



**British American Tobacco Half-Year Results 2015**  
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## PRESENTATION

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### **Nicandro Durante - *British American Tobacco plc – Chief Executive***

Good morning everyone. I'm Nicandro Durante, Chief Executive of British American Tobacco and with me is Finance Director, Ben Stevens.

This morning we'll be taking you through the interim results. Like last year, following this presentation, there will be the opportunity for you to ask questions.

And now to the headlines.

As we anticipated at the Prelims, we had a challenging first half, mainly due to a tough comparator. Despite this, I am pleased to say that the good underlying performance of the business has continued.

Group cigarette volume was down 2.9%, with underlying volume down 2.5%, as we continued to grow share in an industry we estimate to be down around 3.5%.

The GDBs posted another excellent performance with volume up 6.0%, driven by their continued strong growth in market share.

Currency movements had a significant effect on reported numbers. However, on a constant currency basis, revenue was up 2.4%.

Price mix was 5.3%, which compares favourably with the 3.1% we saw last year. The pricing environment continues to be better than last year, although Australia remains more competitive.

Margins were maintained at 39.2%, despite the absorption of significant transactional FX. This was an excellent result and reflects the continued good progress we are making on the cost base, including the implementation of the TaO/OneSAP programme.

As a result, constant currency operating profit grew 1.3%. Excluding the effects of transactional FX, operating profit would have grown by 5.4%, meeting our strategic metrics.

Reported EPS was 1.6% lower due to adverse currency translation of more than 5%. However, on a constant currency basis, EPS grew by 3.9% and excluding transactional FX, EPS would have grown by 8.1%.

These first half results are in line with our expectation, and I'm very happy with how the business is performing.

As the effect of the strong first half comparator unwinds, we expect an improved second half. I'm confident we remain on track for another year of good earnings growth on a constant currency basis.

I will now hand over to Ben, who will take you through the numbers in a little bit more detail.

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### **Ben Stevens - *British American Tobacco plc - Finance Director***

Thank you, Nicandro, and good morning, everyone.

Looking at the Group's performance by region:

Group cigarette volume of 322 billion was down 2.9% on the same period last year. This was a good result against a strong first half comparator.

Western Europe volume was down only 1.7%, as the weak economic environment continues to show signs of gradual improvement.

Strong pricing in the Americas, together with good results in Western Europe and EEMEA, helped group revenue grow by 2.4%, on a constant basis.

Strong results in Australia in the prior period impacted revenue and profit growth in ASPAC, masking an otherwise good underlying performance.

Group operating profit was up 1.3%, on a constant basis, as strong growth in the Americas and Western Europe was partially offset by results in ASPAC and EEMEA, where profits were impacted by transactional foreign exchange.

Translational currency headwinds affected all regions, resulting in reported revenue and profit both down 6%.

Turning now to currencies.

Given exchange rate volatility over the last 18 months, once again I would like to give some detail on the impact this has had on our results.

As you will see from this chart, Sterling has continued to appreciate against a number of our major currencies.

At the time of our year end announcement, I highlighted the movements in the Brazilian Real, the Russian Rouble and the Australian Dollar. These currencies have remained weak and, in some cases, have weakened further.

In addition, the current situation in Greece has had a significant effect on the Euro over the last few months.

For the six months to June, translational foreign exchange reduced earnings per share by more than 5%.

However, as I explained in the full year results announcement, these currency movements are not only causing sizeable translational impacts, but are also generating significant transactional headwinds.

Profit declined by 6% on a current basis, but at constant rates grew 1%. This was achieved despite absorbing a significant transactional exchange impact into our cost base.

As I mentioned in February, with our hedge positions unwinding and being replaced by hedges at less favourable rates, we expected larger transactional FX headwinds this year than in 2014.

As you know, we do not strip out the effect of these headwinds from our results, but if we did, we would have grown profit for the six months by 5.4%.

Based on our current exposure and hedging positions, at today's rates I would anticipate the full year transactional exposure to be around 6% on constant currency operating profit.

In addition, the translational currency headwind on EPS would be around 8%.

Turning now to the regions in more detail.

In ASPAC, volume was down only slightly against an industry decline of over 3%, reflecting strong share growth in most key markets.

Revenue and profit were both lower, principally due to unfavourable FX, geographic mix dilution, as we continue to grow strongly in lower priced emerging markets, and the more competitive pricing environment in Australia.

This offset strong revenue and profit growth in a number of markets including South Korea, Pakistan and Bangladesh.

In Australia, volume declined as the overall market contracted following the large excise-driven price increases. Pricing remains more competitive, which led to lower profits. However, overall corporate share has recovered and remains stable at just over 40%.

