Full-year 2013 Results interview with Alison Cooper, CEO and Bob Dyrbus, FD

Results – Alison Cooper, CEO

Q: There's a lot to digest in these results, but what are the key points from your point of view?

AC: Well, it's been a huge year for the business. It's been great to see the robust performance we've delivered given that it's a very challenging environment for consumer goods companies generally at the moment and that robust performance has come through in 6% earnings growth and a strong 10% growth in the dividend per share as well. But, for us, it has also been a key year of transition, working on our portfolio optimisation, looking at the realignment of our market priorities as well and, also, driving our cost optimisation programme forward. All about strengthening our business, improving the quality of growth we're generating and you can see that coming through in the numbers. You can see our Growth Brands; they're growing share, they're growing revenue. You can see our Growth Markets with share, revenue and profit growth and some very robust and resilient performances too in our Returns Markets in the year.

Growth Brands and Specialist Brands – Alison Cooper, CEO

Q: So, looking now at your Growth Brands which combine your Key Strategic Brands and Focus Brands, are you satisfied with the performance there?

AC: Our Growth Brands are outperforming the market, growing share, up 20 basis points in the year. Key to that is JPS which is performing exceptionally well in both the EU but also in Australia and New Zealand. Davidoff and Gauloises performing well in markets such as Germany, Russia, Turkey and Algeria. And, if I looked at Asia, West is performing well in Asia along with brands such as Bastos and Fine and the portfolio initiatives supporting these successes include new formats, particularly queen size, and also, our development of our add-free variants during the year.

Our focus for growth going forward is these Growth Brands. We've got very strong resonance with consumers, strong equity and we need to leverage and capitalise on that going forward and these brands are our focus for investment in 2014 and will add to the quality of growth we're delivering in 2014 and beyond.

Q: What can you tell us about the performance in your Specialist Brands?

AC: Well, these brands reflect the broader total tobacco portfolio that we have and cover a broad spectrum of consumer occasions. Within this we have Snus which has had another fantastic year. Premium cigars have again grown revenue with a particular focus in our Growth Markets. We have some specialist cigarette brands within the Specialist category which include Gitanes and Style. Again, good performances from those brands. And, also, our specialist fine cut brands sit here along with our papers business and again, they grew value in the year too, reinforcing our world leadership in this category. So, overall, 5% revenue growth from our Specialist Brands adding to the quality of growth that we're generating.

Fontem Ventures – Alison Cooper, CEO

Q: And, what can you tell us about Fontem Ventures, your new business?

AC: Well, this is an exciting standalone venture looking to develop new consumer experiences adjacent to the tobacco category and our prime focus at the moment is on developing our e-vapour products. We've got a significant programme of work ongoing. We're making significant progress and we will be in a position in 2014 to launch our first products into this category.

And, to add to the excitement, we've just acquired the assets of Dragonite, the IP for the original e-cigarette, and also with it the know-how that comes with the inventor of that e-cigarette who has also joined our Fontem business. So, some very good progress in 2013, some exciting stuff in 2014 and a step-up in our investment behind this area to take this venture forward.

Growth Markets and Returns Markets – Alison Cooper, CEO

Q: You've realigned your footprint now into Growth Markets and Returns Markets and are managing things on a strategic rather than geographic basis. So, taking the Growth Markets first, were you pleased with the performance in this area and what can you tell me about the US and Russia which both had tough first halves?

AC: Well, we realigned the footprint in April and it's been embedded very rapidly in the business and it's important I think to note that it has gone down very well in the business around the clarity of the strategic role and the resource allocation behind those markets.

So, if I look at the Growth Markets, they're the priority for investment and we've had a number of successes in the year in markets such as Taiwan and Turkey and Italy. But key to our success has been the turnaround in both Russia and the USA in the second half.

In Russia, we've been dealing with a number of pressures in the market due to the regulatory environments and excise increases and we've addressed that with our portfolio, the new portfolio initiatives in the second half and that's really improving our performance and taking our share forward as we go into 2014.

The USA is a great market and we're committed to making our strategy work there. We focused on pricing. We focused on customer engagement and those initiatives are really turning around our performance and you can see that coming through again in the second half delivery and into 2014.

So, our Growth Markets are a focus for growth, but it's also about the quality of that growth and so Growth Brands performances are really important to us. It was great to see the share of those Growth Brands up by 20 basis points in the year in those markets as well. And, going into 2014 we'll be investing more behind these markets, behind the brands in these markets to further improve and strengthen our performance as a business.

