

Gary Aldridge – Manufacturing Director

Good afternoon ladies and gentlemen, my name is Gary Aldridge and I have been the Group's Manufacturing Director since January 2008. I joined Imperial via the Reemtsma acquisition as the Regional Director for Central and Eastern Europe, and in 2005 my remit was extended and I became Regional Operations Director for the Far East, Eastern Europe, Africa and the Middle East.

Agenda

Over the next 20 minutes or so I will be covering the following topics.

I will start with a brief look at our manufacturing footprint following the acquisition of Altadis last year and will then cover our manufacturing strategy or what we call "the way we work" including some of our performance statistics.

I'll then look at the make up of our cost base, our progress on the Altadis integration and then end by talking about other major projects in 2009.

Our Manufacturing Footprint

The enlarged Group currently has 57 factories, including 8 cigar factories. There is a broad geographical spread with 23 factories in the EU, 13 across Africa, 6 in Eastern Europe, 5 in the Far East and 10 in the Americas.

Many have been acquired through the acquisition process, for example the African factories we acquired with Tobaccor in 2001 and these remain important.

We also have factories in countries where tariff levels make importation prohibitive or where imports are banned. Additionally, we have new factories such as the one we recently opened in Taiwan which I will talk about in more detail a bit later.

Of the 57 total factories, we have 5 OTP, 2 tube, 1 paper, 7 processing, 8 cigar, and 34 cigarette, of which only 21 are "complete" cigarette factories with both primary and secondary operations.

We operate in a dynamic, competitive industry and constantly keep our manufacturing operations under review in order to improve efficiencies, enhance productivity and adapt to changing market conditions.

And it was the changes in the US cigar market which led my colleagues in cigar to announce the closure of our Havatampa factory in Florida, last week. These decisions are always regrettable and our thoughts at this time are with the employees who have been affected.

Our Production Volumes

If I look back 10 years to 1999, we produced just over 40 billion cigarettes, now we produce over 7 times that, 300 billion cigarettes, quite a transformation.

On top of that we produce 27 thousand tonnes of fine cut tobacco, approximating to 34 billion cigarette equivalents, and 2.5 billion cigars.

Our People

In manufacturing, we employ nearly 20 thousand people across all disciplines with 96 per cent of them working in factories, 10 years ago this would have been just 4 thousand.

We have already made good progress on the integration of Altadis and that has resulted, so far, in a 3 per cent headcount reduction. We expect further progress in the coming months as our integration projects move towards completion.

The Way we Work

Now I'd like to move on to the "way we work".

In terms of people we believe we have some of the best in the industry. We aim to keep things simple and pragmatic in what is increasingly a demanding environment.

Let me take you through some of the other aspects within manufacturing in more detail.

The Way we Work – Organisation

Within manufacturing we have clear roles and responsibilities, all pulling together as one team.

The operations area is structured regionally, with some of the factories teamed together, to provide optimum support and the larger factories providing a "lead" in the region. This structure is most widely used in parts of the EU, Eastern Europe and Africa.

We also have defined central functions responsible for ensuring standardisation and driving delivery in a number of key disciplines.

The Way we Work – Management Systems and Processes

Manufacturing would not operate without effective systems and processes, and we pride ourselves on our ability to deliver excellence in this area.

Our systems and processes cover quality, both service and product, the environment, the protection of our people and use of resources, the delivery of our projects and the performance and development of our people.

The Way we Work – Cost and Performance Management

Cost and performance management is what manufacturing is all about.

Our ongoing focus on driving simplification and standardisation, performance measurement through the use of defined "key performance indicators" and the relentless focus on continuous improvement.

Application of key financial criteria is also a prominent tool in the evaluation of major business projects.

In the current climate the balance between cost and cash requires careful management, with KPI's flexed as appropriate to meet changing requirements.

The next couple of slides emphasise our focus on simplification, and our delivery to date.

