“Following our acquisition of RAI, and the progress we are making with NGPs, we can now accelerate our ambition to transform tobacco”

Nicandro Durante
Chief Executive
Leading the industry
The Group delivered another set of strong financial results in 2017, despite a challenging trading environment. Following the transformational deal in July 2017, these results benefit from the acquisition of Reynolds American Inc. (RAI) while also demonstrating the strength of the organic business. The Group has delivered outstanding returns to shareholders for many years. We recognise that the tobacco and nicotine industry has entered a dynamic period of change. Increased public health awareness, new societal attitudes and rapid developments in new technologies have all combined to create a unique opportunity to accelerate the delivery of our long-held ambition to provide our consumers with less risky tobacco and nicotine choices.

Since 2012, together with RAI, we have invested approximately US$2.5 billion in the growth of our Next Generation Product (NGP) business – comprising vapour and tobacco heating products (THPs). Following the acquisition of RAI, not only have we become the world’s leading vapour company, we have also significantly increased the size of our existing oral tobacco and nicotine business with the addition of leading snus and moist snuff brands in the US. Collectively, we refer to these products as our potentially reduced-risk products.

Our investments are now coming to fruition and, recognising that not all consumers are the same, we now have an unrivalled range of exciting and innovative products across the potentially reduced-risk categories – including, vapour, THPs, oral tobacco, tobacco-free nicotine pouches and moist snuff. With the increased size and scale coming from RAI, we are clear leaders in the potentially reduced-risk product space and we are confident of leading the NGP category. This year we generated NGP revenue of £397 million. On a full year basis, including the contribution from RAI, this would have been approximately £500 million and we expect this to double in 2018 to £1 billion, rising to more than £5 billion in 2022.

New Strategic Portfolio of brands
In light of the evolution of the business, with the addition of leading brands in the US, as well as the growing importance and progress of our potentially reduced-risk products, we have taken the opportunity to establish a new portfolio of priority brands – which we will in future refer to as our Strategic Portfolio.

This Strategic Portfolio comprises our existing GDBs, combined with RAI’s Strategic Brands (Carmel, Newport and Natural American Spirit). Also included is our portfolio of potentially reduced-risk products, including our key oral tobacco brands and NGP brands in vapour and THP. Further details can be found on pages 14 and 15.

From 2018, the Group will introduce a new metric called Revenue Growth of our Strategic Portfolio, replacing the Global Drive Brand (GDB) & Key Strategic Brand (KSB) volume growth metric. To provide the comparator against which 2018 will be measured, Revenue of our Strategic Portfolio in 2017 would have been £16,711 million assuming we had consolidated RAI for a full 12 months and after recognising the impact of implementing the new accounting requirements of IFRS 15.

Strong results across our portfolio of products
Notwithstanding the good progress we are making with our potentially reduced-risk products, combustible cigarette products remain at the core of our business – delivering growth today and providing the funds required for investing in the future. I am therefore pleased that 2017 saw the Group yet again deliver another good performance.

The Group’s cigarette market share in its Key Markets continued to grow strongly (up 40 bps). This was powered by another excellent performance by our GDBs, which grew 110 bps (ex US) and now account for more than 50% of Group cigarette and THP volume outside the US. Over the year, market share in the US also grew strongly and was up 20 bps, with the RAI Strategic Brands growing 40 bps.

Total Group cigarette and THP volume grew 3.2% to 686 billion, or on an organic basis fell 2.6%, outperforming the industry, which was estimated to have declined by around 3.5%.

In 2017, we also made excellent progress with our NGP business. Our flagship THP, glo, first launched in Japan in December 2016, reached 3.6% market share by the end of 2017 – having been rolled out nationally from October 2017. Since then, 50% of the overall category growth in Japan has been from glo – demonstrating its strong consumer appeal in a very short period. Good initial progress is also being made in our other launch markets of South Korea, Russia, Canada, Romania and Switzerland.

In the vapour category, Vype is now present in nine markets and we remain the market leader in the UK, with Vype and Ten Motives combined delivering around 40% share of measured retail in December 2017. We also lead the vapour category in Poland. In the US, the Vuse range of products continues to have a significant presence in the market. We see the rapidly developing vapour category, as a whole, contributing significantly to our long-term growth ambitions in NGPs.

The Group’s financial performance was positively impacted by the accounting for the acquisition of RAI and the subsequent US tax reforms. These drove diluted earnings per share up by over 600% to 1,830.0p.

However, while trading conditions remain challenging in a number of markets, including ad hoc excise increases and increasing illicit consumption, 2017 again saw the Group deliver on its high single-digit earnings growth commitment on an adjusted basis, increasing adjusted diluted earnings per share by 14.9% to 284.4p, or 9.9% at constant rates of exchange.

Group structural changes
Having the right organisational structure will set us up for continued long-term success as a truly global multi-category business, with NGPs embedded at the core.

With the NGP business set for significant expansion and growth, we decided to integrate it into our existing geographic structure. This has enabled us to begin fully leveraging the scale and expertise of the whole Group to drive growth in an area that is fast becoming a key part of our core business.

In order to address the key opportunities and challenges we face going forward, we recognised the need to ensure the combustible business operates even more efficiently than ever before. To achieve this, we created three new regions – Americas and Sub-Saharan Africa; Europe and North Africa; and Asia-Pacific and Middle East – in place of the previous four.

The creation of these three new regions has simplified the existing structure by rationalising the complexity and scale of existing direct reporting business units (DRBUs) and has pushed decision making further down the organisation by creating fewer, larger DRBUs. These changes took effect from 1 January 2018 and the revised regional structure will therefore form the basis of our reporting going forward.

To facilitate these changes, we created the new role of Chief Operating Officer for the International business – reporting directly to me and managing our global business outside the US. The President and CEO of RAI also reports directly to me and leads our business in the US – reflecting its scale and the importance of ensuring a smooth integration that does not impact ongoing business delivery.

Confidence in future growth
The Group’s results in 2017 are testament to our commitment to delivering strong results for shareholders whilst at the same time investing substantially in the long-term future of the business. Following our acquisition of RAI, and the progress we are making with NGPs, we can now accelerate our ambition to transform tobacco. With the right people, products and strategy we are ideally positioned to deliver greater choice for our consumers, potential benefits for society as a whole and long-term sustainable value for shareholders.

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Chief Executive