Q: So, looking at your Returns Markets now, it seems to be quite a mixed picture with strengthened Returns Markets North not quite enough to offset weakness in Returns Markets South. So, what's going on?

AC: Well, overall, it's been a resilient performance from the Returns Markets and these markets are about holding share and maximising profit growth from that basis. If I look at Returns Markets North, a relatively strong performance, particularly from Germany and from Australia. And Australia is particularly pleasing because this is our first year since the plain packaging was introduced and we're growing share, we're growing revenue, we're growing profits. Excellent performance from the Australian team.

In other markets like Algeria and Portugal we're also having successes. But, overall, our South markets were weaker. France, Spain and Morocco have been particularly weak markets and we're working on our portfolio total tobacco initiatives to strength our position in those markets going into 2014.

Overall, the Returns Markets are also about quality of growth and the focus on the Growth Brands within those portfolios and it's good to see that those brands represented 40% of the revenues in the year.

2014 Priorities – Alison Cooper, CEO

Q: So, it's clear that 2014 is going to be a key year of transition for Imperial Tobacco. What are you going to be prioritising?

AC: It's a very important year of transition in 2014 and it's about backing growth and all those growth initiatives in the business. But, at the same time, recognising that we need to build resilience, particularly given the operating environment which I'm not anticipating to improve within the next 12 months. There are a number of initiatives going on around the portfolio as we optimise the portfolio, focus our investments behind initiatives, migrate brands and reduce stock-keeping units and that has a knock-on effect to our cost optimisation programme, allowing us to take out complexity, improve manufacturing efficiency and also, look at capacity utilisation across the business as well. And, from an overhead perspective, we can realign our overheads and our expenditure also to match those portfolio and footprint priorities. So, a huge agenda and adding to that, we have opportunities on the stock front to take out trade stocks, to improve our supply effectiveness and also, support and get quicker at our portfolio initiatives in markets.

Given the transition priorities for 2014 we need the flexibility to invest behind our portfolio and our footprint, to take stocks out of the trade where we see opportunities to improve our supply effectiveness and also, the flexibility to manage the market environment and the headwinds.

Therefore, a working assumption is for modest EPS growth in 2014 whilst continuing a strong dividend growth of at least 10%. The initiatives in 2014, as we continue this transition, will strengthen our portfolio, strengthen our footprint and strengthen the growth platform of the business to provide future opportunities for growth in 2015 and beyond.

Financials – Bob Dyrbus, FD

Q: So, your cost savings programme delivered £30m this year. What can we expect in 2014?

BD: Well, yes, we will be generating in fact £300m a year from September 2018 and, as you said, we realised £30m in 2013. This was through a combination of product cost optimisation, refining the operating model, operating efficiencies and global procurement benefits and these, in fact, are the core areas that are driving that cost programme and we're seeking to further drive momentum in the current year. At present, I would anticipate incremental savings of around £60m to be realised in 2014.

Q: Net debt is higher now than it was at this time last year, so what's gone on there?

A: Yes it is higher, but it was impacted by two factors. Firstly, foreign exchange and other costs were some £300m of an outflow and there was also a one-off payment of some £200m in respect of a settlement of outstanding tax matters. So, if you adjust for those two items, net debt was actually lower.

Q: You must be particularly pleased with your cash conversion figures.

A: Yes, very pleased. Cash remains a key focus area for the business. Cash conversion this year was 86%, well within our 80% to 100% range and an improvement on last year. Working capital outflows were minimal, less than £100m, and restructuring and CapEx outflows were at a similar level to last year. In fact, if you exclude restructuring, cash conversion was actually 93%.

Q: And you've raised the dividend by 10% again. Looking ahead, are you committed to continuing to grow it?

A: Yes, of course, we're committed to raising the dividend by at least 10% per annum and we're committed to that for 2014. The business is highly cash generative and we're positioning the business for 2015 and beyond. In fact, the payout ratio does have very great scope to increase and so I can see dividend increases of at least 10% per annum for quite a number of years.

Q: This is your last set of results today before you hand over to Oliver Tant later today. How do you feel looking back on your last 25 years at Imperial Tobacco and 17 as Finance Director?

A: Well, Oliver is taking over the reins at a great time and I do wish him all the best for the future.

In terms of final thoughts; it's been a great ride. As you say, 25 years at Imperial, 17 as Plc Finance Director. I think our shareholders will be happy with what we've done over the time. The business is in great shape. The ongoing transition successes and a strong balance sheet means I'm sure they're going to enjoy strong returns for many years into the future.

Q: Enjoy your retirement.

A: Thanks.