

Operating Review

We target long-term share and profit growth in Growth Markets and prioritise sustainable profit performance, while actively managing our strong share positions in Returns Markets. This approach drives better resource allocation and greater collaboration between markets, providing a strong platform for generating higher-quality growth.

Footprint and Portfolio Overview

Growth Markets include selected markets in the EU, Eastern Europe, Asia, the Middle East and the USA. We typically have shares below 15 per cent in these markets. Returns Markets are split into North and South and include Australia and markets in the EU, Eastern Europe and Africa, where we tend to have large shares above 15 per cent.

Our portfolio priorities are focused on driving the performance of our Growth Brands and Specialist Brands. These are the most important brands in our portfolio and together they account for 54 per cent of our tobacco net revenue. The remainder are 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		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	5.7	5.4	+30bps		
Net revenue (£m)	2,737	2,729	–	+4%	+9%
Percentage of Group volumes	44.5	40.7	+380bps		+460bps
Percentage of tobacco net revenue	41.6	38.9	+270bps	+220bps	+280bps

¹ See Performance Measures table on page 1.

Growth Brands generate a significant amount of our volume and revenue. They are high-quality assets and our aim is to increase the contribution they make over time in order to strengthen the sustainability of the business.

Growth Brands outperformed the market in the year with underlying volumes growing 7 per cent, against a backdrop of market volume declines in our geographic footprint of 4 per cent. We grew the share of Growth Brands from 5.4 per cent to 5.7 per cent and increased underlying net revenue by 9 per cent.

Growth Brands accounted for 44.5 per cent of our total volumes, up from 40.7 per cent last year, and 41.6 per cent of tobacco net revenues, up from 38.9 per cent last year.

Specialist Brands

	Full Year Result		Change		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Net revenue (£m)	811	866	-6%	-2%	+2%
Percentage of tobacco net revenue	12.3	12.4	-10bps	-10bps	–

¹ See Performance Measures table on page 1.

Specialist Brands appeal to specific consumer groups across the tobacco spectrum. We increased Specialist Brands net revenues by 2 per cent on an underlying basis. These brands account for 12.3 per cent of our overall tobacco net revenue.

Growth Markets

	Full Year Result		Change		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	5.8	5.7	+10bps		
Tobacco net revenue (£m)	2,113	2,254	-6%	-	+7%
Adjusted operating profit (£m)	597	668	-11%	-2%	
Growth Brands % tobacco net revenue	38.3	36.8	+150bps	+90bps	+330bps
Growth Brand volume (bn SE)	53	53	-		+11%

Market share excludes China; 1 See Performance Measures table on page 1.

We're building good momentum across our Growth Markets. Against a backdrop of industry volume declines of 4 per cent in our Growth Markets, we improved underlying net revenue by 7 per cent. Our Growth Brands performed well in a broad spread of Growth Markets and our share was up slightly to 5.8 per cent.

Country	Performance
Italy	We continued to perform well in a highly competitive environment, driving the performance of JPS to further increase our cigarette share.
Greece	We improved our cigarette share with Gauloises Blondes and Davidoff and focused on strengthening our fine cut tobacco position with gV.
Sweden and Norway	An excellent performance from Skruf was behind another set of strong results from our snus business, with share, volume, revenue and profit all increasing.
Turkey	Our market share dipped and profit declined due to significant price competition. We launched West queen size and Davidoff superslms to capitalise on the rapid growth of these formats. We also continued to make ground in the growing crushball segment with West Duo.
Iraq	The worsening political and security situation had a major impact on industry volumes. This, combined with our stock optimisation programme, significantly affected our performance.
Saudi Arabia	We grew our cigarette share in a growing market with contributions from Davidoff, Gauloises Blondes and West.
Egypt	We entered this 80 billion cigarette market in the year and have focused on establishing our presence with Davidoff and Gauloises Blondes.
Japan	We continued to build our position in Japan with a focus on West and customer engagement initiatives.
Taiwan	West was the driver behind our cigarette market share and volume gains, supported by Davidoff. We also added to our portfolio with the launch of Parker & Simpson.
Vietnam	Bastos performed well in a challenging environment of increasing regulation and significant growth in illicit trade.
Cambodia	We grew volumes, share, revenue and profit following another strong performance from Fine.
Russia	Our stock optimisation programme has strengthened our position in a market that poses challenging conditions as a result of adverse excise and regulatory changes. We have targeted key growth segments with a number of portfolio initiatives, including queen size formats, big boxes and charcoal filters, which has stabilised our cigarette share.
Kazakhstan	We achieved excellent cigarette volume and market share growth with West and Parker & Simpson.
USA	We increased profit and grew our cigarette share in key states with USA Gold, which is now available in Glide Tec packs.