In Indonesia, Dunhill continued to grow both volume and share, despite excise increases driving an overall industry volume decline. Although Indonesia remains an investment market, profitability improved in the period.

In Japan, profit was flat, as mix improvement and cost savings offset adverse transactional FX. Share continued to grow, reaching 12.7%, driven by another strong performance from Kent. Volume was marginally lower.

A continued strong performance in Bangladesh and Pakistan drove good increases in volume, revenue, profit and share.

The GDBs again performed very well with volume up 7.0%, driven by the outstanding performance of Pall Mall in Pakistan, Dunhill in Indonesia, Rothmans in Australia and Kent in Japan.

In the Americas region, reported revenue and profit declined due to exchange rate movements.

However, on a constant basis, strong pricing drove double digit revenue growth. Profit was also up strongly with good performances in Canada, Mexico, Chile and the Caribbean.

Industry volume declines in Brazil and Argentina more than offset volume growth in Mexico, leading to regional volume down 4.4%.

In Brazil, volume declined as the overall market was impacted by a weak macro-economic environment. This, together with excise-driven price increases led to an increase in illicit trade. Profit was lower at constant rates, despite good price/mix, as a result of lower volume and increased price competition in the low segment.

In Canada, profit in constant terms grew for the third consecutive year, mainly due to favourable pricing. Volume declined in line with the industry, following the rollover of steep excise increases in 2014. Share was slightly lower, but Pall Mall grew strongly. On the topic of Canadian litigation, last week the Quebec Court of Appeal accepted Imperial Tobacco Canada's arguments and cancelled the Provisional Execution order. This allows ITC to focus on its appeal of the original class action judgement.

Mexico delivered another impressive performance in the first half. Profit grew strongly as a result of improved pricing and volume growth of nearly 10%, driven by share gains by Pall Mall and Lucky Strike.

GDB volume was up nearly 6%, due to excellent performances from Pall Mall in Mexico, Chile and Canada, Lucky Strike in Mexico and Chile and Dunhill in Brazil.

In Western Europe, the economic environment is improving, albeit slowly, and consequently, pricing appears to have normalised, driving growth in revenue at constant rates.

Good performances in Germany, Romania, Denmark, and Spain, together with cost savings, helped increase profit by 5.3% in constant terms.

At current rates revenue and profit declined 7.6% and 3.4% respectively, due to the weakness in the Euro.

Volume in the region was down 1.7% as market contractions across the region were partly offset by the unwinding of the inventory build in Denmark in 2014.

In Romania, profit grew driven by higher pricing, share growth and cost savings. Volume declined in line with the industry, however we strengthened our market leadership position, increasing share, with Dunhill and Pall Mall both performing well.

In the UK, volume and share grew, with a good performance from Rothmans.

In France, volume and share were up, driven by Lucky Strike.

The Global Drive Brands performed well across the region with volume up over 4% in a declining market, driven by good performances from Rothmans in Italy and the UK, Pall Mall in Poland, Germany and Romania and Lucky Strike in France.

Fine Cut volume declined by 6.3% as declines in Germany, France and the UK offset good performances in Hungary, Italy and Serbia.

EEMEA reported revenue and profit was significantly impacted by FX, in particular the depreciation of the Russian Rouble and Ukrainian Hryvnia.

Revenue in constant terms was up 2.6%, driven by good pricing.

Constant currency profit was down due to the impact of transactional FX, although this masks an otherwise good underlying performance.

Volume growth in Turkey, Iran and Kazakhstan was offset by industry volume decline in Russia and Ukraine.

However, regional share grew, due to good performances in Ukraine, Russia, Turkey and Kazakhstan.

In Russia, profit on a constant currency basis was down due to transactional FX. Share continued to grow, driven by the strong performance of Rothmans. Continued industry volume contraction following the large excise-driven price increases led to lower volume.

In South Africa, volume and profit declined, principally due to growth in the low price segment stimulated by a weak economic environment. Share was down despite good performances from Pall Mall and Benson and Hedges.

In Ukraine, profit was down due to transactional FX and down-trading. Volume declined due to market contraction; however a good performance from Rothmans led to an increase in total market share.

In Turkey, a good performance by Rothmans helped grow volume and share. A more competitive pricing environment led to lower profit.

The GDB volume in the region was up over 6%, with strong performances from Rothmans and Kent.

Operating Margin for the six months was maintained at 39.2%, compared to the same period last year.

On an underlying basis, excluding all currency effects, it was up by 120bps, reflecting a good performance on costs in all regions.

