

OPERATING REVIEW

We manage our markets based on the strategic roles they play, with markets prioritising Growth or Returns. Our portfolio priorities are focused on driving the performance of our Growth and Specialist Brands.

Brand Performances

Our Growth and Specialist Brands are the most important assets in our portfolio and together they account for 56.9 per cent of our tobacco net revenue, up 270 basis points. The rest of our portfolio consists of Portfolio Brands, local and regional brands that fulfil a variety of roles. Some add to our revenue momentum, while others will create more value by being migrated into Growth Brands.

Growth Brands

	Full Year Result		Change		
	2015	2014 ^R	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	6.6	5.5 ^R	+110bps		
Net revenue (£m)	2,862	2,736	+4.6%	+13.5%	+11.7%
Percentage of Group volumes	50.9	44.5	+640bps		
Percentage of tobacco net revenue	45.8	42.6	+320bps		

¹ See Performance Measures table on page 1. ^R See page 83 for details of restatements made to 2014 comparatives.

Growth Brands have broad consumer appeal. They generate a significant amount of our volume and revenue and our aim is to increase the contribution they make to the business.

Growth Brands outperformed the market in the year with underlying volumes growing 7.1 per cent, against a backdrop of market volume decline in our geographic footprint of 3.5 per cent. We improved the share of Growth Brands from 5.5 per cent to 6.6 per cent and increased underlying net revenue by 11.7 per cent.

Growth Brands accounted for 50.9 per cent of our total volumes, up from 44.5 per cent last year, and 45.8 per cent of tobacco net revenues, up from 42.6 per cent last year. Excluding Iraq and Syria, underlying Growth Brand volumes increased by 13.9 per cent and underlying net revenue increased by 14.9 per cent.

Specialist Brands

	Full Year Result		Change		
	2015	2014 ^R	Actual	Constant Currency ¹	Underlying ¹
Net revenue (£m)	693	743	-6.8%	0%	-0.7%
Percentage of tobacco net revenue	11.1	11.6	-50bps		

¹ See Performance Measures table on page 1. ^R See page 83 for details of restatements made to 2014 comparatives.

Specialist Brands appeal to specific consumer groups across the tobacco spectrum. Net revenue declined in the year, largely due to lower sales of Gitanes in Iraq and Syria. Excluding this impact, underlying net revenue was up 2.9 per cent.

Market Performances

We divide our footprint into Growth and Returns Markets. In Growth Markets we prioritise long-term share and profit growth and in Returns Markets the focus is on sustainable profit delivery and effective management of our strong share positions.

Growth Markets

	Full Year Result		Change		
	2015	2014 ^R	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	6.1	6.4	-30bps		
Tobacco net revenue (£m)	1,449	1,513	-4.2%	+4.2%	-2.5%
Adjusted operating profit (£m)	409	334	+22.3%	+19.0%	
Growth Brands % tobacco net revenue	47.0	47.9	-90bps		
Growth Brand volume (bn SE)	46.4	50.9	-8.9%		-16.0%

¹ See Performance Measures table on page 1. ^R See page 83 for details of restatements made to 2014 comparatives.

We continue to build good momentum across these territories, although results, particularly of our Growth Brands, were held back by the Near East. Against a backdrop of industry volume declines of 5.5 per cent in Growth Markets, underlying net revenue declined by 2.5 per cent. Adjusted operating profit increased by 19.0 per cent, reflecting the impact of last year's stock optimisation programme which reduced the level of stock held by distributors. Excluding Iraq and Syria, underlying net revenue was up 4.5 per cent and adjusted operating profit was up 27.0 per cent.

Country	Performance
Italy	We grew our cigarette share with JPS, supported by Davidoff which is available in key cities.
Greece	Revenue was up, with Davidoff performing well and increasing sales of Rizla, and we successfully completed the migration of Maxim into JPS.
Sweden and Norway	Volume, revenue, profit and share were all higher as we further built on our snus position with another excellent performance from Skruf, supported by gains from Knox.
Turkey	Our results were impacted by significant price competition and we implemented a restructuring programme to reduce costs and strengthen our performance.
Iraq and Syria	Volumes, largely of Growth Brands, declined considerably due to deteriorating conditions in territories where we have a high presence. Cost saving initiatives elsewhere in the Group offset the financial impact.
Saudi Arabia	Contributions from West, Davidoff and Gauloises Blondes enhanced our share in a growing cigarette market.
Egypt	We improved our cigarette share as we continued to build our presence with Davidoff and Parker & Simpson.
Japan	Positive progress was underpinned by cigarette share gains from West and a focus on developing long-term retailer partnerships.
Taiwan	Davidoff performed well, supported by our new marketing campaign, although our overall cigarette share was held back as a result of a decline in West following a price increase.
Vietnam	Regulatory changes and excise-driven price increases have significantly fuelled illicit trade, impacting our volume and share performance.
Cambodia	Price competition undermined the positive progress of Fine. In response we extended the brand franchise with the launch of Fine Blue to strengthen our position.
Russia	Portfolio initiatives and strong pricing have strengthened our delivery in this key market. We stabilised our share, with Maxim performing particularly well.
Kazakhstan	We improved our market share with contributions from West, Davidoff and Parker & Simpson.

USA Market

	Full Year Result		Change		
	2015	2014	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	9.5				
Tobacco net revenue (£m)	707	507	+39.4%	+30.0%	+39.4%
Adjusted operating profit (£m)	375	236	+58.9%	+47.2%	
Growth Brands % tobacco net revenue	13.7	22.0	-830bps		
Growth Brand volume (bn SE)	3.1	3.1	-1.7%		+10.1%

¹ See Performance Measures table on page 1.

