expect low single-digit constant currency net revenue growth, with constant currency adjusted operating profit growth accelerating to deliver a mid-single digit CAGR over the three years.

So as this suggests… this means an average over the three years, and is in line with the expectations we set out in January 2021.

We are confident our investments and initiatives will continue to gain traction, particularly over the next year or so, and therefore we expect the growth rate of our adjusted operating profit to improve within this mid-single digit range over the three years.

We're conscious these are increasingly challenging times for all businesses, with rising interest rates and high inflation.

We won't be immune from these pressures but I am convinced that our actions are creating a strong business better able to navigate these uncertainties.

We remain committed to delivering our plan and to realise the full potential of this business and to unlock long-term value for shareholders.

Thank you for joining us today…

Lukas and I would now like to take your questions.

I will now hand over to operator to moderate your questions.

Thank you.

Q&A

Operator: Thank you. As a reminder, to ask a question, you will need to press star one one on your telephone and wait for your name to be announced. Please stand by, we will compile a Q&A roster. We will now take the first question. Please stand by.

And the first question comes from the line of Rashad Kawan from Morgan Stanley. Please go ahead. Your line is open.

Rashad Kawan (Morgan Stanley): Hi, good morning, Stefan, Lukas, Peter. Thanks for the time this morning. A couple of questions for me, one on the buyback and one on the US. On the buyback, committing to a multi-year programme here, how are you going to think of buybacks in relation to dividends going forward? Do you think the £1 billion figure will be a good proxy for outer years, or will you be looking for a progressive increase on the buyback amount as well? Just some clarity on how you think of that going forward will be helpful.

And then on the US, can you talk about what you're seeing in the cigarette market there? I mean, clearly, it looks like momentum is continuing from a share perspective, but how do you expect your price mix to develop given the level of downtrading we're seeing in the market today? Thanks again.

Stefan Bomhard: I would suggest that Lukas goes on the first question, and I will come back to you on your second question, Rashad.

Lukas Paravicini: Rashad, good morning. Thank you very much for the question. Yes, we, indeed, have committed to a multi-year and ongoing, as we have always said. When you go back to our capital allocation framework, we were very clear that we have four integral pillars to that capital allocation.

We have now reached that low end of the leverage and that allows us to keep that leverage, which is very important to us going forward, but also in going to the share buyback. And as we have said always, this is part of our model. This is part of our capital allocation and therefore it is a commitment, an ongoing process, a multi-year commitment.

Now, we are focusing on the next year in terms of what we can afford, what makes sense in our capital allocation, and that is the £1 billion. And we will review that every year, as part of our ongoing capital allocation strategy to see what will be the next year's allocation to come. And that is what you should look at in that sense. It's a meaningful, systematic approach to that.

From a dividends point of view, for us, it is an integral part from the capital allocation as well. And we believe it is important that dividend continues to flow. We have made it very clear that it is a progressive dividend. And progressive in this sense means that it is progressive in line with our underlying performance. And so you will continue to see that continue as well over the years.

Stefan Bomhard: Firstly, and to answer your second question about US, I came back from the US west coast yesterday after spending time with our team there, and attending the National Association of the Convenient Store operators of the US, which happens once a year, and had, therefore, the chance to speak with the CEOs of several of our top customers. The interesting thing and what they were telling me, for the time they see limited downtrading, but they do see some downtrading starting. And I think that plays to our strengths because if you look at it, as you would be well aware, of the three major players in the US, we, clearly, have the most complete brand portfolio with a good presence in the deep discount segment.

So, in principle, should you, as consumers, start to downtrade in a more meaningful form, our portfolio at Imperial is very well-placed to accompany their needs, yeah? So, I feel quite comfortable whatever the situation in the US will develop to, we are in a good place.

Rashad Kawan: Thank you very much, gentlemen.

Operator: Thank you. We will now take the next question. One moment, please. And it comes from the line of Gaurav Jain from Barclays. Please go ahead. Your line is open.

Gaurav Jain (Barclays): Hi, good morning, Stefan, Lukas, Peter, a couple of questions from me. So, first, you know, on your e-cigarette strategy, so, clearly, you are talking a lot about heated tobacco, but could you also talk about how you are thinking about e-cigarettes and you haven't yet launched disposable in the EU. And in that context, you know, clearly, a lot of focus on the disposable e-cigarette market in the UK right now in the media. So could you just help us understand what really is happening and is it leading to increased cannibalisation of cigarette sales in the UK market?

