

Chief Executive's review



A strategy
that consistently
delivers

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Nicandro Durante
Chief Executive

2015 was further proof that our strategy remains the right one to consistently deliver for shareholders.

We delivered outstanding results in 2015, against a very challenging external environment and with significant adverse transactional foreign exchange rate movements.

Driven by a very strong second half of the year, with cigarette volume higher by 1.7%, total Group cigarette volume for the full year was down only 0.5%, to 663 billion. This was significantly better than the overall estimated industry decline of 2.3%. After excluding the impact of the TDR acquisition, organic cigarette volume decline was still ahead of the market at 0.8%.

Market share in our Key Markets increased by over 40 bps. This was driven by an excellent performance from our Global Drive Brands, which grew volume by an exceptional 8.5% and increased market share by 120 bps.

At constant rates of exchange, we grew revenue by 5.4%, adjusted profit from operations by 4.0% and adjusted diluted earnings per share by 10.1%. Excluding the significant transactional effect of foreign exchange on the cost of raw materials and leaf, adjusted profit from operations would have grown by approximately 10%.

Price mix of 5.9% was up from 4.2% in 2014. Underlying operating margin grew by around 160 bps, although on a reported basis it was down by 60 bps to 38.1%. This was largely due to the adverse transactional impact of unfavourable foreign exchange described above.

These excellent results in 2015 are once again proof of the strength of our strategy. They were achieved despite unprecedented adverse exchange rate movements and continuing pressure on consumers' disposable income.

Continuing progress in Next Generation Products

We are confident that Next Generation Products can deliver a substantial and sustainable commercial return to shareholders over the long term.

In 2015, we continued to grow market share of Vype, our e-cigarette brand, in the UK where we launched three new products and a range of new e-liquid flavours. We also expanded the geographical footprint of our Next Generation Product business beyond the UK, with launches of Vype in France, Germany, Italy, Poland and Colombia. Additionally, our first Tobacco Heating Product, the 'glo iFuse', was launched in Romania, with excellent initial levels of consumer acceptance.

We also continued our R&D focus on building a high quality pipeline of products across three distinct Next Generation Product categories – Vapour Products (e-cigarettes), Tobacco Heating Products and Licensed Medicinal Products.

Progress is encouraging and our ambition is to lead the category worldwide.

Our approach to better regulation

We have always been clear that we support regulation that is based on robust evidence and thorough research, that respects legal rights and livelihoods and delivers on the intended policy aims while recognising unintended consequences.

That is why, on issues such as the regulation of Next Generation Products, we have been working with governments and regulators to ensure appropriate frameworks are in place to protect consumers whilst ensuring proper marketing freedoms exist. This will help grow the category and meet the demand for less risky alternatives to smoking. An example of this work is our collaborative approach with the national standards bodies in France and in the UK to establish voluntary standards for Vapour Products (e-cigarettes).

With respect to plain packaging, we have always believed that the policy is not proportionate, will not deliver the intended results and will significantly erode our Intellectual Property Rights. Consequently, we have reluctantly taken legal action to protect shareholders' interests.

Our strategy continues to deliver

Since we updated the Group Strategy in 2011, we have seen the business continue to perform strongly. We have increased our share of the global cigarette market and significantly grown share in key market segments. Our Global Drive Brands have grown year on year, accounting now for 45% of all Group cigarettes sold (up from 34% in 2011) and they continue to be a key pillar for future growth.

In 2016 we expect the trading environment to remain challenging but our resilient business model has shown the Group is well placed to face future challenges. As such, I am confident that we have the right brands, people and focus on efficiency to enable the continued delivery of value to shareholders.

Nicandro Durante
Chief Executive