Imperial Brands

JP Morgan Consumer CEO call series

Fireside Chat with Stefan Bomhard CEO and Philip Spain, JP Morgan

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Operator

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I would now like to turn the call over to your host from JP Morgan, Philip Spain.

Philip Spain [PS]

Thank you very much, operator and good afternoon, everyone. My name is Philip Spain and I work in the European Staples research team at JP Morgan and covering, amongst other subsectors, tobacco. Many thanks to all of you who've dialled into this session.

I'm delighted today to host the discussion with Stefan Bomhard, CEO of Imperial Brands. Good afternoon, Stefan. Thank you very much for being with us today on a busy results day.

Stefan Bomhard [SB]

Philip, thank you for the invitation. As you say, it's a special day for us today because we reported today our half year results and I'm sure we're going to come to it. We're quite excited because as you'll see the results have been very well received as we speak, and looking at the share price it was up about 5%. But I think it’ll lead to a good discussion today and the team are really looking forward to our conversation.

[PS] Yes, absolutely, it was a very solid set of results and of course you also reiterated your guidance for the full year as well and for the midterm. Maybe that's where we can start just around the guidance for fiscal 24 and I suppose what gives you confidence in your expectation for a stronger performance in the second half given I suppose the ongoing challenges in the US cigarette market. And as well, maybe some potential risks in terms of volume elasticities given the strong price increases you brought in in the first half.

[SB] Absolutely. Philip, I mean the key thing what gives me and the management team confidence in the second half and many of the things that we're seeing in the first half, you refer to strong pricing. We've taken some important pricing action the first half where we'll see the full benefit in the second half of the year. And you would have seen that in the first half our pricing more than overcompensated the volume declines that we've seen that led to the 2.8% net revenue growth of the business, which was our best in more than 10 years.

I think the, and look, we will logically also continue to always look at our pricing in the second half as well. So, and we're not expecting a material change in the underlying volume trends of our industry in the second half so that's not something we're counting upon.

The only thing I probably would call out, which are some of the headwinds that we experienced specifically in the AAACE region, so this covers our Africa, Middle East, Australia, Asia region, they will become less so, but specifically the first half year that region logically you have the challenge of the Red Sea crisis, supply chain disruption and the overall turmoil in the Middle East.

So that is probably the one region I would single out where in the second half you would see a better performance than in the first half. So overall I feel very comfortable.

And the last point I would just add that we had a very good performance in the first half on NGP. We reduced our losses versus the year ago and we will continue to see that trend in the second half and that also will make a contribution to the profit delivery in the second half.

[PS] That's very clear and maybe also just given you reiterate the medium-term guidance looking beyond fiscal 24, I mean the early years of the medium-term plan have seen very strong execution, but nonetheless there have been challenges. We touched on the US but also opportunities across your markets as well.

What gives you confidence in achieving your targets to 2025 and within, I suppose, your performance to 2025 how much do you expect NGP to contribute to those targets?

[SB] Yeah, I mean, I think you touched upon it. I think what is great to see when I, as we're sitting here, half year results our fiscal year 24, we are now three and a half years into our five-year strategic plan, and for three and a half years, we've now reported our delivery on the operational targets and the financial targets. So, I think we are building a track record as a company which is different from where we started in fiscal year 21.

I think that overall, that increases my confidence that on the final stretch, the final one and a half years after three and a half years, we will deliver it as well. And I think the confidence for me comes from the fact, if I reflect in the last three and a half years, Philip, there wasn't a period of time that there weren't extra challenges that we didn't foresee when we laid out the strategy.

I mean, we both know the level of inflation and nobody could see that in fiscal year 2021, the reality the impact it had on consumer spending overall, a constant stream of regulatory changes, the exit of Imperial out of the Russian market that we were one of the players of our industry to exit ourselves from.

So, it's not that we haven't seen in these three and a half years some clear changes or disturbances to our programme, but I really believe we have now the right momentum on our side.