In Asia Pacific, good pricing in a number of markets and cost savings, as a result of improved productivity following the SAP implementation, drove a good underlying improvement in margin. This was more than offset by transactional FX in Japan, a margin decline in Australia and continued negative geographic mix.

In the Americas, operating margin increased 20 basis points, driven by good performances in Canada, Mexico, Chile and Venezuela.

Western Europe operating margin grew strongly due to good pricing in Germany, Poland and Romania and cost savings in the region.

EEMEA suffered significant transactional FX during H1, particularly in Russia and Ukraine, where consumer price increases lagged the increase in the cost base. We expect this to benefit the second half.

As you know, on average we aim to grow our operating margin between 50 and 100 basis points per year, and I remain confident of growing margins this year.

Reported earnings per share was 2% lower at 100.2p, although it was 4% higher at constant rates.

This was driven by profit growth, despite the transactional FX headwinds, together with good results from our Associates, in particular Reynolds American.

The share buyback programme, which we suspended in July last year also continued to make a small contribution.

In addition, the effective tax rate at constant rates was below last year at 29.7%, although at current rates it is only marginally below the same period last year at 30.6%.

Net Finance costs increased, mainly due to the funding raised to maintain our holding in Reynolds American and support its purchase of Lorillard.

Now on to cash flow. Overall free cash flow was £766m which is £199m above the same period last year. Exchange rates had minimal impact on this movement.

Depreciation is the main component of non-cash items.

Working capital outflows, at £609m, were lower than this time last year and this is partially due to higher working capital at the start of the year. As always, I would like to caution that the timing of working capital movements tends to absorb cash in the first half. This is largely driven by the timing of leaf purchases, although there is also an element of stock builds. I expect the increase to partially unwind by the year end.

Net capital expenditure of £196m is below the same period last year. As our spend on the SAP programme is beginning to wind down, I expect gross capex to be lower, at around £650m this year.

Pension fund outflows related to shortfall funding for UK schemes and are in line with last year.

Outflows for finance costs were slightly lower and the small reduction in tax outflows is primarily due to exchange rate movements in some key markets, as well as the timing of tax outflows in others.

Restructuring outflows are slightly lower, aided by exchange rates, as we continue to incur costs associated with rolling out the new operating model and SAP implementation.

Dividends from associates were lower than the same period last year, which included the proceeds from the Reynolds share buyback programme, closed at the end of May 2014.

This delivers free cash flow of £766mn.

Finally, I'd like to touch on financing and shareholder return.

Over the last six months we've invested \$4.6 billion to maintain our 42% holding in the enlarged Reynolds American business.

We have also made proposals to purchase the remaining 24.7% of Souza Cruz shares not already owned by BAT at a cost of some £2 billion, and announce the proposed acquisition of TDR in Croatia for €550 million. Each of these investments will enhance shareholder returns.

Net debt increased by £2.9 billion; however, our credit rating was held at A3 by Moody's and at A- by Fitch and S&P.

We suspended the share buyback programme from the end of July 2014, and as we've said previously we do not expect to restart the share buyback programme until 2017.

In addition, we increased our full-year dividend in 2014 by 4% despite the impact that translational FX headwinds had on our reported results.

We remain committed to growing shareholder returns and will be increasing the dividend in 2015, reflecting our confidence in the underlying strength of the business.

Thank you. That's all for now, and I'll hand you back to Nicandro.

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**Nicandro Durante - *British American Tobacco plc* – Chief Executive**

Thank you Ben. Having gone through the details of the numbers, I would now like to take you through a few highlights of the year so far.

As we have explained, a tough comparator and significant FX have impacted our first half performance metrics; however, I am very pleased that BAT continues to perform well on an underlying basis.

In general, pricing across the industry is stronger than last year, as reflected in our price mix of 5.3%.

We have also continued to grow market share. In the first half, corporate share was up 40 basis points, benefiting from a particularly strong result in South Korea and continued growth in markets such as Bangladesh, Pakistan, Mexico, Turkey, Ukraine and Kazakhstan.

This builds on the consistent growth in market share we have achieved in recent years. We have now grown share by more than 130 basis points over the last 5 years.

All four regions performed well. In EEMEA and the Americas, share grew by 20 basis points.

In Western Europe, share is up in the UK, France, Poland and Romania and regional share has now been held flat over the last 12 months.

In ASPAC, share was up strongly, growing 70 basis points, driven mainly by South Korea, Pakistan, Bangladesh, Japan, Australia and Indonesia.

This share performance is an excellent result and is, I believe, one of the best indicators of the underlying health of the business.

The GDBs have been a key driver of our share growth and they have continued to grow strongly, with volume up 6% and share up 80 basis points in the first half of the year.

