

Company Name: Imperial Brands
 Company Ticker: IMB LN
 Date: 2018-05-09
 Event Description: Q1 2018 Earnings Call

Market Cap: 26513.8871266
 Current PX: 2780
 YTD Change(\$): -376
 YTD Change(%): -100.0

Bloomberg Estimates - EPS
 Current Quarter:
 Current Year: 2.592
 Bloomberg Estimates - Sales
 Current Quarter:
 Current Year: 8508.857

Q1 2018 Earnings Call

Company Participants

- Alison J. Cooper, CEO & Executive Director
- Dominic Brisby, Division Director of Returns
- Joerg Biebornick, Unknown
- Matthew R. Phillips, Chief Development Officer and Executive Director
- Oliver R. Tant, CFO and Executive Director

Other Participants

- Adam Justin Spielman, MD and European Tobacco and Beverage Analyst
- Alicia Ann Forry, Analyst
- Chas Manso, Analyst
- Fulvio Cazzol, Equity Analyst
- Jonathan Leinster, Analyst
- Owen Michael Bennett, Equity Analyst

Presentation

Alison J. Cooper, CEO & Executive Director

Well. Good morning, everyone. Welcome. I'm joined here today by our CFO, Oliver Tant; Chief Development Officer, Matthew Phillips; Chairman, Mark Williamson plus Dominic Brisby; Joerg Biebornick; and Amal Pramanik from the Senior Executive Team. I'm pleased to be updating you on our progress in the last six months. Building on the success of our investments behind our strategy both in tobacco and the NGP. And building on the improving metrics in the second half of 2017. Let's start with some headlines. With a clear focus on our product, brand and market priorities and our focus is delivering results. Our volumes are outperforming the market, reflecting the outperformance of our growth brands, including good organic growth. And our share result overall and in our 7 priority markets. As we previously flagged, price/mix has been weak in the first half but is now strengthening into the second half. And we're stepping up our activity in NGP and it's exciting to get the early feedback from the myblu launches and see the significant progress with our innovation pipeline.

And as we continue to sharpen our strategic focus, we are progressing opportunities to divest assets, which will further simplify the business and create additional value. We're delivering against our strategy in a better environment. Many of the headwinds carried over from 2017 into the beginning of '18 are remunerating. We're lapping the EUTPD impacts of last year, particularly the negative mix in the U.K. from the ban of high-margin small packs. We're also lapping some excise increases, although there are continuing negative impacts in Saudi and Taiwan. And France continues today, I think the polite word is challenging.

If we look at the headline, industry decline, they seem high, they are stripping out an outlier like Japan where we have limited exposure. The decline is around 4%, which is more manageable. And price/mix is improving at around 4% in the Second Quarter. Against this backdrop, as I've already highlighted, our performance is ahead of the market and with improved quality of growth. We're on track to target with our NGP launches. I, therefore, anticipate much stronger H2 with tobacco growth driven by our growth brands and improved price/mix. And NGP growth from market expansion and growth in existing markets, including mix of launches from next month.

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In addition, profits will benefit from further cost savings which are second-half weighted. We're on track to deliver in line with our guidance.

Now to Oliver to cover the financials.

Oliver R. Tant, CFO and Executive Director

Thank you, Alison. Good morning, everybody. I'm going to start with a summary of our results for the half year. The results we've announced this morning are further evidence of our investments initiatives delivering with our volumes outperforming the industry. Volumes were down 2% in the first half, comfortably ahead of the industry footprint declines of 5.7%. We delivered first half results slightly ahead of our expectations at the time of our February update. First half net revenue was down 2.1% with flat price/mix due to the carryover of a tough trading environment from last year and the impact of a one-off IP settlement in the first half of FY '17.

We've seen a much better price/mix performance in our Second Quarter of around 4% and this improving trend is expected to underpin our second half delivery. EPS was down 1%, reflecting the revenue performance. But was partially offset by lower finance costs due to deleverage, a marginally lower tax rate and a better contribution from Logista.

Our actual rates, EPS was impacted by 5.2% currency headwind. Our focus on cash has delivered another strong performance with debt reduction of GBP 1.2 billion or GBP 900 million excluding FX movements. Our volume performance, as I said, has significantly outperformed the market, driven by market share gains. As I've also mentioned, our volume performance has been led by our growth brands, as these continue to benefit from the increased focus on investment.

Growth brands outperformed with volumes up over 6%, growing 100 basis points of market share. Excluding the benefits of our migration program, they grew 1.6%, demonstrating the benefits of our focus brand strategy in generating quality growth. We've achieved a strong performance in our growth brands in every year since we began this strategy in 2013. In Specialist Brands, we've delivered strong volume performance with Backwoods and Kool; however, volume was disproportionately impacted by lower volumes of Gitanes in the Middle East, although this has had minimal financial impact.

Growth in Specialist Brands now represent 65.2% of total tobacco revenue, up 3.9% at constant currency. Portfolio Brands were down partly as we migrate volumes into Growth Brands. As compared to the industry volumes in our footprint, these brands underperformed by only 1.7%, a really good performance given the focus in investment is directed elsewhere.