And, if you then look at it more practically, number one what will drive performance going forward…our core business that is now clearly in very different shape versus where it was at the beginning of the strategy. We have delivered to move to holding share or gaining share versus being the number one share donor before we start to the strategy with that. And we have now proven that with the improved brand equities of our brands, the better sales execution, we can take pricing to an extent that we weren't able to take before.

But also, what is now nicely contributing to the picture is the NGP business, where we have said at the end of fiscal year 25, our NGP business will be a different sized business from a net revenue perspective, but also will be a business that will be at break-even point.

So, from a business perspective, quite a number of things that are moving in the right direction. And the only point I would add which we haven't spoken about so far is our strategic plan included a lot of self-help opportunity from an efficiency perspective where we have a lot of duplication in the business, a lot of inefficiencies in the business that we are now step-by-step eliminating and floating at least partially to the bottom line.

So, what excites me, the final one and a half years of our delivery in the strategic plan, don't rest on one pillar deliveries. There are several pillars that will drive that performance, which hopefully will also allow us - should there be any further headwinds from a macroeconomic perspective in the remaining one and a half years - that we will be able to deal with it the same we've dealt with it in the last three and a half years.

[PS] Absolutely. OK, that's very clear. And, I mean, you touched on it there and I suppose you've also spoken about it extensively over the last few years in terms of those five must win markets, which together account for 70% of your tobacco profits.

Can you maybe just talk about the progress you've made so far in those five markets high level. It would be great to hear where you see yourself in the journey in in those markets individually and overall, and I suppose where you see the key risks and opportunities for market share going forward as well.

[SB] Absolutely. And you pick on one of the central themes of our strategy. Imperial is unique and it's a reflection of our smaller size that virtually five markets drive more than 70% of our profitability. Which was one of the key drivers of change that we say we need to focus on these top five. If we move them in the right direction, it will make a material difference to our results.

To be clear, as a management team it is also easier to stay very close to 5 vs. when you have to stay close to 10 or 20. But I think what's also important, that when we planned out our strategy the financial model is based on us holding our share, maintaining the share as an aggregate between these five markets. So, the ambition is not to grow share in these markets consistently. If we achieve it in 1,2,3 years fantastic. But what we're looking at as a business is when we add them together, we want to hold our share - that is the underpin of our strategy because this is a highly competitive industry.

You know it now very well. This is not an industry where you can consistently gain market share at the expense of your competitors. But we've really managed the portfolio. What we've done so far, which I think is exciting, we've typically grown three out of five markets. So, when you look at today's results, we've grown it in the US, which is our largest market. We've grown it in Spain and in Australia. At the same time, our market share was down in Germany and our market share was down in the UK.

So, as you ask, what has changed? So just to go to the details of your question, Philip, I think what's really changed for each one of these five markets we defined some very clear must win battles and they - to certain extent - fall for a classically consumer goods company into two buckets. There are marketing decisions and marketing brand equity investments - investments in innovation on the brands - and there are sales investments.

As in our industry, having worked across quite a number of different consumer goods industries, given how important the point of sale is in our industry, these salesforce investments are more important than in many other consumer goods industries. And here historically we have under invested the same way we have under invested in many of our brands in the brand equities.

So, what we've done, to stay with the US example as our largest market, we've invested in brands like Winston and Kool, our most premium brands which historically lost share year on year because of under investment. And now both brands when we look in aggregate are typically holding share, or, for example in the case of Winston also gaining share.

At the same time, we've looked specifically at our salesforce investment in the US since we started our programme. We've invested in increasing our sales force size in the US by 30% versus where we started. And at the same time, we've also invested in key account capabilities which was something that was underdeveloped at Imperial. And as the market has switched, this is something we feel is becoming an important element of the industry and talking about the US but also a number of other markets.

At the same time, we also have invested in better technology for our salesforce. So today we're using many of our market salesforce which gives our sales team when it hits the store that information about our own assortment, sales sell out but also competitor actions that have taken.

So, what you hopefully take away is quite a number of different levers that we're using to allow us to get to a better performance and they're proven tools in the consumer goods industry. But I see that also as a self-help opportunity to drive our performance to a different level.