Together they now account for 44% of the overall portfolio in terms of volume.

Now, turning briefly to each of the brands:

Dunhill delivered another excellent performance with volume up 2.4%, driven mainly by growth in Indonesia and Brazil.

The brand's share was up 20 basis points with strong performances in Indonesia, South Korea and Brazil.

In Indonesia, Dunhill volume grew by 35%, helping to increase national market share to 4.3% in May. Dunhill Filter, the full flavour kretek launched in November last year, has been the most successful launch in Indonesia in recent history, already gaining a 1.6% share of the market in May.

In Brazil, Dunhill continues to reach new heights, growing to a record share of 12.8% in May.

This year also saw the successful launch of Dunhill tubes in ASPAC, predominantly in South Korea, with tube volumes now 14% of Dunhill innovation volume.

Innovations account for over 80% of volume and continue to grow.

Dunhill remains one of the key drivers of the Group's continued growth in premium share.

Kent volume was down 0.9% in the first half, mainly due to industry volume decline in Russia and Ukraine. This offset the brand's strong volume growth in the Middle East, Turkey and Japan.

Kent's share was stable, with growth mainly in Turkey and Japan offset by a small decline in Russia. However, Kent maintained its premium segment share and remains the leading premium brand in the country.

In Japan, share grew 30 basis points to 7.5%, due to the success of tube filters across the core range and the continued growth of Kent Slimmer variants.

Kent tubes grew strongly in EEMEA, with new launches across the region. In total, innovations now account for 80% of the brand's volume.

Lucky Strike continued its good performance, with volume up nearly 3%, driven mainly by France, Benelux, Serbia and Mexico.

In France, Lucky Strike remains the fastest growing brand in the market this year. Share reached a record high of 8% in May, driven by the Capsule and Additive Free ranges.

The brand also posted good performances in Mexico, Argentina and Belgium.

Overall share grew by 10 basis points.

New Lucky Strike innovations, such as the Black Series double-capsules in Spain and Poland and the world's first four-in-one Mix Pack in Mexico, are showing very encouraging initial results.

Overall, Lucky Strike Innovations grew strongly and were up over 14%, mainly driven by capsules and additive free.

Pall Mall posted another good result, growing both volume and share.

Volume was up 2.8% with good performances mainly in Pakistan, Poland, Romania and the Americas.

In Pakistan volume was up 14% and in Poland the brand continues to grow strongly with share now over 5%, up nearly 300 basis points on this time last year.

In Mexico, the brand also continues to perform well, growing both volume and share.

Finally, Pall Mall is now the fastest growing brand in Romania. Volume grew by over 12% and share by more than 100 basis points.

Overall share was up 10 basis points during the first half of 2015.

Rothmans had another outstanding performance with volume up nearly 37% and share growing 40 basis points.

This was driven by strong performances in a number of markets including Russia, Ukraine, Australia, Turkey, Kazakhstan and Italy.

In Russia, Rothmans continued to increase its share and is now at 4.7%, driven by its slimmer variants. In Australia, the brand grew strongly with share now almost 13% just 12 months after launch.

In Turkey, Rothmans has already reached a share of almost 2% following its launch at the beginning of the year. This makes Rothmans one of the fastest market entries in Turkey in the last ten years.

Rothmans is the fastest growing GDB in the EEMEA region. In Russia, Ukraine and Kazakhstan, Rothmans has grown volume by over 50% and now has a share of around 5% in all three countries, driven mainly by the success of demi-slimes.

Elsewhere, we also saw a good performance from our China JV brands, State Express 555 and Shuang Xi.

As Ben has already said, we had another strong result on operating margin, maintaining it at record levels despite a significant transactional FX headwind.

Implementation of our TaO/OneSAP programme remains on time, on budget and on plan.

The success of this programme is a key contributor to the 120 basis points improvement in operating margin, excluding all currency impacts, that we have achieved at the half year.

We made good progress with our NGP developments during the first half of the year.

The Vype product pipeline continues to develop rapidly.

The Vype e-Pen and e-Stick, launched at the end of last year, are performing well, and we are now seeing an encouraging trend in the ratio of cartridges versus device sales.

In June, we launched a range of 9 new flavours and nicotine strengths in ePen and eStick formats.

In July, we expanded Vype with the launch of the Vype e-Tank and Vype e-Liquids. This is our open-system product designed to compete in the fastest growing segment of the vapour market. We will launch in additional markets in the coming months.

Launch plans for Voke, our nicotine aerosol product, which received a medicines licence, are in development. We expect to be in-market in the UK around the year end.

Finally, plans to test market one of our Tobacco Heating Product platforms in 2015 are progressing well.

