“Pricing and value share growth in combustibles, as well as increased Vuse consumables volumes, has more than offset total volume declines”

Ricardo Oberlander
President and CEO (RAI)

Volume and Market Share

The cigarette industry was estimated to be around 4.5% lower in 2018 partly due to the impact of higher fuel prices on disposable income, the growth of the vapour category and the full year effect of the change in excise in 2017 in California. The decline moderated in the second half of the year, from 5.3% to 4.1%.

In 2018, cigarette volume from the US business was 77 billion sticks, which represents an increase of 118% due to the recognition of a full year’s volume from RAI. On a representative basis, this was 5.3% lower than in 2017, with market share declining 20 bps, as continued growth in market share in Natural American Spirit (up 20 bps) and Newport (10 bps higher) and stable Camel share was more than offset by lower market share in Pall Mall (down 20 bps) and declines in the remainder of the portfolio. US volumes were further affected by a strong comparator due to Camel and Newport product launches in the first six months of 2017. Total value share grew 25 bps driven by the performance of the premium brands.

The US vapour market experienced strong growth (up approximately 120% in volume terms) which the Group estimates has contributed to a total volume decline in cigarettes of 0.7% during 2018. While new competitor vapour brands have taken market share, Vuse continued to grow volume of consumables (cartridges) by 36%, on a representative basis, with distribution of Alto reaching over 70,000 outlets, which is estimated to be approximately 70% of the retail universe. Performance was negatively impacted by a product recall, of Vibe, arising from a few isolated issues which have been resolved.

Oral volume declined 2.3% on a representative basis, with market share down against the prior period which, on a representative basis, benefited from a competitor’s product recall.

During 2018, the US Food and Drug Administration’s (FDA) regulatory proposals contributed to increased uncertainty in the US operating environment. Given our long track record of success in the face of regulatory change in the industry, and our strong portfolio of brands, we are confident in our ability to manage the proposals noting that any FDA regulation or proposed ban of menthol in cigarettes must be developed through a comprehensive rule-making process, be based on a thorough scientific review and consider all unintended consequences in order to withstand judicial review.

In 2017, the FDA accepted and filed for substantive review the Modified Risk Tobacco Products (MRTP) applications for Camel Snus, which were subsequently provided with a favourable recommendation from the Tobacco Products Scientific Advisory Committee (TPSAC). There is no timetable for the FDA to issue a decision on the MRTP applications, however, the Group anticipates a decision during 2019.

In 2017, in the period since acquisition, cigarette volume was 36 billion, outperforming the industry with total cigarette market share at 34.7%, up 20 bps on 2016. Newport and Natural American Spirit continued to grow market share driven by the investment into the trade and, together, were the fastest growing premium brands on the market. Camel market share increased due to the performance of the menthol range. Pall Mall market share decreased due to the price competition in the value-for-money category. Combined, the US strategic combustible portfolio grew market share by 40 bps in 2017. Volume of moist snuff was equivalent to 3.2 billion sticks in the period since acquisition. Total moist market share was up 100 bps on 2016 to 34.4%, primarily due to the performance of Grizzly in the moist snuff category, benefiting from its strength in the pouch and wintergreen categories, as well as the recent national expansion of its Dark Select style and the limited edition packs.

Revenue

Reported revenue was £9,495 million, an increase on 2017 of 128%, largely due to the 12-month inclusion of results from RAI, compared to approximately five months in 2017.

On a constant currency, representative basis, adjusted revenue was up 1.5% as pricing in both the combustibles and oral categories and higher Vuse consumables volume more than offset the reduction in combustibles and oral volume (noted above).

Revenue in 2017 on a representative basis included £94 million of revenue recognised by RAI related to the sale of inventory associated with the international brand rights of Natural American Spirit. *Excluding the revenue related to the sale, adjusted revenue would have increased by 2.5% on a representative, constant currency basis. Revenue from vapour grew by 149% to £184 million, an increase of 20% on a representative, constant currency basis. @Excluding the impact of the recall related to the consignment of batteries noted above, management estimate the increase would have been an increase of approximately 32%.

In 2017, revenue was £4,160 million in the period since acquisition. Prior to July 2017, RAI was an associate and no revenue was recognised by the group in the periods previous to the acquisition.

Profit from operations

Reported profit from operations was £4,066 million, an increase of 244% on 2017, largely due to the full year’s inclusion in the Group’s results. Excluding adjusting items related to Engie and integration costs, profit from operations was £4,511 million, an increase of 1.8% on an adjusted, representative basis, or 5.8% excluding the translational foreign exchange headwind. This increase reflects the growth in revenue from the portfolio and cost reductions since the acquisition of RAI.

Cost synergies are progressing well, with annualised savings of over US$300 million delivered to date. The Group continues to expect to deliver over US$400 million of synergies by the end of 2020.

In 2017, profit from operations was £1,165 million in the period since acquisition. Profit from operations was impacted by the FDA user fees of £62 million and product liability defence costs of £59 million. Additionally, £865 million was incurred as part of the State Settlement Agreements, with £109 million in credits recognised as part of the non-participating manufacturers’ (NPM) adjustment claims. The US business also incurred other costs that relate to adjusting items, including the Engie progeny cases, tobacco-related or other litigation and other costs associated with the integration with the rest of the Group. Adjusted profit from operations at constant rates was £1,827 million for the period since acquisition.