What I think is important to mention in this, we talk a lot about share and it's often in analyst discussion a key focal area. But we are a team of business people. Fundamentally, we're talking about share because this is where a significant part of the value creation opportunity in our industry sits. And therefore, this focus for us to manage our share in the right way is a key ingredient that allows us to to increase profitability of this company on a year-by-year basis. So, from that perspective that's important.

And therefore, let me also give you another example which illustrates that point, which is the United Kingdom. As we're all sitting in the UK, we had two great years on market share growth in fiscal year 21 and 22 in this strategy. But last year and this fiscal year in the first half, we took a deliberate decision to actually increase prices in order to create the right value for our shareholders. And, as a consequence of that have accepted that we were giving away some market share. But that gives you hopefully the evidence that we're looking at the business as a portfolio and we're doing it in order to try to see overall more attractiveness of our business to our shareholders.

[PS] OK. And maybe when we zoom in on some of the markets - those five markets specifically - and maybe starting with the US, I mean it's been a challenging cigarette industry in recent months, and clearly, you've been a winner within that relatively and you've been outperforming. But do you think anything has structurally changed in the market that’s driven the weaker volumes and the accelerated down trading and how significant do you think illicit vape is in terms of driving the industry volume declines?

[SB] Yes. Our assessment is that the fundamentals of the US market have not changed. If we really step back, one thing, what makes the US and also Germany very attractive markets in our industry is the relative affordability of the product. Now this might not apply if we go back, we both go to the JP Morgan head office in New York. But if you look at where the bulk of consumption of tobacco happens in the US, cigarettes continue to be very affordable.

And that is one of the key drivers of the penetration of industry and also the ability for the industry to continue to take price. However, you're very right. In the last 18 months, we have seen two factors that have led in our opinion to a temporary higher level of volume decline than usual. And as you will know, they're all common with our peers that these two factors are: number one the macroeconomic pressure on consumer spending. We clearly see that at an elevated level as consumer disposable incomes have actually clearly post COVID with the inflation that US has seen specifically with the target group of our categories. And we are clearly seeing that consumer squeeze at an elevated level and therefore that has led to higher level of decline in the volume rates.

The second factor is the the impact of illicit disposable vapes also flagged by our peers. We've seen in the US at this point in time a very significant growth of a category that actually shouldn't be there because it's not per the FDA rules, it's not there. But for lack of control at this point in time, this is a segment that clearly is taking consumers out of the cigarette market.

Our expectations, when you look at the rest of typical things, so the secular decline rate, price elasticity - we track them on a monthly basis, and we don't see any changes in these two. So, which means, once the macroeconomic pressure is easing, I think we should see a slight improvement in the decline rate and we are seeing that inflation is improving, employment rates high.

So, I think when you look at and I can't tell you when, but it should have a positive impact on the market size decline rates. And at the same time, you will know very well there's a lot more noise about enforcement at the national level as well as the regional state level against illicit vapes.

So, we'll see what difference that makes. But we do believe that should also help the market size development over time. And as you very nicely stated in this context, at the same time we are the one among the three bigger players in the industry that continues to gain share. And I think we are fundamentally well positioned with our portfolio in the US.

Reality is when we started the strategy, we had a market share below nine per cent. We're now well established in double digit territory and the key driver is that investment in the brands, the investment in our sales force, but also our brand portfolio that has a brand at every single price point in the US market. So, from that perspective I think we are in a good place, and we'll weather out the market size decline in the US in the right way,

[PS] Yes, absolutely, and maybe just moving in the US as well to the cigar business and I think we've seen some green shoots there. Certainly, some improvement was shown in the first half results which you reported today. What is supporting the improved performance here? What have you been doing to support that business?

[SB] Yes, we're clearly seeing an improvement in our US mass market cigar business. Last year was a transition year, last year was against a period where the COVID drove a very significant growth in the mass market category as consumers stayed at home and perhaps their disposable income could be spent on mass market cigars.