We remain excited about the opportunity in NGPs and believe all three categories, Tobacco Heating Products, Vapour and also Licensed Medicinal products, have good potential.

Turning now to M&A, we had an active first half.

Following FTC approval in May, we are pleased that the Reynolds deal completed as expected during the first half.

This is an excellent deal for Reynolds from a strategic standpoint. Reynolds now has a very strong brand portfolio with excellent growth prospects. Our \$4.7bn investment has maintained our 42% holding in what is a much stronger and more competitive company.



Regarding Souza Cruz, we expect to be in a position to formally launch the offer for the 24.7% minority shareholding in the second half of August. At present, we remain in discussions with the Brazilian regulator, the CVM, regarding the offer documentation. We expect these discussions to conclude in early August.

During the first half, we also announced the proposed acquisition of TDR in Croatia. This will give us a much stronger market position in South East Europe, with leadership in Croatia and Bosnia, two markets where we are currently not well represented, and a strong number two position in Serbia. The deal has now received local shareholder approval and, subject to anti-trust approval, is expected to close in October.

In summary, the underlying business is performing well.

Our volume performance continues to outstrip the industry and we have good share growth momentum, powered by the continued success of the GDBs.

Price mix of 5.3% reflects good pricing in the vast majority of our markets.

Exchange rates remain a key challenge this year, but we still grew operating profit, despite more than 4% transactional FX impact. Excluding the effects of transactional FX, operating profit would have been up by 5.4%, meeting our strategic metrics.

Margin was stable at 39.2%, an excellent result given the transactional FX headwind.

We continue to expect a good second half performance. This is helped by a more like-for-like comparison base, as the impact of the strong H1 comparator unwinds, and we start to see the benefit of recent M&A investments.

I remain confident that we are on track for another good year of earnings growth on a constant currency basis.

Now I'd like to open for the Q&A session, and I'd like to ask you who would like to start?

## **QUESTION AND ANSWER**

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### ***Operator***

The first question comes from the line of Jon Leinster from Panmure Gordon. Please go ahead, your line is open.

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### ***Jonathan Leinster – Panmure Gordon & Co – Analyst***

Thank you very much. Good morning gentlemen.

Just a couple of questions, really, on the margins. I mean, on the Cantos interview, Ben, I think you suggested that the currency transaction would have a substantially bigger impact in the second half, mentioning, sort of 8% off operating profits versus four in the first half. But at the same time, of course, you've mentioned that you expect margin progress in the full year and therefore presumably in the second half.

And I was wondering, really, how you can – clearly there are going to be some easier comparator – but I mean, what's driving your confidence that margins will improve in the second half, given the mid-year currency transactional impact, and has that currency transactional impact got worse than when you stated it originally at the full-year results in 2014?

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### ***Ben Stevens - British American Tobacco plc – Finance Director***

Okay, well margins obviously break down into two parts, Jon – so you've got the pricing impact on margins and you've got the cost reduction impact on margins – and over the years it's tended to be about, sort of, 50/50 contribution.

So in the second half of the year, we've had price increases that have happened a little later than maybe in 2014, so we've got the second-half effect of those rolling through, and that will help us in terms of operating margin in the second half.

And also, of course, our SAP programme is fully live across Europe, it's fully live across Asia, so we will see extra savings coming through from that as well.

So I think that those are two drivers of operating margin going forward.

And then of course Australia, we'll have a more similar comparison for the full year than we had for the first half of this year against the first half of last year, so that gives me some confidence in terms of the fact that we will grow margins.

Yeah, of course, you know, it's – everything is wildly thrown off track by significant changes in FX rates.

FX rates do look a little bit worse than the guidance I gave at the half-year, so I was talking about 5% guidance on transactional impact on profit at 2015 full-year result. That's looking more like 6% now in terms of transactional.

In terms of translational, I was talking about 7%; that's looking closer to 9% now on operating profit, about 8% on EPS.

But, you know, we continue to drive the cost base down, we continue to sweat the benefits out of the SAP system; as Nicandro says, it's on time, it's on budget and it's on spec, and that makes it in a very small company of SAP implementations, I have to say.

And we're just driving the cost base down, as we have to do.

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**Jonathan Leinster – Panmure Gordon & Co – Analyst**

Just to follow up and be absolutely clear: in terms of the margins rising, is that a current currency or is that a constant currency?

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**Ben Stevens - British American Tobacco plc – Finance Director**

No, I only quote margins at current rates. I think you can get into an awful, sort of, maze if you start quoting margins at constant currency and then excluding this and excluding that, so just take that as a current rate.