We continue to optimize the Portfolio Brands for profits and cash, which has an impact on volumes. Revenue reflects our volume outperformance on a price/mix that was broadly flat, in line with our year-end guidance. This has been driven by some adverse mix in certain markets. Price mix was also affected by the benefits of the Fontem IP royalties we received in the First Quarter of last year. These royalties are on an ongoing revenue stream for Imperial, although their timing is irregular. Price mix was up 1% excluding the NGP IP and up 4% in the Second Quarter. A weaker dollar resulted in an FX translation headwind of 2.9% and resulted in a 5% decline in revenues in the period on an actual basis. The adjusted operating profit reflects the lower revenue on the additional investment in NGP. It was also impacted by GBP 13 million of transactional FX, which we expect to be circa GBP 30 million for the full year, in line with guidance. This is primarily due to the increased input costs of Leaf.

We also achieved other gains in operating profit with a net benefit of GBP 7 million, comprising GBP 40 million profit from the sale of other tobacco assets in the U.S., offset by last year's GBP 33 million of gains on the sale of Logista bank shares and the benefits arising on post-retirement benefit schemes in the U.S.

The prelims we undertook to provide greater clarity and transparency on these gains in future. As a result and in line with our full year guidance of GBP 50 million to GBP 100 million, we expect further one-off gains in the second half. Logista improved profits by GBP 16 million by further developing their non-tobacco business and continued cost

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discipline.

Looking at the markets, growth market volumes were up with the growth of West in Saudi Arabia and improved share performance in other priority markets. The net revenue movement reflects mix pressures in the Saudi as a result of excise duty changes as well as the Fontem IP income we received in FY '17, which I've referred to already.

The U.S. has had another strong positive performance with strong net revenue reflecting price/mix and the continued growth of our mass market cigars business. Profits in the U.S. were helped by the sale of other tobacco assets, although stripping these out, underlying profits were still up over 12%. Returns markets saw volumes down, broadly in line with market declines in the footprint, revenues were affected by the carryover of last year's trading conditions particularly with the tough trading in France and the mix impact from EUTPD in the U.K. As you can see, our portfolio simplification and investment focus has delivered Growth Brands share gains across all our divisions.

Overall, the business continues to generate strong cash flows with cash conversion of 111% in the half, benefiting from better working capital with the GBP 700 million inflow over the 12-month period. Of this, around GBP 250 million came from the timing of duty payments of Logista and around GBP 350 million was from lower finished goods levels in the U.K. and Russia, due to the changes in the timing of excise increases. Without these, the cash conversion would have been around 90%. None of these are expected to benefit the full year cash conversion, which we expect to be around 95%. We've also seen another GBP 900 million of debt paydown at constant currency over the last 12 months and a GBP 1.2 billion at actual rates. I should remind you that the full year cash flows will be affected by GBP 160 million due to P&H entering administration and a step-up and restructuring spend of circa GBP 200 million this year as previously guided.

Given the strong track record on cash generation and debt paydown, credit metrics continue to improve. I'm sure many of you will have seen, 2 of our credit rating agencies recently reaffirmed our rating.

In summary, these results are further evidence of continued delivery against our strategy. We are targeting to deliver full year constant currency revenue and earnings growth in line with our medium-term guidance. This will be driven by a far stronger price/mix delivery and we will build on the improved volume and share performances we've achieved over the last six months. It will also be supported by the rollout of myblu, which we expect to enhance our top line growth.

The improving top line will drive a better margin performance in the second half as were the cost savings, which will be second-half weighted. We expect that full year earnings will additionally benefit from the lower tax charge, although FX will remain a headwind of around 4% to 5% at current rates. Our view on full year finance charges, CapEx, et cetera are unchanged and more detail is provided in the appendices to this presentation.

So to finish, we are delivering for a focus on growth brands and priority markets with improving performance metrics that will drive results. On NGP, we are well placed with the rollout of myblu benefiting the second half. Our focus on capital discipline and strong balance sheet supports our strategic agenda as well as growing returns to shareholders and enabling debt repayment. Thank you.

I'll now handover to Matt.

Matthew R. Phillips, Chief Development Officer and Executive Director

Thank you, Oliver. Good morning, ladies and gentlemen. For the next few minutes, I'd like to update you on progress in next-generation products before handing over to Alison to give you some more color on the progress in our tobacco business.

As you know, we see a meaningful opportunity with next-generation products, namely e-vapour, oral products and heated tobacco. And that opportunity is to generate additive revenues and profits. As a reminder, over 85% of the world's smokers are not currently consumers of Imperial Brands products and downtrading within tobacco remains a really important dynamic globally. So being able to offer affordable, yet highly profitable experiences to smokers in

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such an environment is vital.

We are investing for growth. In 2018, in e-vapour, we are continuing to build the blu brand and are in the early stages of the international rollout of myblu and blu ACE. In oral products, we're expanding our existing successful offerings with the introduction later this month of tobacco-free pouches. And in heated tobacco, we have second-stage consumer trials planned for the next few months. For all 3 areas, we, of course, have been investing in production capacity too.