As the COVID period ended, you saw a very significant market size decline. And to be clear, we own the most premium brand in the mass market cigar category with Backwoods. That's a wonderful brand, but it's also a very premium brand. So, clearly the market share of Backwoods last year was under pressure in the context of consumers not being able to afford any longer the most premium brand in the marketplace.

What I think is exciting when you look at half year results in fiscal year 24, I think what we're seeing is Backwoods return back to a much more normal pattern. The market share is absolutely in a better place. At the same time, the decline rates of the industry have been less than it was before. To be clear it's still declining meaningfully because of the consumer spending pressures that I've talked before.

But if I step back I feel very good having left the transition year of '23 behind us. I really feel good about our portfolio with Backwoods. What doesn't change is one of the most attractive brands in that entire market. And also from a volume decline perspective, you have to assume that the volume declines in MMC will be lower than in FMC.

[PS] OK. And moving then to Germany. So, this has been I suppose a tougher market for you to crack from a market share standpoint. But while share declines are ongoing, we did see a sequential improvements in the performance in the first half results today.

What do you think is supporting the more encouraging signs that you're seeing here and when do you think the efforts that you're making in the market will fully bear fruit so that you'll be realising a stable share?

[SB] Yes, absolutely. I remember when we launched the Capital Markets Day in January 21, the strategy, I was asked which of the five markets would take the longest to turn the share around. And I told them, I think it's going to be Germany. And the reason is that was the one where the market share had declined for more than 10 years prior to that. And unfortunately, I wasn't proven wrong.

So why is this? Because the reality is if you look at that, what were the core drivers, it is a very attractive market. You have a lot of competitors in the German market. We had seriously neglected the brand equities in the German marketplace more than any of our competitors. And on top, our salesforce has been reduced over time. The attention to our sales execution wasn't there. So, from that starting point, I think it was clear that would take probably the longest.

But what is exciting now as we covered this morning, we've moved from losing typically 70 to 80 basis points market share last year, fiscal year '23 80 basis points, to at this half year only 25 basis points. So, a very material improvement. Now we're still in share loss territory, but we're moving in the right direction.

Now, as you ask what are the key drivers? Interestingly, the same tools that we're using in many of the other markets – our must win battles. Number one, probably the one that has the biggest impact is truly the rejuvenation of our salesforce. We have increased the number of salesforce in Germany - that is still market where salesforce is very important covering many different channels that exist in the German market.

And I think we've also professionalised our sales force in Germany with better tools, new hires into the organisation. Reality is, to speak frankly, rejuvenating a salesforce in Germany takes longer for a variety of reasons than it would take in the US. So that's why this has taken longer.

The same on the brand side, I think we're starting to see some green shoots also depending on the relative brands. But I think after many years of under investment, the reinvestment, some of our brands are starting to show the first green shoots. But to be clear, Germany is still one of the most open markets from an advertising perspective. Therefore, under-investments have a bigger impact there versus some other markets. So that will take longer.

But I think what is exciting to see is in our portfolio, 5 markets, because that's how we managed the business, we've been able to manage to hold share or gain share in all those three and a half years. What is exciting for me is that Germany has been the one that perennially took us down in the three and a half years is now starting to move in the right direction. But please do not ask me when it will turn positive because it's a very competitive market. It will also depend on what the peers will do in the German market.

[PS] Oh, well we look forward to seeing the stable share one day. So, in terms then of your other three core markets of UK, Spain and Australia. Do you think these are businesses where the pricing and margin expansion is sustainable over the longer term? And particularly thinking about the UK and Australia which are some of the least affordable cigarette markets in the world and we've seen volume under pressure in those markets in particular for a few years now.

[SB] Absolutely. Let me deal with them in two groups. There's the group with Spain and there's the group UK and Australia. Let's start with Spain, one of our top five markets. I mean Spain is a very exciting market, has very affordable pricing in the marketplace and I think historically from a company perspective a less attractive market because the industry didn't take pricing in that market which meant its gross margin/ trading margin was below many of the other markets in our top five.

