Alison Cooper Chief Executive

We made good progress this year in further strengthening the business. Imperial has great potential for long-term growth and our strategic priorities are focused on maximising these growth opportunities to drive sustainable returns for our shareholders.

Our business transition initiatives support our strategy and focus on optimising our brand portfolio and market footprint, implementing better ways of working, managing our cost base and improving supply. The actions we're taking are creating a stronger platform for growth, putting us in a stronger position to get the most out of our key assets: our brands, our markets and our people.

Our brand priorities are built around our Growth and Specialist Brands; this is where the real quality and sustainability of our portfolio lies. We achieved some good performances from these brands in the year, particularly our Growth Brands which have grown volume ahead of the market and gained share.

We have a balanced market footprint which is divided into Growth and Returns Markets. 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. We saw strong results in a number of our Growth Markets and demonstrated ongoing resilience in our Returns Markets.

At the beginning of the year, we said our overall performance would be affected by our stock optimisation programme, which reduced the level of stock held by our distributors in some markets to improve our long-term supply effectiveness.

Our underlying performance, which excludes the impact of the stock programme, has been encouraging and provides plenty for us to build on in 2015.

Creating Shareholder Value

We delivered further earnings per share and dividend growth in a difficult operating environment, characterised by lower industry volumes, high levels of illicit trade and instability in Eastern Europe and the Middle East. In addition our stock optimisation programme, which was completed in the year, affected our volume, revenue and profit performance.

Against this backdrop we grew underlying tobacco net revenue by 2 per cent. Adjusted operating profit was flat at £3 billion and adjusted earnings per share was up by 2 per cent on a constant currency basis and up by 7 per cent on an underlying basis.

Return on invested capital was 14.2 per cent and we delivered another strong dividend increase of 10 per cent.

A Stronger Business

Our transition initiatives are strengthening the quality of our business and our ability to generate sustainable shareholder returns.

Much of the focus is on optimising our portfolio, improving the way we manage our brands to drive quality sustainable growth. We're also strengthening our operating model, reviewing the way the business operates on a day-to-day basis. This involves looking at systems, processes and structures to reduce complexity and enhance the way we work.

Our Operating Environment

Global Cigarette Market

The global cigarette market is broadly stable. Around 6 trillion cigarettes are sold each year and there are around a billion adult smokers.

Our markets prioritise Growth or Returns. Growth Markets have large profit and/or volume pools and include selected countries in the EU, Eastern Europe, Asia, the Middle East and the USA. We typically have shares below 15 per cent in these markets and focus on growing share and profit. We tend to have larger shares in Returns Markets, which include Australia and markets in the EU, Eastern Europe and Africa. In many of these countries, particularly in the EU, industry volumes are declining and we focus on generating sustainable profit, while actively managing our share.

Illicit Trade

Around 660 billion illegal cigarettes are consumed every year. Cigarette smuggling and counterfeiting deprive governments of around £30 billion in legitimate taxes per annum.

We work with governments and law enforcement agencies to combat illicit trade, investing in systems and processes to improve the security of our products and sharing intelligence to help authorities disrupt the supply of illegal cigarettes.

Regulating Tobacco

Regulation is driven by the World Health Organization (WHO, through the Framework Convention on Tobacco Control, the FCTC), the European Commission (through the European Union Tobacco Products Directive, the EUTPD) and the USA's Food and Drug Administration (FDA).

We support reasonable regulation, such as appropriate ingredients disclosure and measures that will reduce illicit trade and stop children smoking.

We don't support disproportionate regulation such as display bans, plain packaging and excessive excise increases. These measures don't have any material impact on tobacco consumption and only serve to disrupt markets and fuel illicit trade.

We reinforced this with governments and regulators during the revision of the EUTPD, which includes legislation to standardise the appearance and taste of tobacco products. The revised Directive came into force on 20 May 2014 and EU Member States have two years to transpose it into national law.

During the year, we reorganised Group Marketing and appointed a single global marketing agency to drive a sharper focus on our portfolio priorities. We also started reshaping Group Sales to further support our performance ambitions in Growth and Returns Markets. Other business functions are also evolving in line with our transition agenda.

Portfolio Priorities

Our portfolio consists of Growth, Specialist and Portfolio Brands. Our priority is to drive the performance of Growth and Specialist Brands and build the contribution they make to our business.

Portfolio Brands are a mix of local and regional offerings that fulfil a variety of roles. Some have the capacity to keep adding to our volume and revenue momentum; others are being delisted or migrated into Growth Brands.