And we're focused on building great brands. Great brands require great consumer experiences and our innovation pipeline remains totally focused on delivering these experiences across the NGP spectrum. To repeat, we see a meaningful and additive opportunity for Imperial Brands in next-generation products. And none more so than in e-vapour, which is by far the biggest NGP experience in terms of numbers of consumers and even more so in our markets. Whilst the e-vapour market today is fragmented in certain countries, we actually see this as a fantastic opportunity, everything starts with the consumer. Simplistically, what has been missing to date are standout consumer experiences. The marrying of a fantastic brand with a drumbeat of new innovations that continually improve the experience with a consumer engagement strategy that is seamless across channels. The more we enhance the experience, the more the consumer base grows and the more the consumer spend grows.

As we scale, the more we can leverage overheads and normalized marketing spend more effectively. And as we innovate, our cost of goods fall dramatically, all driving our profitability. And you recall from a recent presentation by Oliver that we are targeting gross margins of around 70% and operating profit margins of around 45% over the next few years. And all of this is underpinned by the increasing levels of scientific and regulatory know-how required to bring innovative new products to market, an area in which few have the requisite capabilities.

Before talking a bit more about some of the innovations coming over the next 12 months, a reminder about myblu and blu ACE, both platforms are simple to use and therefore of wide consumer appeal. myblu is a simple-to-use pod-based platform that genuinely provides smoker satisfaction. Over the next couple of months, we will be enhancing the platform further with the introduction of nicotine salt liquids under the name myblu intense, all targeting adult smoker conversion. Building on the success of our blu pro platform, we're also launching a simple-to-use and powerful open system platform called blu ACE enhanced by adult-focused juice ranges.

In terms of the international rollout of myblu, we are currently in the early launch stages in 5 markets with a further 5 to follow in the second half of the year. We aim to be in 20 markets during FY '19. And by the end of 2020, we are aiming to have at least 8 million blu consumers. As I said earlier, the consumer engagement strategy has to be seamless across channels. And you can see on the slide examples of activations. In this case, in partnership with vape channel players and online retailers.

We are already receiving really good consumer feedback and seeing positive early traction and reorder in retail, the vape channel and online. The approaches we are testing have different biases in different markets. And by way of example, over the next few months, we expect to be in more than 50,000 retail outlets in the USA, 6,000 outlets in Russia and 12,000 outlets in France, reflecting the different approaches being tested in the different markets. As I said earlier, we are building -- we're focused on building Great Brands. Great Brands require great consumer experiences and our innovation pipeline is totally focused on delivering these experiences across the NGP spectrum. So finally therefore here's a reminder of blu's proprietary innovation pipeline for the next 12 months. I've touched on many of these already. And many of you in this room have experienced a number of them.

Of course in oral products, we are expanding our existing successful offerings with the introduction of tobacco-free pouches and in heated tobacco, we have second stage consumer trials planned for the next few months. There are 1 or 2 other exciting opportunities we hope to be able to talk to you about over the coming weeks and months.

In summary, we are delivering the significant step-up outlined at the end of last year with revenue momentum expected to build in H2 as the various rollouts continue. And I'd like to hand you back to Alison to give you some more color on the progress in our tobacco business.

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Alison J. Cooper, CEO & Executive Director

Thank you, Matt. NGP momentum is building through focused investment as we step up behind NGP this year. We've also recently restructured our NGP business to leverage its strengths of the tobacco business even more effectively. And in tobacco, momentum is also building through focused investment. Focused investment behind our priority markets and behind our Growth Brands to deliver quality growth. Our Growth Brands success builds on our successful portfolio simplification work over the last few years, boosted by the step-up in investment last year behind our Market Repeatable Model or MRM. All key metrics are significantly improving with volumes up 6.3%, including organic growth excluding migrations of 1.6%. A 100 basis point increase overall in share and contributing to an increasing proportion of net revenue from our Asset Brands now at 65%.

And this investment behind our MRM is also reflected in our overall share performance in priority markets. We have a clear portfolio focus and have continued investments in equity building, distribution and customer relationships this year. This brand and customer focus has been integral to our share success. Shares up in Germany, the U.K., France, Russia, Italy. And Japan driven by our Growth Brands and the disciplined implementation of the MRM.

Russia has been a notable success following some tough calls on portfolio simplification and our subsequent investment, particularly in key accounts. And the U.K. turnaround continues, again a clear portfolio focus and investments in activation and customer relationships underpinning our share growth. In France, share is up with a great performance from News, benefiting from increased focus within the simplified portfolio. Although share will come under pressure in the second half as we balanced share and profitability in a difficult trading environment.

Share is up significantly in Saudi, where our portfolio is well positioned given the market dynamics. But mix is significantly negative given the decline in the premium segment post the excise increase last year. Share was down temporarily in Australia due to a price disadvantage around an excise increase towards the end of last year. But this spot share has since recovered significantly. And in Spain, share continues to be impacted by the dark segment but our blonde share is on an improving trend.