But what has happened since we launched our strategy, we've seen price increases in the Spanish market. So, we've seen in the last two to three years price increases have happened which wasn't the case before, which inherently makes the Spanish market now more attractive.

At the same time, our focus on local brands, we bought the local monopoly many years ago and therefore own a disproportionate share of local brands in this market and us reinvesting back in these local jewels has allowed us to gain market share every single year in Spain.

So, in principle, we have here a real sweet spot, a market that is very attractive, so market size declines are very low because of relatively very affordable pricing, a very low level of NGP penetration. And we have a very good portfolio of brands and we're now taking pricing. So, on this one, the answer is very clear. Spain should be able to contribute to our profit for many years to come.

I come to the second group of Australia and UK. They clearly from a pricing perspective, both operate today, a pack of cigarettes in both markets for a smoker is significantly more expensive than in Spain and Germany or the US. But we hold some very good positions in these markets, and both will remain two important profit contributors to Imperial.

And in our 2021 strategy, when we launched it, we took quite a cautious approach on what these markets could deliver because the fact that cigarettes prices were already much higher than the other three was already there in 2021. So, it's not a surprise to us.

We are overall very optimistic about the continued value creation from these markets. So, if you look structurally, we're holding good positions, good brands, we're reinvesting our brands when we could, we have reinvested in sales capabilities. I really feel they will continue to make a good contribution to our overall top line as well as bottom line delivery.

And just to round it out in this one, we shouldn't forget our overall tobacco net revenue growth was 2.3% including these two markets which is the highest it has been an Imperial in quite a number of years.

[PS] That's very clear and maybe then just moving away from the core markets to your markets beyond that I mean you have strong positions in a few of the African markets as well as Central and Eastern Europe. Can these markets be meaningful contributors to growth at a group level, do you think their long-term growth rate is better than that of your core markets.

And how do you think about the downside risk here to the cigarette industry should NGP penetration accelerate in in those markets?

[SB] I mean we're convinced they can make a meaningful contribution for the growth of Imperial, and it is these markets outside the top five. I mean when we launched the strategy, we actually created a region to specifically serve these markets which is our AAACE region which combines typically the African, Central and Eastern Europe, our Asian and our Middle Eastern markets.

And I think what is exciting as we now got the real handle on that top five, we have increasingly been able to turn our attention to these markets. And there are some very attractive markets in there where I think we have, there's a lot of self-help opportunity for Imperial.

You touched on one point and look there is, they're at different stages of development. Like if you look at the African market say, the penetration of NGP is virtually nil in all of them. It will come over time. So, you have different dynamics, but I think then if you look at Central and Eastern Europe, you have some very high penetration levels of NGP already.

But I think what is exciting is we doing the same model we've done for the top five must win battles, what is the focus area. So virtually for all of these clusters/ markets, we've now developed their specific must win battles where we are investing behind, and I think it's exciting the progress we've made.

I mean half one fiscal year 24 saw a bit, some significant headwinds, specifically in the Middle East. But if you look at the numbers in fiscal year 22, I think profitability of these markets grew by 6%, fiscal year 23 by 16%. So, if you really look at it, you can already - it's not about the promise of the future - you can already see the difference they're making.

And importantly, they include Central and Eastern Europe where we've grown our NGP business by 300% in the first half year of this year. So, I believe these markets have absolutely the opportunity and potential in Imperial now under very clear, clarity about their role to make a positive contribution to the top line performance of the company, the bottom line performance of the company and our future NGP growth strategy in the markets where NGP is relevant.

[PS] That's very clear. And so I think we've covered uh quite well the tobacco side of the business. So maybe moving to NGP. Maybe to start, how important is scale to achieving strong margins in this side of the business over time and looking to the long run, what do you think is a reasonable EBIT margin that you could achieve in NGP given your challenger approach?

[SB] From our side, about achieving a sustainable and profitable NGP growth or business is important in the long term for us. It's very clear, that when we wrote the strategy, it was one of the three strategic pillars and delivery of the business.

