Finance Director’s overview

“These financial results illustrate the ongoing strength of the Group – delivering against the financial objectives whilst investing for the changing environment”

Ben Stevens
Finance Director

Another set of good financial results

The Group delivered another set of good financial results in 2017. Whilst the results are dominated by the inclusion of RAI as a wholly owned subsidiary since the acquisition date of 25 July 2017, the Group continued to perform well on an organic basis.

The Group’s results continued to benefit from the weakness in sterling which, due to the Group’s operating results being predominantly delivered in local currency and converted to sterling for reporting purposes, acted as a tailwind of 4%.

Increased revenue and profit from operations

Revenue grew by 37.6%, or by 2.9% excluding the impact of acquisitions and excise on bought-in goods, and on a constant currency basis. This was driven by pricing and the growth of NGPs, notably in Asia Pacific, more than offsetting a decline in organic volume.

Profit from operations was up 39.1%, as the inclusion of RAI and growth in revenue more than offset the marketing investment in NGPs, the amortisation of acquired brands and costs incurred as part of the Group’s restructuring programme.

Adjusted profit from operations on a constant currency, organic basis was up 3.7%.

A full reconciliation of our results under IFRS to adjusted revenue and adjusted profit from operations is provided on pages 218 and 219 of the Annual Report and Accounts.

All regions performed well (as described on pages 42 to 47 of the Annual Report and Accounts) on a constant rate basis, in challenging conditions. Asia-Pacific delivered an increase in adjusted profit from operations whilst supporting the roll out of NGPs in Japan and South Korea.

In Americas, adjusted profit from operations was up as growth in Canada, Chile and Mexico more than offset the continued economic challenges in Brazil. Transactional foreign exchange headwinds and difficult trading in Russia, GCC and South Africa led to adjusted profit from operations in EEMEA being marginally lower than prior years. In Western Europe, adjusted profit from operations was up driven by Romania and Germany.

Operating margin increased, with net finance costs and tax impacted by the RAI transaction

Our operating margin increased by 270 bps, driven by the performance of the organic business and by RAI, which had a positive mix effect on margin, and partly due to the US$70 million synergies achieved by the year end. Organic adjusted operating margin increased by 40 bps.

Net finance costs grew as the Group incurred an increase in borrowings to support the acquisition of RAI. Our banking facilities require a gross interest cover of at least 4.5 times. In 2017 this was 7.8 times (2016: 12.2 times).

Due to the change in reporting of RAI as a wholly owned subsidiary following the acquisition, the Group recognised a deemed gain of £23,288 million on the deemed disposal of RAI as an associate. Our material associate, ITC, continued to perform well.

Due to the impact of the deferred tax credit (£9.6 billion) arising from the US tax reforms, our tax charge was a net credit of £8,113 million, being a tax rate of 27.4% (credit) compared to 22.5% (charge) in 2016. This is also affected the inclusion of associates post-tax income, in our pre-tax profits. On an underlying basis, excluding such impacts and the affect of adjusting items, the tax rate was a charge of 29.7%, a marginal decrease on 2016 (29.8%).

Continuing strength of cash flow generation

Net cash generated from operating activities grew by 16.0% to £5,347 million, largely due to the cash generated by RAI subsequent to the acquisition, the profit from operations earned in the period from the rest of the Group and a reduction in inventories. This more than offset an increase in receivables, reduction in trade and other payables, the payment of the 2017 liability related to the Master Settlement Agreement (MSA) in the United States and the final quarterly payments in relation to the Quebec Class Action.

Adjusted cash generated from operations (as defined on page 222 of the Annual Report and Accounts) was £3,282 million, an increase of 5.4%, or in line with 2016 on a constant rate basis. This increase was impacted by the timing of the early payment of the 2017 MSA liability, which is tax deductible at 2017 tax rates. Excluding the timing of this payment, adjusted cash generated from operations would have increased by over 45%.

Based upon net cash generated from operating activities, the Group’s cash conversion ratio decreased from 99% in 2016 to 83% in 2017. Operating cash flow conversion ratio (as defined on page 221 of the Annual Report and Accounts) fell from 93% to 79%.

Excluding the timing of the payment of the 2017 MSA liability, our operating cash flow conversion ratio would have been 96%, ahead of 2016 (93%), and reflecting the Group’s ability to deliver cash from the operating performance of the business.

Delivering in a period of change

These financial results illustrate the ongoing strength of the Group – delivering against the financial objectives whilst investing for the changing environment and managing the various challenges that working in a global business bring.

Ben Stevens
Finance Director