In the U.S., we delivered a strong financial performance. Our cigarette share decline is ameliorating. Winston, Kool and Maverick are all doing well as is mass market cigars where share was up to 14%. Overall some good share performances to build on in the second half. So volumes are good in the first half. But the overall top line performance was held back by the carryover of some 2017 headwinds as we anticipated. For clarity, there's been no investment in 2018 behind our always-on-price strategy element of the MRM. You'll remember that the focus here is about price parity with relevant competitive brands. Price mix pressures are environment driven. Not the result of aggressive price positioning which merely borrows share.

And I mentioned in the beginning, price/mix is improving as we lap the '17 headwinds up 4% in Q2 as the trading environment improves. Our volume performance combined with improving price/mix plus additional cost savings underpins our confidence in the second half whilst recognizing that markets like France and Saudi will continue to be a headwind. Our clear strategic focus sits behind our 2018 delivery, we're prioritizing the brands, products and markets that are central to our strategy. We're driving continued portfolio simplification, active market prioritization and realizing NGP growth opportunities through targeted investment, all supported by a lean operating model and a continued focus on cost and manufacturing optimization.

As we further focus the business behind our priorities, we're also evaluating opportunities for assets that are not central to our growth agenda. The recent small example was the disposal of our U.S. OTP brands. There is more that we can do and today we've announced the initial scale of our thinking, looking to realize up to GBP 2 billion of proceeds within the next 12 months to 24 months. As you'd understand and we are able to provide further details at this stage. But there are clear strategic benefits for the business. It drives an even sharper execution focus and facilitates further simplification and agility, delivers efficiencies in costs and cash and unlocks capital to redeploy to maximize value.

So to conclude, I'm pleased with our progress in the first half, reflecting continued focus on our priority markets and strongest equities, we have improving momentum into H2. It's exciting times in NGP with launches and progress on new initiatives and that will also add to our H2 revenue growth. Thank you. We'll now take any questions.

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Questions And Answers

Alison J. Cooper, CEO & Executive Director

This presentation is being webcast. So please make sure you use a microphone beside the seat and give your name and organization before asking your question. Any question? There's a microphone in the seat, I believe.

Owen Michael Bennett, Equity Analyst

Owen Bennett at Jefferies and couple of questions, please. I mean at year-end you said you're hoping to do price/mix between 4% to 5% for the full year taking your model. And that, therefore, requires 8% in the second half, I was just wondering what are the key drivers of that pickle and particularly how much is vapour contribution accelerating contribute to that in second half. Then secondly more NGP related in terms of products and just any commentary on the myblu rollout in the U.S. and how that's getting on against JUUL from any kind of feedback you've seen already.

Alison J. Cooper, CEO & Executive Director

Okay. Do you want to pick up with the US and myblu? Then price/mix.

Matthew R. Phillips, Chief Development Officer and Executive Director

Yes. And I mean we're a couple of months in and it's going well and we are -- the feedback from retailers and the vape channel and from consumers both directly and through the retailers is very, very positive. And it's -- a lot of people focus on Nielsen data, which we don't for maybe obvious reasons given the challenges that we see, the way that they cover the market. But -- so it's anecdotal at the moment. I mean the guys are really, really excited about the response that they're getting to the product. So it's very positive.

Alison J. Cooper, CEO & Executive Director

And we have the nicotine salt addition coming up as well. So that will further drive momentum into H2.

Oliver R. Tant, CFO and Executive Director

And on the price/mix, you're right, around the 8% and you're right to assume that there is a tick up in the revenues from blu which obviously contribute to that. And I think Matt referred to that during the course of his presentation. If you look at what we're expecting from tobacco, it's much more in line with our historic norms, in fact, we exit numbers of the first -- of the Second Quarter and actually the step-up is not, therefore, that dramatic from where we exited Q2 and we've got quite a lot of confidence in the ability to deliver that given where pricing currently sits across the market.

Adam Justin Spielman, MD and European Tobacco and Beverage Analyst

It's Adam Spielman, Citigroup. Really quick question on the nic salt, many questions on the nic. Nic salt is (ameliorating) in the U.S. (inaudible)

Matthew R. Phillips, Chief Development Officer and Executive Director

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And yes, they will be getting into the U.S. They're going in liquid form in the next month or so. And they're going in pod form in July.

Alison J. Cooper, CEO & Executive Director

And on mix, Oliver?

Oliver R. Tant, CFO and Executive Director

On price/mix, I mean pricing has been, broadly speaking, in line with our expectations, which are -- they are second-half weighted. And from memory I think they were around sort of 2% to 3% and I'll come back to you on that, Adam. But where we have been more materially impacted is around mix where we've seen some element of product mix changes, to some large degree driven by excise duty and other events that have occurred across the markets in Saudi, for example, where we have seen excise duty absorbed across the markets in markets like France. And there has also been an element of geographic mix, which is, I guess, a feature of the industry, the rates of size decline will change the portfolio and its contribution period on period and that broadly equally weighted in terms of their impact in the first half.

Adam Justin Spielman, MD and European Tobacco and Beverage Analyst

If you think about how mix is going to go forwards, do you think it will -- as I said I understand the pricing is getting better, that is very clear and the IP factor drops out, that's very clear. But I'm wondering if you can talk about how you think whether mix will be as negative in the second half as it was in the first half orâ€

Oliver R. Tant, CFO and Executive Director

No. It ameliorates. It's because from -- for the market one and the product one actually ameliorate is quite significant in the second half.