We're making good progress with brand migrations. We successfully achieved several migrations during the year and accelerated plans for further migration initiatives, which will continue into 2015.

Good Performance from Growth Brands

Our Growth Brands are: Davidoff, Gauloises Blondes, JPS, West, Fine, News, USA Gold, Bastos, Lambert & Butler and Parker & Simpson.

In optimising our portfolio we've clustered these 10 brands on to five platforms, or 'brand chassis'. Brands that share the same chassis also share the same growth initiatives, including innovations and pack designs. This reduces cost and complexity and drives greater consistency in the way we drive their performance.

Growth Brands continued to outperform the market, with underlying volumes up 7 per cent and underlying net revenue up 9 per cent. In contrast, market volumes in our geographic footprint declined by 4 per cent.

Brand migrations supported the performance of our Growth Brands and included the migration of Royale Club to Parker & Simpson in Iraq, Brooklyn to West in Spain and Maxim to JPS in Greece.

Performance highlights included JPS growth in Australia and the EU, Davidoff gains in Germany and Taiwan, and good progress from West in Turkey, Ukraine and Japan. Innovation initiatives and a new international marketing campaign supported the development of Gauloises Blondes. USA Gold maintained its momentum in key focus states and there were further launches of Parker & Simpson, extending the brand's presence to 27 markets. Bastos performed well in Vietnam and we grew Fine volumes in Africa and News volumes in France. We also strengthened the UK share of Lambert & Butler with a new value variant.

Our total Group tobacco volumes for the year were 294 billion stick equivalents, compared with 317 billion last year. This reflects the impact of market declines and our stock optimisation programme, which reduced the level of stock held by distributors by more than 9 billion stick equivalents.

Growth Brands accounted for 44.5 per cent of total Group tobacco volumes (131 billion), an increase of 380 basis points, and 41.6 per cent of overall tobacco net revenue, an increase of 270 basis points. On an aggregate basis, we grew the market share of our Growth Brands to 5.7 per cent.

Sales Growth Drivers

We have selected four sales growth drivers that we want to excel at: portfolio management, innovation, customer engagement and pricing.

We apply our expertise in each of these areas in all our markets to drive the performance of our Growth and Specialist Brands. This is where the quality of our portfolio lies and we continually seek to grow and develop these brands.

Through portfolio management we focus on connecting our brands with consumers to enhance brand equity and build sales.

With innovation we're creating a drumbeat of initiatives: small and frequent innovations that keep our brands fresh, vibrant and relevant to consumers.

Strong retailer partnerships are integral to customer engagement. We work with retailers to support their business and maximise the availability and advocacy of our brands at the point of sale.

We evaluate pricing opportunities by brand, pack size and sales channel. We take excise structures into account when making pricing decisions and focus on maximising revenue growth while continuing to give consumers value for money.

Strong Returns from Specialist Brands

We have quality brands and products that span the tobacco spectrum and this is reflected in our Specialist Brands: Style, Gitanes (cigarettes), Golden Virginia, Drum, Route 66 (fine cut tobacco), Cohiba, Montecristo, Romeo Y Julieta (premium cigars), Backwoods (cigars), Skruf (snus) and Rizla (papers).

These brands appeal to specific consumer groups and generate strong returns.

Contributions from Golden Virginia, Drum, Route 66 and Rizla continued to underpin our world leadership in fine cut tobacco and papers, while some challenging market conditions and stock optimisation initiatives in Eastern Europe and the Middle East affected the performance of Style and Gitanes.

Our premium cigars, led by Cohiba, Montecristo and Romeo Y Julieta, made gains in a number of Growth Markets and Skruf had another excellent year, further enhancing our share position in Scandinavia.

We increased Specialist Brands net revenues by 2 per cent on an underlying basis and these brands continued to account for 12.3 per cent of our overall tobacco net revenue.

Encouraging Progress in Growth Markets

We have relatively small positions in Growth Markets and see considerable opportunities to build on them to generate long-term share and profit growth. Key territories include the USA and selected countries in the EU, Eastern Europe, Asia and the Middle East.

Our overall share position in Growth Markets was up slightly to 5.8 per cent and our financial performance was good, with underlying net revenue up 7 per cent.

We made good progress in a broad spread of these markets including Italy, Greece, Sweden, Norway, Taiwan, Cambodia and Kazakhstan. Results in Russia were undermined by difficult trading conditions, as industry volumes continued to decline following excise increases and changes to regulation and the route to market. In the USA, we improved our share position in a number of key states.

