Imperial Tobacco

Preliminary Results 2012

30 October 2012

Alison Cooper Chief Executive

Good morning, to everyone here in the room and those watching via our webcast, welcome to our 2012 results presentation.

I'm Alison Cooper, Chief Executive, I'm here with Finance Director Bob Dyrbus, our Chairman Iain Napier and other members of the senior management team.

Disclaimer

Sales Growth – a differentiated approach

Over the last two years we've made great progress in shifting our strategic focus to put consumers at the heart of our business and drive organic sales growth.

It's been a rapid transition and I'm excited about the progress we're making – we've got quality brands delivering quality growth, sustainable sales driving sustainable returns.

Our success is built around a differentiated approach that's focused on applying our understanding of consumer motivations to realise the potential of our portfolio - fantastic brands and products that offer consumers the best tobacco experiences.

This is fuelled by our winning culture, our people and our values; it's not just what we do, it's how we do it.

The response from our people to these changes has been remarkable; a united focus on sales, on building total tobacco brands and consumer experiences that deliver high quality sustainable growth. A great job everyone, and thank you.

Creating Sustainable Value

Our business model is familiar to you, we apply our sales growth drivers and key enablers to maximise the growth of our total tobacco portfolio, driving high margin sales to generate cash that we use to reinvest in the business and create value for our shareholders.

FY12 Results Overview – driving sales growth momentum

Our focus on driving quality growth, whilst effectively managing costs and cash, delivered a number of highlights in the year.

We increased tobacco net revenues by 4 per cent and grew revenues of our key strategic brands Davidoff, Gauloises Blondes, West and JPS by 13 per cent.

We're generating great momentum behind these brands; they now account for 30% of our total stick equivalent volumes, and their success was a key driver of the 10 per cent revenue growth we achieved in our Rest of World region.

Tobacco operating margins remained strong at 42 per cent, with tobacco adjusted operating profit up 4 per cent and adjusted earnings per share growing by 8 per cent.

Free cash flow was 1.3 billion pounds, you'll have seen from the RNS that we've written down the value of our Spanish goodwill due to further deterioration in Spanish economic indicators.

This impairment charge is a non-cash item and has been excluded from our adjusted results, and Bob will talk more on this later.

In terms of supporting sales growth, we've been increasing investment behind our key assets - ensuring we balance investment with price, mix and cost management.

Our focus on maximising value has increased returns to shareholders by over 40 per cent in the year – up to 1.5 billion pounds - including share buybacks of just over half a billion pounds, and the buyback programme is ongoing.

And we're again increasing our dividend payout ratio – up to 52.5 per cent of adjusted earnings per share, with the Board proposing a final dividend of 73.9 pence per share, bringing the total dividend for the year to 105.6 pence per share - an increase of 11 per cent.

Building Total Tobacco Brands

The strong performances we're delivering across the portfolio highlights the quality of growth we're generating.

The volume and revenue growth from our key strategic brands was excellent, and although fine cut tobacco volumes were flat, we improved revenues by 13 per cent.

Our overall stick equivalent volumes declined 2.7 per cent – but were flat excluding compliance with Syrian trade sanctions and the impact of Ukraine and Poland, where there's been a steep decline in the legal markets.

This reflects the performance of our key strategic brands and the strong growth we're achieving in make your own tobacco.

Our premium cigar division had another great year, growing volumes by 11 per cent and revenues by 10 per cent, and in smokeless we continue to go from strength to strength in Scandinavia.

Building Brands – Key Strategic Brands

We're driving momentum behind our key strategic brands and here you can see how we're driving that growth through the lens of our business model.

Starting at the bottom of the wheel, with reinvestment; this year we increased A&P behind these brands by 26 per cent, and there's been further investment in capex, product quality, innovation and our people to support sales.

Every pound we've invested in these brands has generated over five pounds in sales, with pricing and innovation boosting performance.

These brands already generate excellent gross margins and we improved them again this year, in both percentage and absolute terms.