Simplification – blend rationalisation

Since the acquisition of Reemtsma we have seen considerable progress in the area of blend rationalisation, with ongoing rationalisation a key support to delivery of our cost initiatives.

From 387 blends in 2002, we had 138 in 2008, excluding Altadis.

Simplification – ingredients reduction

In an ever increasing legislative environment, reduced ingredients usage is beneficial when we consider the cost of potential future product testing regulations. Up to 2007, we concentrated on the "absolute" number of ingredients and you can see that in OTP we reduced our ingredients from 588 in 2002 to 120 in 2007 with similar levels of reductions within cigarette. Since 2007 with an agreed palate of 185 single ingredients we work within this range in the development of our products, balancing standardisation and innovation.

Simplification – NTM specifications

There is a definite correlation between “non tobacco material” specifications and cost management.

We have been very successful in reducing specifications in this area, whilst maintaining our support to sales and marketing in the area of innovation. For example, in terms of acetate tows we have reduced the number of specifications we use from 24 in 2002 to 8 in 2008.

The Way we Work – Supporting Sales and Marketing

We have continuous dialogue with sales and marketing, who are, of course, our customer, on the best ways to support and deliver the agreed business objectives. There have been a number of developments implemented, specifically in the areas of project co-ordination, integrated supply chain & product innovation; specifically designed to support ongoing sales and marketing delivery and response speed.

Product development is also a key function, with a sensory network set-up to support ongoing blend developments and innovation toolboxes available for all products looking at product design, cost base and regulatory compliance.

The following two slides show examples of recent innovation in cigarette and fine cut tobacco.

Product Development – innovation in cigarette

Here you can see examples of innovation both in terms of packaging including Davidoff and JPS Pink as well as Fortuna and Lambert & Butler and in terms of product including JPS Ice and Super Slims. These innovations are available in a number of markets.

Product Development – innovation in FCT

Again further examples, but this time for fine cut tobacco & papers, innovation in terms of product, packaging, pack and format.

Our Cost Base

I'd now like to talk about the make up of our cost base.

Leaf and non-tobacco material costs are a broadly similar proportion of the cost base at around 30 per cent each, with conversion and other costs which mainly relate to central services, making up the remaining 40 per cent.

In 2009 we have been able to mitigate the impact of inflationary pressures on leaf costs by utilising surplus stocks and strategic buying, but we expect next year to be tougher for us and the rest of the industry, and so expect these costs to rise as a proportion of total costs.

Offsetting this we expect to see the conversion cost element decrease as we realise the benefits of our announced restructuring projects.

From a performance perspective, we have continued to deliver cost savings annually, across the whole cost base, since the acquisition of Reemtsma, despite a backdrop of both inflationary and legislative pressure and going forward we expect to continue to do so.

Altadis Integration – manufacturing

In the current financial year, of course, a key priority is on delivering the manufacturing proportion of the Altadis synergy targets, and the integration of the Altadis' manufacturing facilities is not solely about operations restructuring, it also encompasses a number of other objectives.

For example, the implementation of standard systems and processes, the leverage of business

standardisation and simplification, the adoption of best practice in all areas and the realisation and delivery of cost reduction opportunities.

Restructuring Programme – cigarette operations

In June 2008, we announced a number of restructuring projects as part of the integration process.

Within our cigarette operations, these have had an impact on 13 locations, with some 33 per cent of EU volume being relocated, around a 30 per cent reduction in roles and a capital investment programme of 100 million pounds

Restructuring Programme – FCT operations

And within our fine cut tobacco operations, the numbers are smaller but still 15 per cent of existing volumes will be relocated, a reduction of 30 per cent in roles and an investment of 35 million pounds.

Restructuring Programme – cigar operations

In cigar, we will consolidate all EU volumes into one location, Cantabria in Spain, with 60 per cent of volumes relocated, a 60 per cent reduction in roles but offsetting that around 7 per cent new roles being created. The investment will be around 15 million pounds.