In July we agreed to invest $7.1 billion (£4.2 billion) to acquire a number of assets in the USA from Reynolds American. These assets are being sold as a result of the acquisition of Lorillard by Reynolds American and include a portfolio of US cigarette brands and blu, a leading e-cigarette brand in the USA. The cigarette brands are being acquired without historic product liabilities. An indemnity against such liabilities will be provided by Reynolds American under the terms of the transaction.

The acquisition will be debt financed and is subject to regulatory and shareholder approval, which we expect to receive in the spring of 2015. This is a key strategic investment for the Group that will transform our USA operations, diversify our profit stream and create significant value for our shareholders.

Resilience in Returns Markets

In Returns Markets we focus on sustainable profit performance and actively managing our market share. Key territories include Australia and selected countries in the EU, Eastern Europe and Africa.

We divide Returns Markets into North and South for reporting purposes. Trading remains challenging in a number of these markets, particularly in Returns South, where difficult economic conditions and illicit trade are resulting in industry volume declines.

We delivered a resilient performance against that backdrop, with good results in Germany, Portugal, Australia, Ukraine and Algeria mitigating the impact of weakness in Spain, France and Morocco.

Our share across Returns Markets was 26.7 per cent compared with 27.3 per cent last year, 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. Adjusted operating profit was up by 1 per cent, a robust result given the pressures in Returns South.

Growth Brands generated 43.2 per cent of tobacco net revenue in Returns Markets, up by 270 basis points.

Fontem Ventures

Our standalone non-tobacco subsidiary Fontem Ventures launched the Puritane e-cigarette brand in the UK in February. Puritane was initially sold exclusively through the national retailer Boots and Fontem is now widening the brand's availability in the UK by partnering with additional retailers.

Fontem Ventures is also focused on expanding its presence across Europe with a second e-vapour product. Earlier expansion plans were revised after Imperial agreed to buy assets that were being sold as a result of the acquisition of Lorillard by Reynolds American. These assets include the e-cigarette brand blu, which is sold in the UK and the USA.

Fontem Ventures continues to assess other potential product launches, in a variety of non-tobacco lifestyle consumer categories, while further developing and licensing its patented technologies.

Brand Migrations

Our brand migration strategy focuses on migrating Portfolio Brands into Growth Brands.

We have a considerable number of Portfolio Brands, a legacy of our long acquisition track record. Many are single market offerings with limited brand equity. These brands can better support our quality growth aspirations by being migrated into stronger, higher-quality Growth Brands.

Migrations are carefully planned and implemented gradually, usually over a three to six-month period.

A key measure of success is the number of consumers who can be persuaded to complete the journey from one brand to another. In the five brand migrations we completed in the year, we've achieved a high success rate in transitioning consumers.

As well as supporting the global development of our Growth Brands, brand migrations are reducing the complexity of our business and supporting our cost optimisation programme.

More brand migrations will be progressed in 2015 as we continue to focus on simplifying our portfolio and building momentum behind our Growth Brands.

Logista

Logista is one of the largest and most dynamic logistics businesses in Europe, making more than 35 million deliveries a year to 300,000 outlets across Spain, France, Italy, Portugal and Poland.

The business services tobacco and non-tobacco customers and has a long track record of delivering good results in tough conditions. 2014 was no exception, with distribution fees up 2 per cent at £848 million. Adjusted operating profit was £166 million compared with £176 million last year, largely due to one-off items.

In tobacco logistics, cost control measures and efficiency improvement programmes continued to mitigate the impact of tobacco volume declines. In non-tobacco logistics, our transport business performed well in Spain and we continued to grow sales in our direct delivery pharma business. We also grew sales of convenience products in the tobacconist channel.

The Logista team continues to focus on managing costs and generating new growth opportunities to drive the profitable development of the business.

In July a partial IPO of Logista on the Spanish Stock Market resulted in the sale of approximately 30 per cent of Logista for a consideration of £395 million net of fees (€518 million). Retaining a majority shareholder position ensures we continue to benefit from the strong cash flows that Logista generates.

Cost Optimisation

Efficiently managing cost and cash supports our sustainable growth agenda.

Our cost optimisation programme remains on track to save £300 million per annum from September 2018. More than £60 million was realised in 2014 through a range of initiatives that are reducing complexity in the business, including simplifying our portfolio, driving operational efficiencies and securing further global procurement benefits.