Finally strong cash flows: after A&P, net brand contribution was up by 13 per cent, and we'll continue supporting our total tobacco brand growth with further investment in the coming year.

Let's now look at how each of these brands performed.

Building Brands – Davidoff

We grew Davidoff by 9 per cent, achieving very good results in Asia, the Middle East and Eastern Europe, where we're gaining volume and share at high margins.

Our success in king size superslims and the launch of a queen size variant continues to drive sales, and we're accelerating momentum with the launch of

Davidoff iD, the new king size range in standard and GlideTec packs.

This was a major portfolio initiative in the second half; through iD we're opening up the Davidoff experience to a much broader consumer base, making the brand more accessible to more consumers in more markets.

In just five months we've launched iD in 19 markets, including Global Duty Free, generating very positive consumer feedback and strong initial sales that are supporting the further growth of Davidoff.

The international roll-out continues and iD will be in lots more markets by the end of FY13.

iD's a fantastic addition to the Davidoff family, as you can see from this video.

Davidoff iD video

Building Brands - Gauloises Blondes

We delivered another great performance with Gauloises Blondes, building on its strong base in the EU and driving sales in emerging markets.

Volumes were up 11 per cent, with excellent results in Africa and the Middle East.

Innovation and portfolio management initiatives continue to support the brand's growth momentum, including Tactil with GlideTec and a crushball variant in France, and new additive free cigarette and fine cut tobacco launches in Germany.

Building Brands – West

The turnaround we've achieved with West has been a real highlight of the year - we grew volumes by 5 per cent, with particularly good results in Eastern Europe and Asia Pacific.

Innovation's been central to West's strong performance in these regions, with queen size, king size superslims and crushball variants enhancing the brand's profile in high growth segments.

We've also significantly improved West's position in Turkey through new pricing and customer engagement strategies, with volumes up over 50 per cent.

Building Brands – JPS

JPS had another good year, generating very strong results in the UK and Australia where the brand resonates strongly with value seeking consumers.

Gains in cigarette, and both roll-your-own and make-your-own fine cut tobacco were the key drivers of growth, supported by innovation initiatives including JPS GlideTec in Germany and crushball in the Netherlands.

Focusing Beyond Key Strategic Brands

Our enhanced sales agenda has initially focused on our key strategic brands; the priority two years ago was to get these brands really motoring with consumers to drive sustainable sales growth.

You've seen the results we're delivering, and as I demonstrated with the key strategic brand growth model, we'll be building on these going forward – but we're also actively managing core heritage brands in the portfolio that have significant untapped potential.

Four of them are on the slide, News in the EU, Bastos in Asia-Pacific, Maxim in Russia and Fine in Africa and Asia-Pacific.

They're among several brands in our portfolio with strong heritage – brands that resonate with consumers, and we have initiatives underway to add to the growth of these and other heritage brands.

Building Brands – Fine Cut Tobacco

Our world leadership in fine cut tobacco is a real strength of the business and a great place to be in the current economic environment.

We know the category and the consumers better than anyone else and excluding Poland, where there's been a significant and rapid increase in the use of non duty paid tobacco, our volumes were up by 4 per cent. Including Poland, volumes were flat and revenues grew strongly by 13 per cent.

This reflects some great successes we're achieving in core EU markets particularly in the high growth make your own sector.

We improved make your own volumes by 8 per cent; excluding Poland they were up 20 per cent. A number of strong brand performances are driving this growth, including JPS and Fairwind in Germany, West in the Netherlands and Ducados in Spain.

We also grew volumes in papers and tubes by 4 and 8 per cent respectively – adding to our margin generation from fine cut consumption.

Building Brands – Premium Cigars

Our premium cigar division, which includes Habanos and other premium cigars, continues to perform well.

We delivered very strong results in emerging markets through our luxury Cuban cigars, with excellent growth in China, Russia and the Middle East, and we're also driving good growth in the USA.