Alison J. Cooper, CEO & Executive Director

Now your point about the portfolio, Adam, there are some specifics on portfolio in terms of product mix that come through. So Saudi is the standout example because of the doubling of the excise, clearly, the premium segment is under a lot of pressure, consumers are downtrading to the value segment. We're well positioned there. So it's a very good share performance for us. Though as everybody in that market, there's a mix hit from that because of the shift in terms of the consumer. But in most markets, we're very value-biased anyway. So it's not going to be a significant mix hit, in that sense, it's going to be one-off examples, like the one I called out in Saudi that's going to be more significant. Other than that, as Oliver called out it has a lot to do with some of the market mix impact in the first half which will ameliorate into the second half.

Yes, Jon?

Jonathan Leinster, Analyst

Jon Leinster, Berenberg. I have a couple of quick ones. On the currency minus 4 to 5, is that just translation or was that translation and transaction given for the full year?

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Oliver R. Tant, CFO and Executive Director

That's translation.

Alison J. Cooper, CEO & Executive Director

That'd go into translation.

Jonathan Leinster, Analyst

It's translation, okay. And secondly in terms of couple of -- on the gain on NGP, just to be clear you've obviously got second phase trials for the heated tobacco, I think previously you had said you wanted a product launch sort of by the end of calendar '18 or early '19, is that -- still remain the sort of broad timetable?

Alison J. Cooper, CEO & Executive Director

Matt?

Matthew R. Phillips, Chief Development Officer and Executive Director

Yes. If we choose to launch, that would be the timetable.

Jonathan Leinster, Analyst

And so on the oral, the sort of non-tobacco oral pouches, is that something developed for the European market, or is that -- and if so, is that purely going to go in Scandinavia or you are going to try and launch elsewhere in Europe as well or perhaps even America with FDA approval?

Matthew R. Phillips, Chief Development Officer and Executive Director

Absolutely. I mean it is broader than Scandinavia and -- but you are right if it was to be the U.S., it would need FDA approval. So we are mainly focused on non-U. S. markets, maybe put it that way.

Jonathan Leinster, Analyst

(inaudible) Non-Scandinavian markets?

Oliver R. Tant, CFO and Executive Director

Yes. We think it's an interesting opportunity.

Alison J. Cooper, CEO & Executive Director

Chas?

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Chas Manso, Analyst

Chas Manso from Soc Gen. So a question on your dividend policy. So a 10% growth in the interim and the Chairman's statements are supportive of saying always under review, can you just sort of give us a bit more color on what that means, does that mean that given that is so high and growing, you may consider changing it at any time soon or whether actually the board is giving its 100% support to the continuance of the 10% growth policy?

Alison J. Cooper, CEO & Executive Director

It's really a statement that says what it says on the tin really, which is any board's responsibilities are -- they do keep the dividend policy under review. As you've seen in the half year, we continue to have very strong cash generation, strong margins, we believe we're putting investment we need behind the business and therefore there is nothing further to comment about the policy but under review is really just the good discipline of the board to keep it under review, nothing more than that.

Oliver R. Tant, CFO and Executive Director

I think it is worthwhile noting, Chas, with 67.6% payout ratio is not high against the peer group. We're producing GBP 1.2 billion of debt paydown, doesn't exactly look like a group that's challenged for cash at the moment.

Alicia Ann Forry, Analyst

It's Alicia Forry with Investec. Just a few questions. I think in a statement you mentioned in H2 that you expect further share gains. Can I just confirm that you're referring to volume share here? And in light of the significant outperformance versus your markets that you've seen on volumes in H1, I was just wondering if you could talk about a little bit more about what's driving that, are you taking perhaps less price than some of your peers, is it just simply a factor of downtrading in your markets benefiting your brands? Just trying to understand what gives you confidence on the volume share gains to continue in H2 and possibly even beyond? That's question one. Then secondly, on the U.S. and the recent FDA letter to JUUL, just wondering if you've seen any fallout from that or had any change in dialog with the FDA regarding your myblu products in that market and what the implications are of that development there? And on NGPs, are you planning at some point to break out the financials as some of your peers do? Then finally, sorry for the long list of questions. And with regards to the earmarked assets for disposals and appreciate that there is a limit to what you can say. But if you could help us with regards to how you view possible dilution, what we should kind of prepare ourselves for?

Alison J. Cooper, CEO & Executive Director

Let's get off the first one very quickly the volume share we're talking about clearly with the improving price/mix dynamics we've got coming through Q2 at 4% as we see that improving through the second half as well that clearly moves into a good value performance as well. I'm going to ask, Dominic, can you -- briefly to comment on 2 markets, I'm thinking Russia and U.K., you pick. In terms of what's driving that volume performance, we talk about the market repeatable model and really it's the disciplined implementation of that. I can give you some examples where we've really driven the share and -- as I said earlier is around the brands, the portfolio focus. But also around the whole customer relationship dynamics. I want to be absolutely clear that some of the bit around always on price strategy on the MRM is about price parity to competitor brands in the market. There's been no investment behind that part of the wheel in 2018. So this isn't a price driven, I call it borrowing share when you use price to drive share because it's not sustainable and we are driving a sustainable focus on share growth. So I'll come back on that shortly. FDA, if you pick up on that, Matt. And either you or me can pick up on this point on dilution. Do you want to go and pick up briefly, think of a market. I'm thinking Russia, U.K. where it's worth giving a concrete example.