Returns Markets

	Full Year Result		Change		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	26.7	27.3	-60bps		
Net revenue per '000 SE (£)	23.1	23.4	-1%	+3%	+4%
Adjusted operating profit (£m)	2,253	2,335	-4%	+1%	
Growth Brands % tobacco net revenue	43.2	40.0	+320bps	+280bps	+270bps

¹ See Performance Measures table on page 1.

Industry volumes declined by 3 per cent in Returns Markets. The impact of a weak operating environment in Returns South was offset by results in Returns North, such that adjusted operating profit across our Returns Markets increased by 1 per cent. Our aggregate market share was down, largely reflecting the weighting of higher than average market size declines in the UK and Morocco where we have higher share than in other Returns Markets.

We grew net revenue per thousand stick equivalents by 4 per cent. We also increased the revenue contribution from our Growth Brands; these brands generated 43.2 per cent of tobacco net revenue in Returns Markets, 320 basis points higher than last year.

Returns Markets North

	Full Year Result		Change		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	24.8	25.5	-70bps		
Net revenue per '000 SE (£)	27.0	27.0	–	+5%	+6%
Adjusted operating profit (£m)	1,511	1,543	-2%	+2%	
Growth Brands % tobacco net revenue	46.7	43.9	+280bps	+210bps	+220bps

¹ See Performance Measures table on page 1.

We achieved robust results in Returns Markets North, increasing net revenue per thousand stick equivalents by 6 per cent and adjusted operating profit by 2 per cent. Growth Brands delivered 46.7 per cent of tobacco net revenue, up from 43.9 per cent. Our market share was 24.8 per cent, impacted by industry volume declines in the UK.

Country	Performance
UK	We maintained our leadership position against a backdrop of weak industry volumes. We grew volumes of JPS, strengthened the Lambert & Butler brand franchise with a new value variant and made fine cut tobacco gains with Player's Gold Leaf.
Germany	We delivered a strong financial performance, increasing revenue and profit. Our fine cut tobacco share was down and growth from JPS and Davidoff kept our cigarette share broadly stable.
Benelux	Competitor pressures in the Netherlands affected our overall cigarette and fine cut tobacco shares but good performances elsewhere delivered further profit growth.
Australia	We grew volumes, revenue and profit and increased both our cigarette and fine cut tobacco shares with JPS.
New Zealand	We enhanced our cigarette and fine cut tobacco shares with growth from JPS and West.
Azerbaijan	Our cigarette share was down slightly but we grew revenue and profit and increased volumes of Parker & Simpson.
Ukraine	We performed well in a turbulent environment, significantly improving revenue and profit, although our share dipped slightly. Parker & Simpson gained ground following its launch in the year and West volumes were up.

Returns Markets South

	Full Year Result		Change		
	2014	2013	Actual	Constant Currency ¹	Underlying ¹
Market share (%)	29.4	29.9	-50bps		
Net revenue per '000 SE (£)	18.6	19.3	-4%	–	+1%
Adjusted operating profit (£m)	742	792	-6%	-2%	
Growth Brands % tobacco net revenue	37.3	33.7	+360bps	+350bps	+310bps

¹ See Performance Measures table on page 1.

Our focus on improving the quality of our growth was reflected in the further development of our Growth Brands, which accounted for 37.3 per cent of tobacco net revenue in Returns South, up from 33.7 per cent last year. However, the weak operating environment in France, Spain and Morocco undermined our overall financial performance.

Country	Performance
Spain	Industry volume declines slowed but the market remained challenging. We grew our blonde cigarette share and strengthened our portfolio by migrating local brand Brooklyn into West.
France	Our cigarette share declined in an environment of weak industry volumes. We made gains in the growing make your own segment with Gauloises Blondes and News and added to our cigarette portfolio with the launch of Gauloises Generation.
Portugal	We achieved excellent results with JPS, increasing volumes and both our cigarette and fine cut tobacco share.
Czech Republic	We increased volumes and profit and grew our cigarette share. Our fine cut tobacco share was down but we improved our position with the launch of Parker & Simpson.
Austria	We stabilised our cigarette share and launched a Gauloises variant with biodegradable filter and an additive-free tobacco blend, to capitalise on growth in the additive-free segment.
Algeria	Our good performance was driven by Gauloises Blondes and West, with both brands gaining volume and share.
Ivory Coast	We have a strong market leading position and made further gains with Fine.
Senegal	We made further good progress, increasing our cigarette volume and market share.
Morocco	There were further steep industry volume declines and our cigarette share was down. We focused on strengthening our portfolio with launches of MQS cigarettes, a modern variant of our local brand Marquise, and the market's first fine cut tobacco products through Gauloises and Marquise. These initiatives improved our second half performance.