Stefan Bomhard: Sure. Gaurav, good morning. I mean, as you ask about the disposable market or vaping overall, I mean, number one, you – clearly, we are very committed to the vaping market because we've always said that we are going to be consumer-led, yeah? Therefore, this launch of heated tobacco in Europe, which clearly is a big decision about going into the largest heated tobacco market in Europe and Italy. At the same time, our test market in France, we have blu 2.0, which an all-new device for us, is going very well.

Like you mentioned, we are clearly also observing a significant growth of the disposable vaping market. In the majority of the market, interestingly, we are observing that for the time being the disposable vaping market growth goes on top of the pod-based systems, yeah? So, we actually see an acceleration when you look at, for example, the Spanish market, an acceleration of our pod-based market overall. But at the same time, we will clearly also study the disposable vaping market. And some of you will hopefully remember, we do have a disposable vaping product in the US, as part of our line-up on the blu brand. So it's a market we are very familiar with, yeah?

Gaurav Jain: Sure. Then, if – you know, what exactly is happening in the UK market, if you could comment? Like, this accelerated growth in e-cigarettes because of disposables, is it leading to an accelerated cannibalisation on cigarette volumes?

Stefan Bomhard: No. I mean, Gaurav, what we are seeing is a significant – I mean, again, this is a very dynamic development, as you rightly point out. It's the growth of disposable is something that has accelerated very significantly very recently. However, at the same time, we are not seeing an acceleration in the decline of the cigarette market in the UK. The only caveat I would have, the UK market is quite difficult to read because you will know of the COVID effects and the return of travel back to markets like Spain, yeah? But we don't see an underlying decline acceleration of the UK market of cigarettes.

Gaurav Jain: Okay. And then a second question just on the, you know, Australian market. You know, it was clearly a bit profit-driven in some of the past few years. But now as sales tax is, I think, gone up or not going up at the same pace, do you expect a big profit recovery now beginning to happen in – on that side of the market?

Stefan Bomhard: I mean, Gaurav, you're absolutely right, the government has chosen not to continue with its duty accelerator. That is good news for the industry. At the same time, I think I wouldn't count on significant profit growth out of Australia. Our focus as a company has been to make sure that we participate market share-wise in the right way in the market, and you would have probably picked up that our market share has grown in Australia, and that would be also the expectations when we report the numbers. And we will make sure that we participate in the right way in the market. But I wouldn't count on a profit recovery in the Australian market because the underlying volume decline of Australia does[?] continue for the time being.

Gaurav Jain: Sure. And if I could sneak in one last question. So, look, clearly, you will have a big translation FX benefit next year because of where the pound is. Could you also remind us what the transaction benefit that happens at Imperial? Because, clearly, a lot of your costs are in pounds, so there should be some transaction benefit as well.

Lukas Paravicini: So, Gaurav, we will have to come back to you. I mean, while the transactional effect is very small and is covered in our normal forecasting, and so, we will have to come back to you with the details. But I would assume that it is a minor effect in our overall business.

Gaurav Jain: Okay. Well, thank you.

Operator: Thank you. We will now take the next question. One moment, please. And it comes from the line of Eamonn Ferry from Credit Suisse. Please go ahead. Your line is open.

Faham Baig (Credit Suisse): Good morning, Stefan, Lukas, and Peter. Thanks for the question and hosting this call this morning. Could I firstly double-click on topline growth? Because I believe at the half-year stage, you were guiding to 0-1%, but now expect around 1%. So, that would imply a slightly better second-half performance. Is that driven by market share performance, if so, where? I believe the two markets you were losing share at H1, were Spain and Germany. The situation there? Or is it the price point? Has pricing stepped up meaningfully better than you expected, which should continue going into next year?

My second question is probably just a quick housekeeping one for Lukas. I believe that debt at the half-one stage was around 64% fixed, and therefore the remainder floating. I know there's been a few changes in purchasing and raising debt over the last few months. How should we see that fixed versus floating ratio right now, and what sort of interest cost are you expecting for next year? Thank you.

Stefan Bomhard: Okay. Let me deal with the first question, then, as you rightly said, second one goes to Lukas.

On – you're absolutely right, top-line performance was slightly improved versus the half-year, yeah? And you also touched what is the key driver of that. That is pricing. We've always said at the half-year that we would expect pricing to improve in the second half, and it did. That is the number one driver.

As you touched on market share, I think it's – we have gotten final market share, as you would expect not to have on – at early October. So, but what absolutely will be the case, which we confirm, is that fiscal year 2022 will be the first year in quite a number of years that Imperial will have grown market share in its top five markets. That is a very material turnaround of market share performance versus where we were before. We need to see where the individual markets then end on this one. But what we can see is through period 11 of the year, we will for the first time in many years report market share growth in our top five markets.