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Dominic Brisby, Division Director of Returns

Yes, I'll speak quickly about Russia and really Russia is an example. But it's pretty consistent with the way we're handling all the markets, which is very clear, very strong execution of the MRM and every aspect of the MRM. So in the case of Russia, we've massively strengthened our position in key accounts, we were always strong in independents, now we're very strong in key accounts. And actually a lot of the growth that we've delivered has come from our strong presence from these. And of course, key accounts are growing very much across Russia at the moment. So we're growing share within a trade channel that's growing significantly. We've simplified the portfolio very much, we used to have a big tail of quite small brands and we put big focus behind the brands as we see the biggest potential to grow, particularly value for money, international brands like P&S. And as Alison has said, we've made sure that price is a point of parity. But it's been nothing more than a point of parity. What delivered the growth has been our work behind brand equity and our strength of these trade relations that we've got in Russia and that's a pretty consistent story across most of the markets where we're growing share.

Alison J. Cooper, CEO & Executive Director

And we're using that to leverage blu now as well, yes.

Dominic Brisby, Division Director of Returns

Yes.

Joerg Biebornick, Unknown

I'm almost afraid, I can't offer a very substantially strategically different answers to what Alison and Dominic have already said, because it applies also to the U.K. Pricing is not the key driver for the share growth, our strategy is clearly a parity pricing strategy, we're in a positive position there that a lot of the pricing is now embedded as well. The share growth really has come from our investments in our growth brands, namely John Player Special. And we are very well positioned at the market-end where consumers are trading into and in our FCT portfolio, these are really the key 2 drivers. Then plus the sales execution, we've extended our sales coverage extensively and that's paying back. We're also very excited about the recent myblu launch, the consumer and customer reaction has been very strong, distribution is in line with the expectations and the initial consumer offtake is also strong. Thank you.

Alison J. Cooper, CEO & Executive Director

Thanks, Joerg. Matt, the FDA?

Matthew R. Phillips, Chief Development Officer and Executive Director

On the FDA, I mean the more interesting thing I thought about the tonality of the enforcement notice -- the enforcement wording that was used by the FDA was actually -- it was very positive towards vapour as a category. And that's great. From an enforcement perspective, I mean I don't know any more than you guys do in terms of actually what steps the FDA will take. We have always had very, very strong youth access prevention mechanisms and policies. So something that we completely endorse. And we're looking forward to working with the FDA to lift the standards basically if those that don't meet them currently. But in terms of our dialog with them, there's not been a change.

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 YTD Change(%): -100.0

Bloomberg Estimates - EPS
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Oliver R. Tant, CFO and Executive Director

And on the disposal program, I think one has to look at the disposals in the context of the strategic framework which is driving them. I mean our whole strategy since Alison's appointment has been around simplification, focus, focus, focus. Focus on key brands, focus on key markets, focus on next-generation product opportunities. And the real opportunity for us in profit terms is that focus, that simplification will drive both top line and bottom line performance. What we're doing therefore with the operations that we will be disposing off is really simplifying to ensure we deliver the stronger earnings profile in the longer term. So there may be some short-term dilution as we actually sell bits. But the longer term expectation is that the strategy focus, focus, focus will deliver a much better both the top line and bottom line performance. There will be no dilution.

Fulvio Cazzol, Equity Analyst

Fulvio Cazzol from Goldman Sachs. Just as a follow-up on that comment, I appreciate 12 to 24 months, things can change significantly. But if you had GBP 1 billion to GBP 2 billion coming in today, what would you be using that cash for?

Alison J. Cooper, CEO & Executive Director

It's an answer which unfortunately is not going to be very satisfactory because there are clearly -- the uses for cash are around the debt position of the business which we're still in the balance sheet rebuild mode following the U.S.. So that would definitely play a part. There's also clearly investment in the business. But at the moment, as we look at the current year, as we look at what we want to do next year, we are confident with the investment opportunities that we have in the funding of those investments. So there will be nothing incremental, I don't think at this stage that we would highlight that we would want to have put more money into. And clearly, that is the aspect in terms of shareholder returns. So right here, right now there's nothing, obviously, I think, different immediately, because we are adopting a very disciplined investment approach to what we are doing in next-generation products. And we do see the way we are looking to unlock this opportunity is something that will be smart and capital-light overall. So it's not a question of looking for more funds for investment in the business currently. So I think initially probably we just take a little bit of debt down to make sure we've rebuilt the balance sheet right here right now, if it was today.

Adam?

Adam Justin Spielman, MD and European Tobacco and Beverage Analyst

It's Adam Spielman again. Can you just talk in general terms a little bit more about tobacco heating both in terms of how you see the threat developing in Europe to the extent you do, where, what sort of customers or clients or consumers. And also in terms of the opportunity for you. So if you -- I guess if you can talk about it, first of all, from a tobacco point of view, the threat. But also then the opportunity. And I'm very intrigued by your comment, Matthew, that you said you may not launch a heating tobacco product. You implied, you still haven't made that decision.