Limited edition launches continue to support sales and overall, we increased volumes by 11 per cent and net revenues by 10 per cent, with emerging market volumes up 7 per cent and net revenues climbing 16 per cent.

Building Brands - Smokeless

Our Scandinavian snus portfolio had another great year, building on what has been a strong track record of growth.

Volumes were up 53 per cent, with revenues improving 46 per cent and our market shares increasing in both Sweden and Norway.

New Consumer Experiences (this slide builds)

We've made great progress with our innovation pipeline this year as we focus on creating new consumer experiences.

We've been broadening our range of crushball offerings.

accelerating the international roll-out of GlideTec.

and expanding our range of queen size variants.

and superslims.

We've also been applying our expertise in blends.

launching a fresh blend of West and additive free blends in cigarette and fine cut tobacco for Gauloises.

These are all scalable initiatives, based on consumer insights and designed to deliver high returns.

Scaling Glide-Tec

Glide-Tec's been a particular focus this year, this leading pack innovation provides smokers with choice and reinforces brand differentiation.

We've rapidly scaled this initiative, improving the performance of our key strategic brands, as well as heritage brands such as Lambert & Butler and Fortuna.

L&B's position in the UK has been strengthened and Fortuna's gaining share in Spain - and as a result of these successes, we're improving sales mix.

In total, GlideTec's delivered sales of over a billion cigarettes in 13 markets, plus global duty free, and there's more to come.

Pricing and Customer Engagement

Our success at building our total tobacco brands is also about our pricing and excise strategies; price/mix doubled in the last year, with innovation and our key strategic brands significant drivers of mix.

We've enhanced our pricing analysis in a number of markets and broadened brand price options, for example with different formats – adding to consumer choice and the quality of our growth.

And we're continually improving our customer engagement approach, this is the conduit to the consumer where we're driving availability and advocacy of our products.

One of our centres of excellence is Australia, where customer engagement has been integral to the share gains we made in the year.

This is a great place to be with plain packaging on the horizon and gives us confidence in our ability to build on our track record of success.

Driving Sustainable Growth - EU

Applying our growth drivers and consumer understanding across our footprint is key to driving sustainable growth.

We see many future growth opportunities in the EU – yes, there are some economic and regulatory pressures, and these are likely to persist, but we've got the portfolio and the expertise to continue growing in this highly profitable region.

Our bias is on driving revenue and profit performance, whilst actively managing our market share positions.

By strategically balancing shares, revenues and profits - and with innovation supporting price/mix – we focus on maximising returns.

Despite the weak environment we grew EU revenues by over three per cent. Operating profit was up by 4 per cent – and up by almost £80 million pounds in absolute terms.

Americas – USA: strengthening our position

In the USA, it's about making the turnaround happen, and we're implementing a very clear plan to strengthen our competitive position and build sales momentum.

Working with the sales growth drivers and our consumer understandings we've developed a fresh focus on driving growth on a state by state basis.

Through customer engagement we're strengthening retailer partnerships and we've stabilised USA Gold and Sonoma shares as a result of a new cigarette pricing strategy. This was rolled out across 19 states in the summer after a successful trial phase, and our cigarette share's been on an upward trend since then.

The excellent performance of our premium cigar portfolio meant we improved volumes by 11 per cent and revenues by 10 per cent, and we'll be building on this strong growth going forward.

We've also got a number of innovation initiatives in hand to support the broader portfolio.

So, we're heading in the right direction; it'll take time, we're driving change on a large scale, and we're focused on further improving our position.

Driving Sustainable Growth - RoW

In our Rest of World region our focus is biased to quality volume and share growth, and we see considerable future growth opportunities across these markets.

Our investments are weighted towards supporting growth in this region and enhancing momentum behind our key strategic brands.

We made excellent progress in the year, growing revenues by 10 per cent and profits by 7 per cent.

Strong performances in a number of markets including Russia, Algeria, Saudi Arabia, Taiwan and Australia contributed to our regional success story.