Lukas Paravicini: Excellent. And just on the technical question on the floating versus fixed. I mean, a few months earlier in the year, we, in the Treasury Committee, which I chair, we reviewed the situation and we adjusted the policy to more a 80-100% fixed, given the environment for the first 3-6 months. And we have instructed also Treasury to make sure that we are within and if not at the higher end of that policy. So, we are going to a more fixed environment given the policy. And we will keep monitoring that and see what the requirements are.

Regarding the interest costs. Over the year – over the last few years, we've had the benefit of lower debt through our efforts to deleverage and, you know, a very beneficial interest rate. This will reduce now; in both sense – we will expect increased interest rates, we have reached our target leverage and that leverage is where we want to be. And therefore, you can expect next year the interest rate to slightly increase over what we have this year.

Eamonn Ferry: Thank you.

Operator: Thank you. We will now take the next question. One moment, please. And the next question comes from the line of Andre Condrea[?] from UBS. Please go ahead. Your line is open.

Andrei Condrea (UBS): Hi, good morning, Stefan, Lukas, and Peter. Thanks very much for taking my question. Just one for me, please. On the recent Florida settlement agreement payment decision, I assume you plan to appeal. And did you, by any chance, factor this in your three-year operating profit CAGR guidance? Thanks very much.

Stefan Bomhard: Okay, sure. Andrei, good morning. I mean, you're absolutely right, we will appeal that decision, yeah. And I think it's also important to know that the underlying Florida court case that you name, that was between Reynolds and ourselves, that we're not making any payments in Florida at this point in time. But you're absolutely right, we'll appeal the decision in Delaware, and we feel quite confident that we'll be successful in this appeal. But again, will be down to the judge.

Andrei: Thank you very much.

Operator: Thank you. We will now take the next question. And it comes from the line of Richard Felton at Goldman Sachs. Please go ahead. Your line is open.

Richard Felton (Goldman Sachs): Thank you. Good morning, gents. First question on Germany, please, which I know has been a slightly more challenging market to fix. I appreciate we'll have to wait until November to get the final market share numbers. But more broadly, have you started to see any signs of trends getting less bad in Germany? That's my first question.

And then my second one. You sound like you're very pleased with the progress you're making on Pulze in Greece and Czech Republic, but as you do start to, you know, if you're confident to roll it out to more markets, how should we think about the level of investment required for that rollout? I think previously, you had spoken about losses in your NGP narrowing to breakeven. Should we still expect you to be on that trajectory even if you're investing more as you're expanding into more markets? Thanks.

Stefan Bomhard: Okay, sure. Let me deal with Germany first, and then Lukas will take the question on NGP.

So, Richard, on Germany, as you rightly say, I mean, the final shares for Germany will only be available in November, yeah. Reality, but reality, I can answer your question. I think when you look at it, we – I don't think you will see the trajectory just change for Germany. At the same time, we do see some green shoots. We've always said from the beginning Germany would take the longest to turn around. And also just remind ourselves what we said, we're looking at stabilising aggregate our market share in our top five markets. It's a highly competitive industry. I don't think you will ever see all five markets reporting market share gains, yeah.

But, on Germany, what I'm pleased to see in Germany, is that we are seeing some green shoots on some of our brands, specifically the Gauloises brand. Unless the market share in period 12 would have turned in a very different direction, is the first time we'll see Gauloises – on Gauloises, which is one of our top three brands that we will grow share, yeah. And that is a big improvement in Germany. That doesn't mean that the German market share all will turn right. There's still JPS. There's still West. But overall, I'm satisfied with the progress we're making in the market that we knew from day one would be the hardest one to turn around on market share, yeah.

I'm going to give it over to Lukas on NGP.

Lukas Paravicini: Yeah, Richard, good morning. Thanks for the question. Yeah, indeed, we are really very pleased with the result of Pulze in Greece and Czech Republic. I think it underpins also that we have very – been very thorough in the year-long test and trials we have done and the learnings we have taken, now allow us to go into the largest market in Europe. And that underpins also our real strong commitment in making a meaningful NGP business in the next few years. And we will do so – and I want to bring you back to how we look at NGP – we will do that in a cost-effective way in markets where there is an established NGP business, where we have a presence and we can win or carve out a fair share for us in that market.

So, that is really – and as you know, it is important that Italy is a good example of that next step and how we build that.