As I am sure you will agree, a large and challenging programme.

Manufacturing Restructuring – building blocks

The overall programme has been broken into a number of “building blocks”.

This encompasses location upsizing, downsizing and closures but also process standardisation, such as AMRUM, our American blend concept as well as expanded shredded stem.

In addition, it includes the restructuring of our Central Manufacturing & Supply services into predominately one location, Hamburg.

So what progress have we made and where are we today.

Altadis Integration – current status (1)

In summary we have made significant progress in all areas.

We now have one manufacturing organisation in place covering the enlarged Group and consultations with Trade Unions and Works’ Councils have been finalised in all countries.

Our cigar factory in Smolnik, Slovakia was closed at the end of 2008.

Detailed plans have been developed for all the restructuring projects with steering groups in place to prioritise resource and monitor delivery.

Simplification opportunities have been confirmed and already been delivered. For example, we have already reduced the number of our stock keeping units by around 10 per cent, mainly in the EU.

We also now have standard reporting processes in place in all our factories; a pre-requisite for the ongoing setting of targets and the monitoring of performance against those targets.

Altadis Integration – current status (2)

A series of investments totalling some 140 million pounds has been agreed and approved over the past 12 months, with others to follow.

This slide highlights the main projects, in the two main process area, primary & secondary, with some specific investment for Supply Chain.

These will support capacity growth in a number of areas, process standardisation, flexibility, innovation and the delivery of our synergy targets.

They also cover areas outside the EU, such as Eastern Europe, Africa & the USA.

Altadis Integration – current status (3)

In the area of systems and processes, standards have been defined and a number of projects are in process.

AMRUM, is implemented and will be further progressed as investments are finalised.

Expanded shredded stem is now used extensively in the Altadis blend concepts and will be further adopted as the ESS plant is up and running in Lograno.

“Delphi” cigarette reclaim equipment has been ordered which will reduce waste and costs. These machines are being installed in all former Altadis factories.

PQRS, our standard quality measurement system, is now in place in all locations.

Cost reduction opportunities have been identified and are being delivered.

Furthermore, we are ready to reallocate and redeploy our surplus manufacturing equipment within the Group, giving benefits on product quality, overhead spend performance, productivity and waste reduction. Re-using machinery will also result in a reduction in capital expenditure over the next few years.

Other Projects – completed 2009

Apart from the Altadis integration, we have also completed a number of other projects.

The Taiwan factory is now completed and in full production, satisfying both local and regional requirements.

The Da Nang joint venture in Vietnam is also in place and the factory in production.

In Germany, we have begun the construction of the Langenhagen warehouse and secondary extension in support of our capacity increase.

And in Reidsville, North Carolina, the upgrading of our cigarette and fine cut tobacco facilities acquired with Commonwealth Brands is also nearing completion.

Taiwan Factory (1)

Just to finish off with a few pictures.

This is a view of the front of our new factory in Taiwan and the high rise warehouse. This is the first factory to be constructed in the country by an international tobacco company.

Taiwan Factory (2)

Here we have a view of the primary and secondary departments.

This state of the art facility is currently producing about 3 billion cigarettes per year and will enable us to respond more swiftly to changing market dynamics as well as provide a strong platform for further expansion in the Asia-Pacific region. We are now able to compete more effectively in the growing value segment and last December we launched Kane as part of this strategy.

Da Nang JV Facility

This picture shows the Da Nang joint venture facility in Vietnam.

Whilst annual volumes are currently low, production levels will improve as newly launched brands grow share.

Conclusion

So, in conclusion, this has been a challenging year – not just related to Altadis integration.

And as I said earlier, we operate in a dynamic, competitive industry and continually keep all our manufacturing operations under review in order to improve efficiencies, enhance productivity and maintain flexibility in adapting to changing market conditions.

These improvements have to be achieved without undermining our approach to best practice or our focus on quality and innovation.

Thank you ladies and gentlemen for your attention, I'll now take any questions.