



Imperial Tobacco half-year 2013 results



Interview with Alison Cooper, CEO, and Bob Dyrbus, FD

Results overview – Alison Cooper

Q: This is a tough set of results in a tough operating environment, so how would you summarise the performance at the half year?

A: As you say, a tough set of results and if I look at the environment in which we're operating, we've seen that impacting a number of FMCG results in recent weeks as they've been reported as well. If I look at our business, the strategic focus is really delivering some quality growth for us and I think that's really important. The Key Strategic Brands have been growing. The fine cut tobacco portfolio has been growing and our total tobacco focus is really proving very important and has been a key contributor to our robust EU performance in this environment. So, down slightly, but we've still done very well in the EU with our portfolio given this environment.

Outside of the EU, in Russia and the USA our results have really masked some really good performances in our Asia Pacific and African Middle East business. Russia and the US have really been about investment and around tackling the top line growth and we see improvement opportunities in both those markets in the second half.

So, yes, a tough set of results, but some good performances within that and some really good portfolio initiatives and cost optimisation initiatives to build on and strengthen our performance into the second half.

The EU – Alison Cooper

Q: Now, the EU continues to be hard going for all consumer goods companies, but you must be pleased with the resilience that you're displaying.

A: The environment is clearly tough for consumers. You've got austerity impacting and for our consumers as well you've very often got increasing excise as well in terms of the price of the product. So we are seeing actually quite resilient consumption across Europe but unfortunately a lot of that consumption is shifting into illicit trade which is impacting the headline duty-paid market volumes.

But within that, we've got a portfolio that's working well. We've got a portfolio in cigarettes, but also, clearly, in fine cut. The total tobacco aspects of our portfolio are incredibly important in this environment. So, a resilient performance from us. Profits are only down 2% and really, that's been about Spain and some of the rest of the EU markets. The UK has been strong in this environment and I've been particularly pleased with the

performance in Germany in growing volumes, revenues, profits and our share both in cigarette and fine cuts have been moving ahead.

And in terms of portfolio, some really encouraging performances from our key strategic brands: JPS growing across the region, Gauloises growing in Germany and in fine cut, strong growth in our fine cut volumes up 9% ahead of the market.

Russia and the USA - Alison Cooper

Q: Russia and the US have clouded your wider performance, so what actions are you taking in these markets?

A: In the USA, we're still transitioning our strategy, and what you can see in the first half is the further investments behind our new pricing strategy which we've now rolled out across 19 states. And there are some encouraging share gains off the back of that initiative and we're now adding to that with a broader focus around our sales growth drivers with further portfolio initiatives and also customer engagement initiatives coming through in the second half as well to strengthen our performance there.

If I look at Russia, that's also been about investment in the first half, but clearly, also, we've been adjusting to some excise changes in the market, and again, we're addressing that with a number of portfolio initiatives in the second half and expecting improved performance from that market going forward.

Rest of the World - Alison Cooper

Q: And you've seen some good performances in Africa, Asia Pacific and the Middle East, so what's driving that?

A: Key to that success is our portfolio focus in those regions and our key strategic brands really resonate with consumers in a number of markets across Africa Middle East and Asia and we're seeing growth in Africa Middle East of 10% in our key strategic brands, and 8% in Asia. So some really strong performances that we'll continue to build on into the second half.

From a total tobacco perspective, our premium cigar business has also been performing very well for us in our Rest of the World region with volumes up 18% in the first half.

As I'm looking at Asia Pacific, I should also mention Australia, we've had the first six months of the plain pack environment in Australia. We've seen the market decline roughly 2% to 3%, so maybe not as bad as we might have anticipated. But I think more importantly, it's our portfolio that has been really successful. The initiatives we've taken in this environment such as our share in both cigarette and fine cut is growing in the market. So, some good initial signs from a plain pack environment and how we're handling that within Imperial in the first half.

Key Strategic Brands - Alison Cooper

Q: In your Key Strategic Brands you've announced volume growth of 1% and revenue growth of 5% today, so can you give us a little bit more colour around what's going on there?

A: Yes, I'm pleased with the trends for the key strategic brands and there is really good underlying momentum with these brands which is very outperforming the current industry trends.

Looking at these brands, they really resonate with consumers internationally and you can see that coming through in the results in the first half. If I look at Davidoff; Davidoff, is a luxury brand, great credentials with consumers growing in emerging markets. So, share growth in markets such as Russia and Turkey, but also growing in a market like Greece currently because of the strength of the brand's credentials and heritage and its profile with consumers.

Gauloises, again, a huge brand in our portfolio; really important in Africa Middle East where we continue to grow the brand, continue to innovate around the brand for consumers. But also growing in Germany, for example, particularly, with our introduction of natural formats into the market over the last year.

And if I look at West; West is also doing really well for us in emerging markets in Africa Middle East and Asia Pacific again. These brands are key to our growth in these emerging markets.