Applying our consumer understanding to our total tobacco brands is realising our growth potential across our diverse footprint, and we're in a great position to build on this growth going forward.

I'll now hand over to Bob to take you through the financials.

Group Results

Thanks Alison and good morning everyone.

I'll start with an overview of the results.

This table includes a reconciliation between reported and constant currency numbers. I'll be focusing on constant currency adjusted numbers for all of my comments.

Results have been adjusted and presented on our usual basis, with details in the appendices.

Tobacco net revenues were up 4 per cent with positive price/mix offsetting volume declines, whilst Logistics distribution fees were down 1 per cent, a robust performance given the economic climate.

Tobacco adjusted operating profits grew 4% per cent and Logistics adjusted operating profits were up 2 per cent.

We continue to invest in the business to drive long-term growth whilst generating high tobacco margins of over 42 per cent.

After tax at an effective rate of 23 per cent, earnings per share grew by 8 per cent.

Investment – driving sustainable growth

Re-investing to support growth is a key element of our business model.

Last year we made further revenue investments in the business of around 200 million pounds, or over 15 pence in EPS terms, split evenly between A&P, brand and product initiatives and investment in people to support sales growth.

Even with this investment, we grew EPS by 8 per cent, and the cash we're re-investing is delivering excellent returns, with strong revenue and profit growth in our key strategic brands, fine cut tobacco, cigars and snus.

We intend to make further incremental investments in 2013 to continue sustainably growing revenues and profits.

Group Results (Spain, interest charge and tax)

Before moving on, some brief comments on Spain, tax and interest charges.

Further deterioration in Spanish economic indicators means that under IFRS the value of goodwill previously allocated to Spain has been reduced by 1.2 billion pounds.

This is a non-cash item, an accounting requirement that's been excluded from our adjusted results in line with our normal policy.

Overall, Altadis has been performing as expected since the acquisition in 2008, delivering returns in line with our expectations and ahead of risk adjusted WACC at the time of the deal.

Our average all-in cost of net debt improved to 5.5 per cent, and 5.5 per cent is our current guidance for 2013.

The net interest charge was stable in constant currency terms, reflecting higher dividend payments, a full year of the share buy-back and increased working capital.

In terms of tax, our tax rate should remain at around 23 per cent.

This is sustainable and is benefitting from the lowering of the UK corporation tax rate, and the introduction by the UK government of more beneficial rules for the taxation of foreign profits.

Logistics

In Logistics we grew profits by 2 per cent, an excellent result given the challenging operating environment.

In Tobacco logistics, price increases and cost saving initiatives have benefitted results, offsetting cigarette volume declines.

In non-tobacco logistics our pharma business improved sales by gaining share and expanding direct distribution, and our lottery business grew by adding new points of sale.

Adjusted Net Debt

Our closing adjusted net debt for the year was 8.8 billion pounds.

Working capital increased by 500 million pounds, reflecting the unwinding of a timing difference in our Italian logistics business, and strategic decisions we've taken to support growth such as extending our leaf durations and investing in our sales agenda.

Cash remains a priority, and following last year's working capital investments we'll continue to actively manage our position.

Net capital expenditure was 303 million pounds, and is expected to be slightly higher next year reflecting ongoing investment in capacity to meet demand in growth segments and to continue building our innovation pipeline.

Tax and interest was 0.2 billion pounds lower than last year, while dividends and buybacks combined were 0.4 billion pounds higher as we increased returns to shareholders.

The net impact of foreign exchange and other cash flows on net debt was minimal. The appendices contain further detail on our debt maturities.

2012 Net Revenues

If I step back from the detail of these results, what stands out for me is how the well business is delivering.

Alison's highlighted how the strategy's driving revenue growth across the portfolio, how we're building total tobacco brands to drive quality growth.

Our revenue performance is equally encouraging from a footprint perspective.

We generate 91 per cent of Group revenues from the EU and our Rest of World region, and we grew those revenues by 6 per cent in the year, an excellent result at anytime, but even more so given the economic backdrop to some markets.