Our enhanced revenue and profit performance reflects the contribution from ITG Brands since the completion of the acquisition of assets from Reynolds American on 12 June 2015. The table above reflects the combined performance of ITG Brands and our existing USA operations. The net contribution of the acquisition to the USA performance was tobacco net revenue of £242 million and volumes of five billion, increasing our total USA volumes to 13.2 billion.

The percentage of tobacco net revenue generated by Growth Brands declined, as a consequence of the larger post-acquisition portfolio.

The acquired cigarette brands – Winston, Salem, Kool and Maverick – performed well in the fourth quarter, maintaining stable market shares. In addition, USA Gold gained share in key focus states.

As a result of the USA acquisition our Growth and Specialist Brands have been reclassified, effective 1 October 2015. Winston has been added to Growth Brands, replacing USA Gold, which becomes a Portfolio Brand, and Kool has joined our Specialist Brands.

Our new portfolio strategy is primarily focused on growing Winston and Kool in the premium segment and Maverick and USA Gold in the discount segment, and the development of these brands is being supported by new retail merchandising programmes.

Competitor discounting impacted our mass market cigar performance and we are responding by strengthening the retail focus of the cigar business model and enhancing the consumer appeal of our key brands Dutch Masters and Backwoods.

Returns Markets

	Full Year Result		Change		
	2015	2014 ^R	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	26.2	26.4	-20bps		
Net revenue per '000 SE (£)	22.1	23.4	-5.7%	+2.8%	+2.8%
Adjusted operating profit (£m)	2,111	2,235	-5.5%	+1.3%	
Growth Brands % tobacco net revenue	50.9	43.2	+770bps		

¹ See Performance Measures table on page 1. R See page 83 for details of restatements made to 2014 comparatives.

We continue to make positive progress in Returns Markets, where we focus on maximising profit and broadly holding our share.

Against a backdrop of industry volume declines of 1.4 per cent, we grew adjusted operating profit by 1.3 per cent, with strong results in Returns North offsetting the impact of the weak operating environment in Returns South.

We grew net revenue per thousand stick equivalents by 2.8 per cent and our market share was 26.2 per cent. Growth Brands performed well, generating 50.9 per cent of tobacco net revenue, up by 770 basis points.

Returns Markets North

	Full Year Result		Change		
	2015	2014	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	25.0	24.8	+20bps		
Net revenue per '000 SE (£)	25.8	27.0	-4.7%	+3.6%	+3.7%
Adjusted operating profit (£m)	1,475	1,511	-2.4%	+4.0%	
Growth Brands % tobacco net revenue	53.6	46.7	+690bps		

¹ See Performance Measures table on page 1.

We achieved good results in Returns Markets North, increasing net revenue per thousand stick equivalents by 3.6 per cent and adjusted operating profit by 4.0 per cent. Growth Brands delivered 53.6 per cent of tobacco net revenue, up from 46.7 per cent, and we grew our market share by 20 basis points to 25 per cent.

Country	Performance
UK	We maintained our market leadership and extended our share in the growing sub-economy cigarette segment. The Lambert & Butler franchise benefited from the good performance of L&B Blue and Fontem Ventures continued to focus on building the presence of blu e-cigarettes.
Germany	Our overall market share was down slightly but both revenue and profit increased as we delivered another strong financial performance.
Benelux	We continued to extend our presence in the growing make-your-own category, although our overall share was down.
Australia	Another excellent performance from JPS, now the leading brand in the market, resulted in further revenue, profit and share growth.
New Zealand	Good results from JPS and West led to further improvements in our cigarette and fine cut tobacco shares.
Azerbaijan	We enhanced our market-leading position with further growth in our cigarette share.
Ukraine	A strong portfolio performance, including gains from the newly-launched Parker & Simpson, improved our cigarette share.

Returns Markets South

	Full Year Result		Change		
	2015	2014 ^R	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	28.0	28.8	-80bps		
Net revenue per '000 SE (£)	17.5	19.0	-7.7%	+1.0%	+0.8%
Adjusted operating profit (£m)	636	724	-12.2%	-4.2%	
Growth Brands % tobacco net revenue	46.0	37.1	+890bps		

¹ See Performance Measures table on page 1. R See page 83 for details of restatements made to 2014 comparatives.

The impact of the weak operating environment in Spain, France and Morocco continued to hold back our overall results in Returns South, with Morocco in particular impacting our market share and profit performance. We made good progress in further building the contribution from our Growth Brands, with these brands generating 46.0 per cent of tobacco net revenue, up from 37.1 per cent last year.

Country	Performance
Spain	We improved our profit delivery against a background of slower industry volume declines and began the migration of Ducados to JPS.
France	We made gains in fine cut tobacco and strengthened our portfolio with the migration of Fortuna to News, although our overall share was down.
Portugal	Another strong performance from JPS was behind our market share gains.
Czech Republic	Our Growth Brands, particularly Parker & Simpson, performed well in a growing market and we increased revenue and profit.
Algeria	Our volumes and share increased following a good performance from Gauloises Blondes.
Ivory Coast	Our revenue performance benefitted from further gains from Fine.
Morocco	Conditions remained challenging, with excise-driven price increases impacting industry volumes and fuelling growth in illicit trade. Our share declined and we continued to focus on portfolio initiatives to strengthen our position.