And I think what's important here, we've chosen a different approach to our peers. We, we see ourselves as a challenger in this market and therefore we have a differentiated approach. One of them is that it's more targeted, it's more cost effective. One differentiation we clearly have, and feel is really different is we as the smallest player will focus on the market where an NGP market already exists, where we see our role of giving consumers and trade partners an alternative. Which is the right thing to do for Imperial.

It also is inherently a more cost-effective approach. And I think that's something that has inspired and guided us which markets we enter with what products. And we follow that methodology very rigidly and we also have a test and learn methodology behind it. So, before we go into market new products, we test to really find out what is the consumer reaction.

And I think what's exciting to see three years ago that was a concept. Three years down the road you can see it working.

We grew in the first half of this year our net revenue globally in NGP by 17% and in our focus region in NGP Europe we grew by 24%. Now we're starting from a smaller base than some of our peers, but these are still sizeable numbers that we're achieving here. And I think one important point and it's great that we have the call today so we can talk about it…at the same time we are also improving our gross margin which comes to the point you asked before about scale. Now I think scale is important here, you need a certain scale, but we are achieving that now increasingly and that's why our gross margin across NGP increased by 580 basis points.

We've also chosen a different approach to work more with partners, which has allowed us to, for example, be the first of the major industry players to launch a 1,000 puff disposable vaping product in the UK market. So, I feel our approach is right, we'll not get every single step right in this area. But I think what's fundamentally changed versus three years ago, I think as an investor you can see our differentiated approach working and us being on track towards the target that we laid out to achieve break even at the end of fiscal year 25.

Now, I haven't forgotten about your side question, which is about what is the right EBIT margin for NGP. Philip, it's a tricky one to answer because you will know very well NGP has today three different categories: vaping, heated tobacco, oral nicotine. And we are active in all three.

In reality, I think it will largely depend where today's consumer shakes out, which markets will be how big, and that will largely influence how or what EBIT margin you can achieve. But I think we have explicitly said it's going to be a profitable business. We see this as an opportunity to drive our purpose of forging a path to healthier future for our consumers for moments of relaxation and pleasure. But we also understand that it must be profitable for our shareholders, and we have a high level of confidence that we'll get there.

[PS] Very clear. And I mean we've seen NGPs continue to take share of of your core tobacco profit pools over time. Do you see a risk of this accelerating and I'm particularly thinking about heated tobacco now starting to be launched in the US. In Europe as well, we've seen some better traction for heated tobacco as well and we've seen - sorry going back to the US as well - we've seen strong nicotine pouch growth there. So how do you think about those risks?

[SB] Sure. From my side, look as you will know, I have joined the industry from the outside four years ago. So, one of the things is, as a relative newcomer to the industry I'm a big believer in data and facts. So, when I joined to ask OK, give me the data for the market that are relevant for Imperial. That's a very important piece because I have to look after the markets that matter for Imperial. And what is striking - and you will know well - the industry has been working on NGP products for 10-20 years. And when you look at the retail sales value as an indicator, when you compare it, when I look through the lens of our market footprint, I mean, in 2023, the last full year available, 89% of the retail sales value in the United States comes from cigarettes, 91% in Germany, and in Spain, 97%.

So, I think that's something we always need to keep that into perspective. We're very excited about NGPs - we want to do the right thing. But as commercial leaders, it is also important to recognise that for the majority of our consumers, despite all the efforts of us as an industry to try to move consumers to potentially reduced harm products, the majority of consumers in the markets that are important for Imperial, virtually 9 out of 10 continue to side with cigarettes.

So, I don't think you will see fundamentally after 10, 20 years of trying a wildly different path. You will hopefully continue to see consumers convert over to reduced harm products and NGPs. And I think what's exciting for us, we now have an offer in the respective market in any of the three categories that is relevant for that respective market.

So, we can participate now. That's the difference today versus where we were four years ago. We have now offers, we can participate if the market switches over. But at the same time, as looking after the interest of our shareholders, that we also have to acknowledge that the majority of our business continues to be on the cigarette side and therefore I have to look after my consumers in this area as well.