Alison J. Cooper, CEO & Executive Director

Do you want to speak out about JUUL?

Matthew R. Phillips, Chief Development Officer and Executive Director

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So I mean our focus is vapour, we've been consistent on that for a while because in our markets where we had strong route to consumer, vapour is by far and away the bigger consumer category. And you're looking at the same number of vapours, for example in the U.K., or France, very similar number to the numbers of heated tobacco consumers. And so we see the opportunity as being a very, very real one on the vaping side. But we recognize that there may will be opportunities from a heated tobacco perspective. Now in terms of the times -- types of consumer, I suppose it's difficult to be stereotypical, I mean there is a suggestion that the heated tobacco consumers in Asia were particularly drawn to a menthol experience, for example. On the vaping side, it's broader than that, the flavors play a far broader role. And I think you've got, in our view, you've got vaping sitting as an opportunity that sits almost beyond heated tobacco, maybe I'll put it that way. So I think there's room for both, I genuinely do think there's room for both. But I still think the bigger opportunity for us is on the vaping side. But we want to have the optionality to launch heated tobacco if there is an opportunity -- if there is a more effective or realistic opportunity to go after.

Alison J. Cooper, CEO & Executive Director

And I think there's a consumer lens here which I think doesn't get discussed enough, which is well in the charts Matt talked to started with that standout consumer experience. We're beginning to see really good vaping experiences with a product like myblu, with blu ACE and really that's not really been in the market today, we've been focused with the assets we've accumulated to really perfect the consumer experience, we will keep perfecting that consumer experience. But we do see a very real opportunity getting that consumer experience right. We have not seen that happen in a way (together) in a market yet to see how that plays out with consumers and the choices that they make. But as Matt says I'm sure there'll be room for heated tobacco. But we very much see the opportunity -- the biggest opportunity for us in e-vapour.

Adam Justin Spielman, MD and European Tobacco and Beverage Analyst

Threat from heated tobacco, I mean let's be absolutely crystal clear about this, Philip Morris is saying that it's going to grow European market share by at least 2percentage points coming from IQOS. Now if that's right, that implies the European market will fall 2percentage points faster or worse than it used to. Now, that's a forecast. It may be wrong, it may be you think it's just complete nonsense, it may be you're quaking in your boots. Can you comment on it, please?

Alison J. Cooper, CEO & Executive Director

We look at the risk clearly and we have -- we are monitoring what's going on with IQOS in Europe, we're looking to understand the consumer behaviors where IQOS does get some traction which interestingly is the slightly more premium markets in Europe where it's getting some traction. But we very much are on top of it looking at the triggers where we might do something in terms of our portfolio. Currently, we think EVP is our focus in terms of providing that alternative NGP experience for consumers. But, yes, we're working on our heated tobacco offerings, we've got quite a broad portfolio of NGP offerings which we believe we've got to use should we need to, if some of these risks really come into play. But at the moment, we've got myblu going into market, we're very focused on the investment behind that. U.K. market, for example, IQOS has been in for a while, heated tobacco has been in for a while and vaping is very much the category that's growing with consumers and myblu, I think, has got a very important role to play there and it's got very significant opportunity similarly in other markets in Europe.

Adam Justin Spielman, MD and European Tobacco and Beverage Analyst

Is that a long way of saying you don't think Philip Morris will grow IQOS as much as they say they will in Europe.

Alison J. Cooper, CEO & Executive Director

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I don't really want to comment on that predictions, I don't have access to how they're thinking and forecasting things. All I do know is what we keep seeing in markets, the reviews that we are doing in markets and where we see the opportunities for us with our portfolio. And you have to keep remembering as well for us in many markets, this is very additive for our business. In some markets, we have very small shares and therefore we see from a consumer conversion perspective from smoking into NGP a big additive opportunity for Imperial which is a different starting point in a number of markets to other players.

Jon?

Jonathan Leinster, Analyst

Right. A couple more questions. First of all, with the collapse of P&H, do you actually see any disruption of costs in the U.K. market or is there any consolidation against you in terms of wholesalers. And secondly, going back to NGP and the way in which it's organized, some of the companies sort of originally set up a very separate organizations now seem to be merging it in just for a general knowledge point of view, how exactly are you doing sort of selling and marketing process? Are you keeping separate teams or you just got it all in with the rest of the tobacco products?

Oliver R. Tant, CFO and Executive Director

No. There's not much to say. We were working with P&H for some while before they got themselves into the sad position that they eventually ended up in. We had contingency plans in place that they have been worked through by the markets and the disruption was insignificant in the context of our business. They were well executed and outstanding performance from our U.K. team.