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**Jonathan Leinster – Panmure Gordon & Co – Analyst**

And lastly – sorry, lastly, just to say on the SAP programme: has that surprised you by how much additional savings that's brought through? That's clearly been quite a bit impact and therefore, when we look at the, sort of – at the rate of savings going forward as you roll out across the Americas and EEMEA regions, would you expect that to be perhaps a bigger impact than you thought – previously?

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**Ben Stevens - British American Tobacco plc – Finance Director**

Well, I think as you deploy SAP, other ways of saving money occur to you as you go forward through the process. So SAP, you know, is a project we undertook, it had its own payback on the assumptions we made at the start, but we're delighted by the way it's been rolling out, we're delighted at the impact it's had on the operating model for BAT, so it's – you know, it's working very well.

It's also got implications for working capital, which allows us to – you know, with better – it's not just SAP, of course, you know, it's the overall processes that go behind it, so with better sales operations planning, you know, we can drive our working capital down, we spend less money in terms of write-offs, we can talk to our suppliers about having longer-term order duration, so all of these things help in terms of driving margins from SAP.

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**Jonathan Leinster – Panmure Gordon & Co – Analyst**

Okay. Thank you very much.

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**Operator**

The following question comes from the line of David Hayes from Nomura. Please go ahead, your line is open.

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**David Hayes – Nomura – Analyst**

Morning gentlemen, thank you.

So if I could just start with a couple of moving parts in terms of that margin progression, to follow up on Jon's point. You mentioned that the release of, I think, Argentina marketing spend was phased into the second half. I just wondered whether you can quantify the impact of that, whether that's actually relatively negligible?

And then similarly, in terms of a lot of product launches in the pipeline, which you outlined, Nicandro, just now: will there be costs incurred, particularly in the 'heat-not-burn' that will be a step up in terms of getting into those test markets?

And then also on the volume: you talk in the release – I may have missed this – you talk in the release about 40-basis-point, one-off volume impact, -2.9 being -2.5. I couldn't see anywhere what that was referring to? I just wondered whether you can talk about that dynamic and whether in the second half, the way the dynamic works, you catch that up?

Thanks very much.

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**Nicandro Durante - British American Tobacco plc – Chief Executive**

Let me try to answer the last two questions.

The first one, you were talking about the underlying volume, 2.5 against 2.9, and the reason for that is because of the implementation of the TOM And One SAP programme this year.

We had to – we had some – a little bit of loading last year, in December. That was 0.1–0.2% of the full year last year, but for the half-year is 0.4, so it's just some loading that we had at the end of last year to be able to go for the implementation of the TaO SAP in more than 75 markets at the beginning of this year. That's the reason for that.

Regarding the additional investments for the second half of the year: talking about the combustible business, there is no – I don't think that you have a different trend that we have at the beginning of the year.

We have a very solid cycle planned in terms of product launch. As I keep saying, this is the moment to offer consumers value, to offer consumers premium propositions.

I'd like to take advantage of the question to say that even in markets that we see down trading, for example in places like Brazil, our portfolio is up trading. Dunhill, in May, reached – as a premium proposition in Brazil – reached the highest share ever with 12.8%, so we see a polarisation of the markets. Consumers are still trading up in Brazil because of Dunhill, and trading down because low-price segment illicit trade is growing, but that's the beauty of having a very strong cycle plan throughout the year. So I don't expect to have market spend disproportionately increased in the second half against the first half.

Regarding the next-generation product: of course, we intend to launch, towards the end of the year, the Voke brand, the medicinal product, as I said previously.

We don't have a date yet, because as you see, it's the first launch in the world of a medicinal product. You have a lot of complexities in terms of supply chain and having even the communication material approved by MHRA, so it's taking a little bit more time, which is normal, we expect that.

So if it's going to be launched at the end of this year, you have some costs for the launch. It's going to be at the beginning of next year, the cost is going to be next year, but I don't think that's going to be substantial.

In the vapour side, Vype, we're extending Vype for five or six markets this year throughout Europe. I cannot disclose now which markets they are going to be, but they are going to hit the market in the second half. We will have a step

up of investments there, but it's all booked in our numbers, and when you are going to – when you are saying that you will have a stronger second half, we are already taking this into account.

And also tobacco heating device, we have a test market at the end of this year, so it's already in the numbers as well.

And even with those investments, we still believe that we're going to have a much stronger second half as compared to the first half for a lot of reasons, also because we have more like-for-like comparator against the second half for last year.

So I hope that I answered the last two questions, and there is a point on the margins that I think that Ben is going to cover now.

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**Ben Stevens - *British American Tobacco Plc - Finance Director & CIO***

Yeah, David, just to go back to your first question. I mean, timing of marketing spend is significant in the Argentinian context, but it makes no difference at all to the regional results or indeed the Group results.