[PS] Absolutely. And maybe then just moving to some of the regulatory environment, do you think this has gotten tougher in recent years and include excise duties within that as well?

And do you see any risk in particular from the EU directives, the TD and the TPD that are, you know, being discussed at the moment, what kind of risk do you see from those directives?

[SB] Yeah, I mean if you step back and look at the bigger picture, I mean the tobacco industry has been the subject of regulation for a very long period of time and if I step back, I cannot see it becoming materially tougher. I think what you would observe is because we're now truly talking about two categories, cigarettes and NGPs, you will have a lot more regulation because historically that regulation was only focused on cigarettes. Now as the NGP segment is developing, you are now seeing a lot more regulation because it's trying to regulate both segments which is the right thing to do.

But I think it's also important to recognise that regulation doesn't only go one direction and since this half year result you have two where actually regulation has gone the other direction with New Zealand pulling back its generational smoking ban or the latest announcement of the delay in the regulation preparation around menthol ban in the United States. So, it moves, as an investor there's always going to be a disproportionate level of noise around regulation in our industry. But I fundamentally don't see it changing and accelerating in material form.

And if you then, and the reality is that applies to excise as well because again I look through the lens of our five markets, we're not seeing a material change. You will always have some markets that move forward - we saw the UK in 2023 because of its excise model being linked to inflation, put quite a hefty excise on it. But as inflation has eased now it will be more normal now. At the same time, you haven't seen a state excise and a federal excise increase in the US in quite a number of years. So, it's a mixed picture and I really can't see on the excise a material change.

But I want to come to your question about the European Union, the European Union being relevant for us as Imperial primarily for our German and Spanish market. I just spent a couple of weeks ago a day with our team in Brussels that works with the European institutions. If you look at three pieces coming out of the EU, the single use plastic, nothing to do with our industry across anybody who uses a single use plastic. It's something I think we've dealt with as an industry, and we have been able to pass this on to our consumers in the right way. So that's probably the easiest one to deal with.

If you then look at the two other directives being considered and for all the investors, I won't use the acronym, so let's call it the Excise Directive and EU Regulation Directive.

If you look at the Excise Directive, there is a desire in the future to lead to a higher level of harmonisation of excise rates in Europe. But I think what is important to recognise here, Europe stretches all the way from Bulgaria to France and Spain, and the reality is excises are often a reflection of the disposable income of the consumers. So, that is one of the reasons for very different excise rates in the countries and I don't think that will change in the material form.

So, I think and it's going to come. I think we can always input. We like the European Union process which allows an engagement and actually allows, because of the process of many of the Member States having to agree, there are many ways of understanding what is going to happen.

And the same also applies to the regulatory side. You will be aware as the timetable has already slipped on this one. But what we are positively seeing is the EU is now also wanting to put a more harmonised framework around NGP which we welcome and as an industry because it will make it clearer for us how to engage and what products we can offer.

[PS] Absolutely and that's very clear. And maybe then moving to your capital allocation policy and M&A, can you just remind us of what your priorities are within capital allocation?

And you've been guiding to be at the low end of your 2.0 – 2.5x leverage range by the end of fiscal 24. Would you be comfortable going below 2x or would you aim to increase the share buyback in order to remain in the range.

And the final part of the question is do you see any M&A opportunities, or do you think that the buybacks are the best use of your excess cash at the current valuation?

[SB] Absolutely. Look, I think it's good for also for the investors we've always seen our capital allocation as a key element and a very integral part of our strategy. It isn't an afterthought. I mean, me and Lukas as the CFO, we felt very strongly.

So, when we launched the strategy in 2021 that was a central part of it and we very deliberately laid it out – here are our rules. And the rules just to share them again, is about priority number one is invest in the business and that will include organic initiatives and it will also include bolt on opportunities from an M&A perspective primarily in the area of NGP and also for our, the diversification of Logista our distribution arm. The second priority is maintaining the leverage or originally achieving the leverage of being at the lower end of 2 to 2.5 times, net debt to EBITDA. And I think that was priority #2.