Yes, the USA has been a drag on the Group's overall performance, but we're implementing a plan to strengthen the business, with encouraging initial results.

Next year will have its challenges, like any other, but we're moving forward from a very strong base - which brings me to 2013, where the focus remains on building momentum across our regions.

First quarter trading last year was impacted by market weakness in Spain and trade de-stocking in Ukraine; our overall volumes were down 7 per cent but adjusting for these factors they were down less than 4 per cent.

The difficult conditions in Spain persist and although trade de-stocking in Ukraine was a one-time event, there's ongoing weakness in the market, and as a result, Spain and Ukraine will continue to impact us in the first quarter of 2013.

However, underlying momentum remains strong and we expect further good performances across our portfolio in the year.

Despite weakness in the EU operating environment, we see many opportunities to continue growing revenues and profits.

The action we're taking in the USA should deliver a turnaround in performance, and there are significant growth opportunities for us in our Rest of World region; our key strategic brands are delivering excellent results in these markets and we'll be building on this strong momentum by continuing to grow shares and volumes.

Maximising Shareholder Returns

I'd like to close my section with a few words about our focus on value creation.

We drive our business to maximise shareholder returns.

Since 2010 we've nearly doubled cash returns to shareholders - up 95 per cent to 1.5 billion pounds - by growing dividends and through our ongoing share buy-back programme.

We'll be building on this, and will continue growing dividends per share ahead of growth in earnings per share.

Thank you. I'll now hand you back to Alison.

Regulation – a sense of perspective

Before I wrap up I'd just like to spend a few minutes on how we see regulation.

There's a lot of noise on regulation, particularly out of the EU, that drives a perception that developed markets like the EU are the real drivers of regulation, but that's a very simplistic view.

The countries that tend to take the lead on regulation are shown here on the slide - most of them aren't in the EU, and we have a comparatively low exposure to these markets.

The newsflow surrounding regulatory issues can also create a perception of rapid change - but again the reality is somewhat different; the actual progress of extreme regulation is, on the whole, slow.

For example, if I look at product display bans.

On average only two countries a year have introduced bans over the last decade, and the potential progress of plain packaging is likely to be even slower as the legal hurdles are considerably more complex to overcome.

Whilst we're clearly concerned about plain packaging on a point of principle – and particularly the impact it will have on illicit trade – we don't believe it will have any real impact on consumption levels.

Extreme regulation, like display bans, hasn't reduced smoking incidence, and we don't believe plain packaging will either.

We know how important the brand experience is to consumers and don't see this changing in a plain pack environment – consumers will still want branded reassurance, regardless of the pack.

We'll continue engaging with governments and regulators to seek balanced, rational solutions, and won't shy away from challenging disproportionate regulatory proposals.

And we have a strong track record of growth in an environment of ongoing regulation, and given our strategic focus we're confident in our ability to build on this going forward.

Sales Growth – a differentiated approach

I began today by talking about the change that's been driven through the business over the past two years, it's involved making choices, and I believe we've made the right choices to deliver long-term growth.

We've put consumers at the forefront of everything we do and applied that to a portfolio that offers consumers unrivalled choice.

Our strategic approach to maximising the potential of our portfolio is delivering sustainable results.

We're building total tobacco brands and consumer experiences that are delivering high quality growth across our markets, and there's more to come.

Our footprint priorities are clear – we'll be further driving revenue and profit growth in the EU, strengthening our position in the USA, and targeting the significant growth opportunities we have in our Rest of World region.

Our success is down to the things that set us apart: our total tobacco expertise, our approach to consumer insights and the motivation of our people and the values that bind them.

These are unique to Imperial, and that gives us broad opportunities for future growth, to build on the momentum we're generating to deliver long-term sustainable returns to our shareholders.

Thank you; we'll now take any questions you may have.

The presentation is being recorded so please wait for a microphone and give your name and organisation before asking your question.