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**David Hayes – *Nomura – Analyst***

Okay. Just on that margin, pushing it a little bit further: Ben, you kind of teased us a little bit with the 50–100 mentioned in your comments, and the margin up. Do we take that teasing being that you may get to 50-plus, or is that too detailed to get into?

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**Ben Stevens - *British American Tobacco Plc - Finance Director***

I'm not going to forecast operating margin for this year, David, but I enjoyed teasing you though.

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**David Hayes – *Nomura – Analyst***

Okay, fair enough. Thank you very much. Thank you.

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***Operator***

The following question comes from Rey Wium from Renaissance Capital. Please go ahead, your line is open.

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**Rey Wium – *Renaissance Capital – Analyst***

Hi, good morning guys.

Just two questions on some of the regional dynamics. If we look at the European volumes down 1.7%, how should we, sort of, think of it in terms of maybe the remainder of the year? I mean, I know you mentioned some benefit from the Denmark trade load, so just some colour on that.

And then in terms of the Asia negative price mix of 2.1%: obviously I would understand that's a lot of country mix in there, but I don't know if you maybe can quantify a little bit more in terms of what the impact was of Australia on that negative price mix as well?

Thank you.

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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

Okay. Let me talk a little bit about Western Europe.

Western Europe has – the volume decline in Western Europe is improving, albeit slowly, but it is better than the previous year.

We think that the market decline in Western Europe is around 2.5%, it's going to be around 3% for the full year because we've had some pricing coming through.

We have a total tobacco volume decline in 2.5%.

We have a good position in share: in several markets we are growing share, in places like France, Poland, UK, Netherlands, Romania, and good share momentum in places like Germany, Belgium and Denmark.

I think that BAT should do a little bit better than the overall industry decline in Western Europe.

I hope that I answered your question, Ray.

The second point regarding the impact of Australia in the price mix in Asia: well, we are doing extremely well in Asia, as you know, and we are growing market share everywhere.

Of the top 11 markets in Asia, we grew market share in ten, and the other one we are stable, so it's quite a strong performance.

But then you see markets like Bangladesh, Pakistan, in which we do extremely well, have lower margins than markets such as Australia and Japan, and because – just because of the growth of the market that grows in different dynamics, in different rate, you see the mix getting poorer.

If you're talking now about the lack of pricing or not having the same pricing dynamic in Australia this year that you had in previous years, and how was the impact in margin, I have to go back on that one to you because I don't have that.

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**Rey Wium – Renaissance Capital – Analyst**

Okay, thanks. Maybe just a quick little follow-up. You mentioned Iran in your commentary; can you maybe just give us a little bit of an indication of, you know, how important Iran is the EEMEA region? I would guess it is probably substantial in terms of volumes.

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Well, it's quite an important market for the future. It's not a significant profit contributor to the region. It's one of those markets that have a low margin, but we believe that it is a market for the future.

From the volume and share perspective, we are doing extremely well. The leading brand in the market is Kent; Kent has been growing very fast in Iran. We are extremely happy with the successes that you have – we have there so far.

We don't have readings by Nielsen. As you know, BAT only quotes offtake share produced by Nielsen, we don't quote shipment share; that's why we don't talk about share in Iran.

But if – our estimate for Iran, we came from market share two years ago that was below 20%; now is around 30%, so we are growing very fast in Iran, we are doing extremely well there.

But it is a very – nowadays, there is a very low contribution in Iran, because it is not a very high growth market – high-margin market in the region.

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**Rey Wium – Renaissance Capital – Analyst**

Thank you.

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**Operator**

The following question comes from Adam Spielman from Citigroup. Please go ahead.

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**Adam Spielman - Citigroup - Analyst**

Hello, good morning.

Can I start – I've got three questions, but can I start with South Africa? I think you said that profit was down, share is difficult. I was wondering if you could talk about how you see the outlook for that market?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Okay, let me start with South Africa.

First of all, talking about the dynamics of the market, what we see in South Africa is sub-optimal GDB growth, and a deteriorating environment. We have high inflation and growing unemployment, so these are the dynamics of the market. And because of that, we see some down trading there, and we see that low price brands are growing market share. That is the scenario of South Africa.

However, we are not doing badly; we are doing very well. South Africa is one of those markets that you – we have an outstanding portfolio, outstanding trading marketing capabilities and outstanding people, so we are doing well there.

What we see in South Africa is that international players are playing in the value-for-money segment, with several launches in the value-for-money segment. And you have a segment in low price – and I'm not talking here about illicit trade – we should have local companies playing there, but if you consider the prices that they are pricing their products, it's below margin, it's below break-even, so that's the reality of the markets. But even then in the legal segment, we are doing quite well in South Africa.