Now, to your question, yes, we are committed to reduce the losses of NGP by 2025. You know, we're going to end up this year, roughly around £100 million, which is good progress. But I think we should be very clear, and I said this at half-year as well, it's not a linear progression. You want us to invest in a cost-effective way in those markets where we're launching now. We have announced Italy. I will not be surprised if that's not the last market you hear from us. And therefore, you will see us supporting those zones in a measured way, but a cost-effective way.

So next year, you might expect the losses to go slightly up, or go up again, around the £130-140 million, but don't expect it to be higher than last year, but well on progress to build a meaningful business and to reduce losses to zero by 2025.

Stefan Bomhard: And Richard, just to reiterate the point from Lukas. I think hopefully, what you get also from today's announcement and also our guidance for fiscal year 2023, where we will step up our profitability and the total business meaningfully versus this year, and we will increase our investment in NGP. That hopefully is an – it should give you a sense about the confidence we have in our plan.

Richard Felton: It does. Thank you, that's very clear. And congratulations on the good results.

Stefan Bomhard: Thank you.

Operator: Thank you. We will now take the next question. As a reminder, it's star one one for questions. And the next question is coming from Alicia Forry from Investec. Please go ahead. Your line is open.

Alicia Forry (Investec): Hi, good morning, everyone. Thanks for taking the question. The first one, I just wanted to, since we are on the topic of Pulze, your heated tobacco product, just a little bit more detail please on what gave you the confidence to enter Italy, and what you learned about that brand in your test market, it's differentiating factors, etc.?

And then secondly, how concerned are you about downtrading in Europe with recessions looming and cost-of-living crisis discussions? I noticed cigarette pack prices are over £14 in a local shop. So, are you taking this into consideration at all in your medium-term guidance? Thank you.

Stefan Bomhard: Sure. Alicia, good morning. The – on Pulze first, I think – and we will update – as you would expect, that the full-year results will give a much more detailed update on where we are. Also, because then we have the final date in for the full fiscal year. But I think to answer your question as much as I can today. In principle, what our now one – more than one-year test markets in Greece and Czech Republic really show us that this – against some very well-established competitors, our Pulze product actually attracts a meaningful number of consumers, primarily because our proposition is different to our competitors.

Our device is a lot about lasting through the entire day on one charge, yeah. So you, like a phone, you only have to charge it in the evening, and that is for a meaningful number of consumers a very important feature, yeah. The other thing is also that our product, our flavour portfolio is attractive to consumers.

So, I think, and what is important, we've always said about our ambition is not the be the market leader in NGP. Our ambition is about carving out our share in the market. And we, clearly see that evident strong enough out of the Greek and the Czech markets, which are big markets for heated tobacco, with nicotine consumption out of heated tobacco being well above 10% of total nicotine consumption. And is the signal that we're launching into the largest market in Europe for heated tobacco, which is Italy, as – that we are feeling very confident that we have a proposition that actually will work with consumers, yeah.

To answer your second question about downtrading trends in Europe. Now, number one, I think, like across all categories, the cigarette category is not going to be immune towards the inflationary pressure that we're seeing. At the same time, I think it's fair to say, and past experience would prove that, that the category – that tobacco is a more resilient category, yeah, when there is a high level of inflation and consumer pressure. And I would add the point, when you look at our portfolio, as Imperial, I think we have a portfolio of brands that is highly advantageous for the current environment. We have an offer, a brand at every price point in the marketplace that will mean should consumers choose to downtrade and look for cheaper brands, Imperial is very well-placed to have a good offer also.

Lukas Paravicini: And Stefan, I think it's probably also a good point to raise here, is that we are still in many of our markets in an environment of very affordable products. You know, the affordability in the US, in Germany, in Spain is very good. And this is a product that is consumed daily multiple times. So, it is – you know, you're constantly exposed and desiring that product. And as Stefan said, it is an industry where we have constantly done pricing. And you will see in the second half, actually, pricing will come through very strongly that shows that we have a regular cadence of pricing which the industry and the traders will accustom to.

Alicia Forry: Thank you very much.

Operator: Thank you. There are no more questions at this time. I would like to hand back over to Stefan for final remarks.

Stefan Bomhard: Sure. Thank you. And look, I want to thank all of you for attending this morning and for asking your questions. So for us, it's been good here to share the progress we've made in transforming Imperial, and particularly in reaching this important milestone of our share buyback today, yeah. And Lukas and me, and Peter, are all looking forward to updating you on the progress at our future meetings, yeah.

Thank you and have a great day.

[END OF TRANSCRIPT]