And finally, JPS, more EU focused (apart from Australia) it's the total tobacco brand. It's performing exceptionally well for us across the total tobacco category and continues to go from strength-to-strength.

So overall, some great progress from those brands. More initiatives to come in the second half. A rejuvenated Davidoff, a rejuvenated West, a number of initiatives across the portfolio to add to that momentum.

Portfolio priorities – Alison Cooper

Q: Performance in the Key Strategic Brands and fine cut tobacco is clearly positive, but what about the wider portfolio? Can you give an update on the portfolio review that you introduced at the Investor Day recently?

A: I mentioned with the Key Strategic Brands that these are brands that resonate internationally with consumers and the focus on those brands is working. So over the last year we've been looking at the broader portfolio and saying, "Well, how do we take that portfolio forward? How do we focus further on slightly broader portfolio to add to that growth momentum and the quality and sustainability of the growth we're delivery?" And we've looked at both cigarette and we've looked at fine cut and we have identified a number of further brands that we're going to focus on to deliver that growth. And together they represent around 50% of our portfolio. They're going to be a focus for initiatives, a focus for investment and a focus in aggregate to drive volume and value growth for Imperial going forward.

Cost optimisation – Alison Cooper

Q: At the Investor Day you outlined a substantial cost optimisation programme, so what progress have you made with that?

A: Well, cost optimisation starts with the portfolio and the right portfolio drives the right product cost and the right overheads in the business, the right infrastructure to support the development and sales of that portfolio. The opportunities for complexity reduction are significant and to drive further efficiency in supply through purchasing, through trade stock, through capacities or adding to the cost opportunity in the business and supporting our quality sales growth strategy.

In terms of numbers, we anticipate delivering savings of around £300m a year by September 2018 with a cash cost of around £600m and around £30m will be delivered in the second half of this year to strengthen our second half performance.

Margins – Robert Dyrbus

Q: So looking at today's results, can you talk us through what's been going on with the margin?

A: Certainly. Last year, the margin was 43%, this year it's 41.4%. Currency was a small negative but the main impact was the additional investment we made this year compared to last year. Adjusting for these two factors, margins were broadly flat year-on-year.

Looking forward, the cost optimisation programme we've announced will obviously be positive for the margins and our long-term earnings model sees growth of between 6% and 10% per annum and margins remain a significant focus in delivery of that earnings model.

Cash conversion - Robert Dyrbus

Q: Your 12 month cash conversion figure was down, so can you talk us through the reasons behind that?

A: Well, tobacco cash conversion was in line with last year. Within tobacco, working capital outflows, Capex to depreciation and restructuring provisions were broadly in line with last year. The main impact was in the logistics business where there was a £400m working capital swing caused by, effectively, excise and the duty creditor. This was principally due to market size reductions in Spain and in Italy and we expect this to reverse over time as excise and manufacturers' prices increase.

For the year, we expect cash conversion to be in the range of 80% to 100%, but I will give my normal caveat on that in that any material excise or price increases around the year-end could distort that.

Debt - Robert Dyrbus

Q: Your net debt has increased as it always does at the half when compared to the full year, so can you remind us about the reasons behind that?

A: Yes, you're right, the net debt does always climb in the half year compared to the full year due to normal working capital outflow and the final dividend payment which we make in February of each year.

This year, in terms of working capital outflows, it was higher as a result of the logistics working capital outflow I mentioned earlier. In addition to that, tax paid was some £300m higher. As a result of clearing a position with various tax jurisdictions, we released significant provisions over the last two years and utilised the balance of them in settling the position, hence the £300m one-off payment.

Shareholder returns - Robert Dyrbus

Q: When it comes to returns to shareholders, I see that you've announced another nice increase in the dividend today and the share buyback continues. So how do you think about returns going forwards?

A: Well, as you know, the interim dividend each year is one-third of last year's total dividend. So we've announced an increase of 11% to 35.2p. In terms of the total dividend for the year, the Board has made two statements. Firstly, it has said that dividends per share will increase ahead of earnings per share and secondly, that dividend per share growth will be at least 10% per annum. In terms of the current year, obviously, the final decision will be taken at the end of the year.

With the buyback we announced a £500m a year annualised buyback in May 2011 and that programme remains ongoing.

Outlook - Alison Cooper

Q: So what's your focus going to be as we head into the second half?

A: It's about continuing to focus on the strategy and the initiatives we are planning for the second half will improve our second half delivery and support our growth in the year within the earnings model albeit at the lower end given the tough operating environment.

The focus is about the portfolio, the portfolio initiatives, about pricing, about cost optimisation and also the second half will be helped by the fact that we're lapping the higher investment levels that we had in H2 of last year. This focus is true for the EU delivery and also true for Russia and the USA and the improvement plans that we have there.

There is a huge amount of energy and focus in the business behind these initiatives to improve the second half delivery and strengthen the business into 2014, continuing to drive quality sustainable growth for our shareholders.