Consultations in relation to restructuring projects announced in April to strengthen our competitive position have been concluded in the UK and remain ongoing in France. These projects include the proposed closure of cigarette factories in Nottingham and Nantes and the consolidation of French R&D facilities. It is intended to implement these projects progressively over the next two years and the priority throughout this period will be to support affected employees.

The cost programme is complemented by our stock optimisation programme, which has improved our supply efficiency and the effectiveness of our sales growth driver initiatives.

Capital Discipline

We use our substantial cash flows to create returns for shareholders, pay down debt and reinvest in the business. Our commitment to capital discipline drives a focus on cash generation and effective management of our working capital.

We increased cash conversion to 91 per cent, up from 86 per cent last year, and significantly reduced our debt level by 11 per cent or £1 billion.

Dividend growth was again strong at 10 per cent and from our 2015 financial year we will begin quarterly dividend payments to provide shareholders with more regular cash returns.

We further enhanced shareholder returns through our share buyback programme, spending £341 million to acquire 14.2 million shares. The USA acquisition will be debt financed and, in order to accelerate the pace of debt repayment, the share buyback programme has been suspended.

Responsibility and People

The responsible way we manage our business is crucial to our long-term sustainability and we continue to focus on improving our performance in the four key areas of our corporate responsibility framework.

Our people take pride in getting involved in our corporate responsibility initiatives and supporting each other to drive business performance. They thrive on collaboration and their vibrancy and passion create an energy around the business that continues to inspire me.

Outlook

We are a stronger business going into 2015. We've strengthened our brands and market footprint, increased cash conversion and considerably reduced our debt level. This has created a stronger platform for generating quality sustainable growth, as we continue to drive the performance of our Growth and Specialist Brands.

We expect to complete the USA transaction in the spring of 2015, which will significantly enhance our operational and financial delivery in this key Growth Market.

Our focus on cost optimisation and capital discipline supports our sales strategy by building resilience and freeing up funds to invest in growth.

The external environment remains challenging but the progress we've made has strengthened our ability to navigate headwinds and we can look forward to delivering another year of value creation for our shareholders, including our commitment to dividend growth of at least 10 per cent.

Alison Cooper

Alison Cooper
Chief Executive

Investing in the USA

Transforming our Presence

In July we announced a deal that will transform our presence in the USA, the world's most profitable tobacco market, outside of China.

The transaction will be debt financed and involves acquiring four USA cigarette brands and the e-cigarette brand blu, plus other assets, for $7.1 billion (£4.2 billion). These assets are being sold as a result of the acquisition of Lorillard by Reynolds American.

The cigarette brands are being acquired from Reynolds American without historic product liabilities. An indemnity against such liabilities will be provided by Reynolds American under the terms of the transaction.

The deal is subject to the Lorillard/Reynolds American acquisition receiving regulatory and shareholder approval. We also require the approval of our own shareholders at a general meeting and will be sending an explanatory circular to them in due course. We expect completion in the spring of 2015.

Powerful Brands

The cigarette brands we are acquiring are Winston, Maverick, Kool and Salem. When combined with our own brands, our cigarette share will increase from 3 per cent to 10 per cent, positioning us as a significant number three player in the market.

The blu brand is a leading e-cigarette brand in the USA and was recently launched in the UK. Building on the strong platform blu has established and combining the expertise we have through our subsidiary Fontem Ventures will provide exciting opportunities to further internationalise the brand.

Great People

The other assets we're acquiring include Lorillard's cigarette factory in North Carolina and its national sales force. This will enable us to sell our brands across all 50 states, a significant step up from our current approach which is to focus on 19 key states.

Around 2,750 employees will join us from Lorillard and like our own people in our USA business, Commonwealth-Altadis, they're highly skilled. The combined team will be led by Martin Orlowsky, a former Chairman, President and CEO of Lorillard.

Sustainable Returns

This is an investment in one of our key Growth Markets that supports our strategy and will create sustainable value for our shareholders.

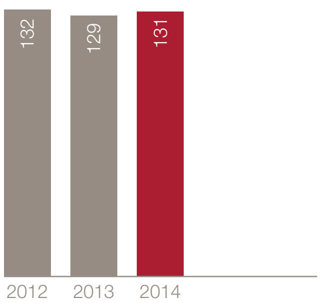
The acquisition is expected to generate a return on invested capital of more than 10 per cent, well in excess of our weighted average cost of capital, in the first full financial year following completion. It is also expected to be significantly earnings enhancing in the first full year following completion.