Priority #3, a progressive dividend policy. And #4, should after delivering on these three priorities there be any cash left over, we will return that excess capital to our shareholders by an ongoing share buyback. And I think what's exciting, in the first one or two years we were busy actually achieving that point #2 of getting our leverage to that target level - that is now achieved. That has allowed us now for two years in a row to return first 1 billion and this year 1.1 billion pounds in a share buyback while increasing dividend, to be delivering on our promise of a progressive dividend.

Let me deal with the subject of leverage. Now reality is we have no intention of further lowering our leverage. That is the target, that will not change in this strategic plan. So that does mean as profits increase you rightly picked up that would mean we could increase our debt levels in the company.

I'll leave it there, so it just gives you a signal that there is increasing opportunity for share buybacks as this business continues to drive its profit growth and has already reached its target level of leverage, which I think is an exciting place to be as a company and an exciting place to be for shareholders.

Now to deal with M&A because I recognise as an investor who asks the question, OK, I'm excited about the capital returns, but is management suddenly going to say, oh, and we're going to buy here a company?

I think again going back all the way to '21, we always said it's bolt on acquisitions primarily in the NGP space. And since the start of the strategy there has not been anything outside the scope. We have done a bolt on acquisition in the US that allowed us now to enter the modern oral nicotine business and our Logista business has done bolt on acquisitions on its diversification strategy.

But don't expect us to come to shareholders and suddenly with a big acquisition in the tobacco space or overall that would consume a significant amount of our free cash, which I think is reassuring for investors because they know what they will get from us. And we believe we can deliver our strategic ambition within this framework.

[PS] That's very clear. And maybe then we can turn to the final question for this fireside chat this evening, this afternoon. Just one of the questions that I am starting to get from investors is what the next step of the journey could look like beyond 2025. And now I appreciate there's still 18 months left in, in the medium-term guidance. But given I am getting these questions, what are your high-level thoughts on the opportunities to drive further earnings growth from here and how do you see NGP fitting into the into this strategy within that?

[SB] Absolutely. Philip, as you rightly say, it's a bit early - we are one and a half years away, but I absolutely understand that you are starting to get the question. At the same time, our priority number one is to deliver the next one and a half years of the current strategy. That is, has to be our priority – it is also in the interest of our shareholders to deliver that. And I think this will, delivering success for the next one and a half years on top of the three and a half that we've done that already is going to be the strongest foundation that we have for the next strategic plan of the company.

And so, I think it will leave the company when we present and we come out with our next five-year strategy, the company is in a very different place in the year ‘25 than it was in the year 2020, which should give investors good confidence. Now rest assured that naturally, as a business that has as one of its behaviours “build our future” among its five behaviours, we have started to also internally to start to already plan ahead as an executive team and as a management team.

But it would be too early, to be honest, one and a half years away from that to be drawn into what it would look like. The only thing as you asked specifically about NGP, NGP will be a key part of that, but so will be our core business.

And we will update the investors as we get closer to the end of the current strategy - Peter Durman and the team will for sure make sure that at the right point in time we share our next strategic phase with our investors in due course.

[PS] Absolutely! Er no, I thought I had to ask but thank you very much for that colour um well I guess so we're pretty much at time. So, Stefan, thank you very much for joining us today on such a busy day.

[SB] No, thank you. Thank you from my side, Philip, and anybody who's on the call.

Look, I really appreciate the opportunity to share the Imperial story, what's happening short term but also what is the bigger picture with you and hopefully what comes across that Imperial is a very attractive investment case at a very attractive valuation that now does have three and a half years of track record of delivering on that strategy behind it, with some very attractive capital returns.

But also, a core business that is now in the right level of health and is also building an NGP business in a differentiated way to its competitors. Thank you.

[PS] Great. Thank you, Stefan, and thank you everyone for joining. Have a good rest of your day.