Alison J. Cooper, CEO & Executive Director

On NGP, the restructuring changes really driven by looking to leverage the strengths of the tobacco business. So when we first started looking at developing adjacencies to tobacco a number of years ago now. We initially set that up as quite a separate entity to make sure it had the space to really evolve and think about how we're going to really win in this space. As we've been stepping up through 2018, what we really want to do is now start leveraging the strengths within our tobacco business. So we look at it from a perspective of innovation, of the realization of that innovation, commercialization strategies and execution. Innovation we keep separate still and we incubate that in terms of a business that needs to be away from the distractions of actually how you actually get this thing to market and how you make it. The realization aspects now, we've now got a dedicated piece that sits within our manufacturing operations, clearly, tobacco manufacturing is not identical to e-vapour manufacturing. There's a lot of skills and principles, quality management, all those aspects that are very, very pertinent to what we're doing in the NGP space. The commercial strategy side in relation to blu, in relation to how we bring innovations to market. Again, that's a separate piece that looks at some -- that looks at that commercial strategy away from the tobacco side of the business. Then in execution, we actually have some different models at the moment. It's one of the areas we're testing out to some degree. The U.S. is standalone leveraging the sales force within ITGB whereas in the U.K. it is fully integrated, for example. So we got some different models that we're playing out and also potentially some models that wouldn't involve our own infrastructure, maybe distribution type model as well. So we got some different models where we're looking to learn from and see what works best in the market. But really looking to leverage where we have it, (particularly) the retail reach and key account reach we have in markets. That's broadly the principles around it. It's working well actually in terms of the business, it's really helping leverage the strengths that we have.

Yes, Fulvio?

Fulvio Cazzol, Equity Analyst

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Just a quick one. Are you able to give us your market share within e-vapour across the key geographies that you track?

Alison J. Cooper, CEO & Executive Director

No. No. I still don't know, because I'm not going to tell you it's because at the moment it's very early days in terms of the launches. But secondly, it's really, really difficult data to guess at. All you ever see is a tiny, very inaccurate Nielsen view of the world, particularly when it comes to the U.S., other markets is less inaccurate, which is at best 1/3 of the market. Visibility in terms of online sales, visibility in terms of the vape channel in particular, which is your other 2/3 of the market and those markets very, very hard to get a decent read. So something we're working on. But actually to get anything that's very accurate is actually quite hard to do.

Matthew R. Phillips, Chief Development Officer and Executive Director

I mean we don't really look at it in terms of market share, I know it's a way of measuring things. We look at it in terms of consumer numbers. So we will be able to talk more as we go through the year and the full year about the number of blu consumers that we brought into the blu franchise.

Alison J. Cooper, CEO & Executive Director

I mean U.K., U.S., you got a very substantial preexisting market. So -- but in a lot of other markets, it's about creating the categories about converting smokers, it's not just grabbing a share of an existing category, if you see what I mean.

Jonathan?

Jonathan Leinster, Analyst

Okay. So I've come up with a little list. So coming back to the price/mix point you say 4% in Q2, can we assume that the exit rates was higher than that. And in terms of do you need any more pricing to come through in the markets or with what's already been announced, you have enough to meet guidance. Then on downtrading. So downtrading environment in combustibles, given your portfolio skew that ought to benefit you. But until now anyway historically that hasn't come through for various reasons, competition got more aggressive down there. Could you perhaps comment on how you're feeling about downtrading starting to benefit you whether competitive intensity at the value-for-money segment has leveled off? And general question on NGP, I mean I think Matt started alluding to. But fragmented market at the moment, how does the industry rebuild entry barriers, particularly in vapour in your case?

Alison J. Cooper, CEO & Executive Director

Quickly on the first 2, yes, it was building through the Second Quarter in terms of price/mix and exit rate. In terms of pricing, vast majority is done and so there's not a lot we need to get additionally in H2. On the downtrading point, I don't think you can ever be complacent around the value for money category, everyone has strong brands there. My point I made earlier to Adam's question was more around that's been the bias of where we are for a long time. So it's not an additional mix push in terms of our portfolio apart from some specifics like Saudi. But everyone's got a strong positions in the value for money category and therefore I'm never complacent around the bottom-end of the market and some of the competitor activity which can go on, which is why we do have always on price strategy in the MRM, we will make sure in priority markets, that we do get the parity that we need, unless there's a really good reason why we want to back off that for some reason which we have done historically for example in the market like Ukraine, when we refuse to play. Then on NGP, I think, Matt, in terms of the barriers to entry?

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Matthew R. Phillips, Chief Development Officer and Executive Director

And I mean there is a few, brand is one of them, the innovation capabilities and pipeline are second, we had to keep moving the experience forward. When you're seeing everyone is aware of what JUUL achieved with a relatively simple innovation, which actually moved the market significantly. And so that's another area. And I think access to the consumer is a third barrier if you want to call it that, particularly retail. And you think about the retail channel which we are finding through our experience is now is a very, very important switching channel for consumers from combustible products to vaping. But there's not that many players that actually have access to retail. I mean and the fourth would be the sort of the science and the know-how that's needed to actually back all of that up and I alluded to it in the presentation, there are very few people that have got those capabilities to be able to actually meet the requirements of regulators to be bringing new products to market. So I've been saying for a while the barriers and if you want to call them that, the right to play is getting more stringent and that's good.

Alison J. Cooper, CEO & Executive Director

Well thank you, everybody, for joining us this morning and for the questions. And have a good day.

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