How We Measure Our Performance

We use the key performance indicators below and the supporting metrics in the Operating Review to measure the progress we make in delivering our strategy. These measures reflect our priorities and are used to monitor and drive business performance.

Key Performance Indicators

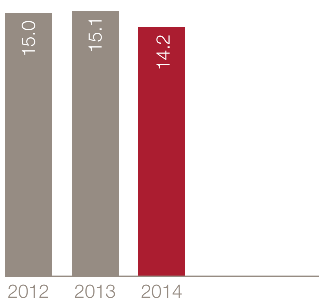
Growth Brand Volumes (bn)



Performance
Our Growth Brands outperformed market trends, with underlying volumes up 7 per cent compared with market declines of 4 per cent.

Definition
Volumes are measured on a stick equivalent basis to reflect combined cigarette and fine cut tobacco volumes.

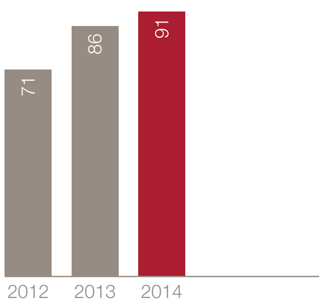
Return on Invested Capital (%)



Performance
Return on Invested Capital (RoIC) was impacted by foreign exchange rates. Excluding this effect, RoIC was broadly stable at 14.9 per cent.

Definition
RoIC measures the effectiveness of capital allocation and is calculated by dividing adjusted net operating profit after tax by invested capital.

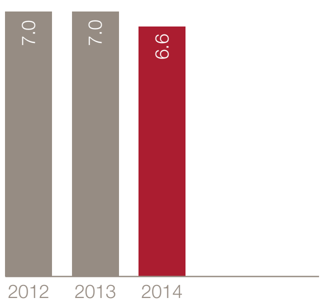
Cash Conversion Rate (%)



Performance
Our focus on cash generation and effective working capital management increased cash conversion to 91 per cent.

Definition
Cash conversion is calculated as cash flow from operations before interest and tax payments less net capital expenditure relating to property, plant and equipment, software and intellectual property rights as a percentage of adjusted operating profit.

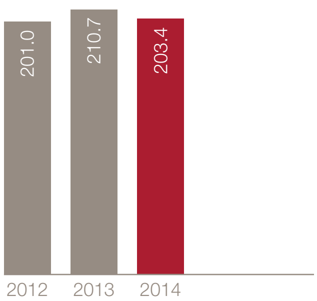
Tobacco Net Revenue (£bn)



Performance
Tobacco net revenue was impacted by foreign exchange movements and our stock optimisation programme. Excluding these effects, tobacco net revenue was up by 2 per cent.

Definition
Tobacco net revenue comprises tobacco revenue less duty and similar items, excluding peripheral products.

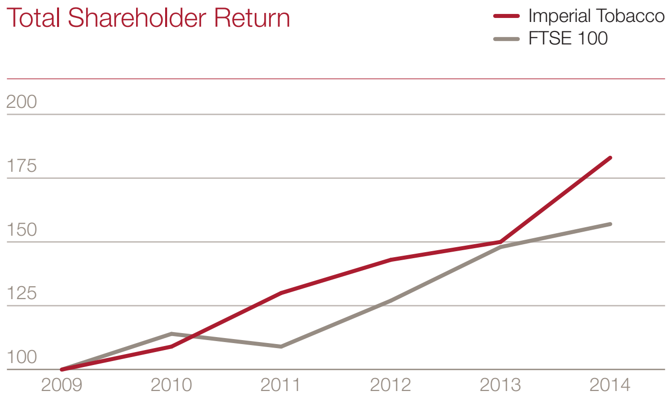
Adjusted Earnings Per Share (pence)



Performance
Adjusted earnings per share (EPS) was impacted by foreign exchange movements and our stock optimisation programme. Excluding these effects, adjusted EPS was up by 7 per cent.

Definition
Adjusted earnings per share represents adjusted profit after tax attributable to the equity holders of the Company divided by the weighted average number of shares in issue during the period, excluding shares held to satisfy employee share plans and shares purchased by the Company and held as treasury shares.

Total Shareholder Return



Performance
In 2014 we outperformed the FTSE 100 Index by 19 per cent. With dividends reinvested, £100 invested in Imperial Tobacco five years ago would now be worth £183 compared with £157 if invested in the FTSE 100 Index.

Definition
Total shareholder return is the total investment gain to shareholders resulting from the movement in the share price and assuming dividends are immediately reinvested in shares.