As I said, I think that we have the capabilities there to go through these tough times in South Africa and come out from this stronger than we went in.

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**Adam Spielman - Citigroup - Analyst**

Do you think it's going to be, I guess, a little bit like Canada or Australia, where it's a very high margin market down trading, and it's going to take a long time before we get back to growth?

I mean, should we think of it as basically now, for the next couple of years, difficult for you to grow profit in South Africa?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Adam, in the last years we have been growing profit in South Africa. We have not been declining in profit. If you're talking about the future, I don't know what's going to happen in the future, to be honest.

As I said, the position that we have in South Africa is a little bit different than the position that we have in other markets. We have a leadership position in South Africa, extremely strong brands, and an outstanding organisation, outstanding trading marketing capabilities. We are the only company there with direct distribution system that put us in a very good position to compete in the market, so I'm not – I don't think that I'm able to make predictions about what is going to happen in South Africa in the next five years, but so far so good, we were doing very well there.

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**Adam Spielman - Citigroup - Analyst**

Okay.

And just turning to Brazil: obviously Souza Cruz has had pretty weak results in the first half of this year.

Can you just talk about – and we know there's been down trading and we know there's a stocking impact in Q1 – but can you talk about – a little bit about Q2, and also how you see the second half playing out in Brazil?

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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

Well, what I can talk to you – I never like to talk about quarters, because analysing the results of companies on a quarterly basis is very difficult, because you have movement of stocks from one quarter to another, it distorts a little bit the results, so let me talk about the first half in Brazil.

It's not a very different case than South Africa in terms of economic environment. Unemployment is going up, disposable income is coming down, and if you look at the consumer goods in general in Brazil, we are facing tough times.

Volume is declining, we saw some growth in illicit trades, that's the reason that Brazil is not – Souza Cruz is not doing as well as it did in the past.

However, Brazil's market share is stable in this environment after substantial growth in the last three years. So it is sustaining a very high level. Dunhill is our premium position, it's still growing, so our portfolio – I'm not talking about the tobacco industry in Brazil, but our portfolio sees some premiumisation, people coming from mid-price to premium, through Dunhill, but we see a lot of price competition at the bottom of the market.

We see local companies that don't fully pay tax competing there with us, which makes our life difficult because the price difference is quite substantial.

And I don't think that things will improve a lot in the future unless the economic situation of the country changes. These are just tough times in Brazil. People have not got money to spend, and it's difficult.

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**Adam Spielman - *Citigroup - Analyst***

Okay thank you.

And then just finally, turning to innovation: I was just wondering, you said you've got a lot of, sort of, new products planned for the second half.

Should we think about those being mainly tubes, or is there a sort of, new big innovation that's, sort of, coming down that we will see fairly soon, beyond what you've got in the market at the moment in combustibles?

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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

Well, yes Adam, the innovations pipeline of BAT is very strong as you know, throughout the years.

One of the reasons why you see a deterioration of pricing across the system, some down trading in the world – in our portfolio is still growing premium. So the percentage of premium brands in our portfolio is more relevant now than it was in the first half of last year, because we are driving innovations very strongly as I said at the moment, to give value to consumers, to give them a reason why to up trade and keep in the premium segment. That's why we have very strong launch plans throughout the year as we had in the last year.

We have a lot of innovations coming through the ranks, but don't forget that a new innovation in the market – we are in 200 markets around the world – it will be a new innovation in the other 199, so there is a lot of rollout of innovations.

There is some new stuff coming, like we launched in a pack, four different novel capsules in Mexico recently, and some other things that you are going through that I cannot disclose for competitive reasons now, of course. We have some new stuff coming, and a lot of rollout of the innovations that you currently have in the markets.

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**Adam Spielman - *Citigroup - Analyst***

Okay, thank you very much.

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**Operator**

The following question comes from James Bushnell from Exane. Please go ahead, your line is open.



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**James Bushnell – Exane BNP Paribus - Analyst**

Hi, thank you for taking my question.

In fact I have two questions.

My first one is on the Americas region. Clearly you've had some very strong results there despite, as you've just mentioned, Brazil not being so great. I was wondering what impact Argentina and Venezuela had in that? Obviously those are countries with pretty high inflation, and I just wonder maybe what the growth of 11% might have been excluding those two countries, if it's possible to either quantify or give us a flavour on that please?

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**Ben Stevens - British American Tobacco Plc - Finance Director**

Yes, James, it's Ben here.

You can take about 2% off the growth rate on profit for EEMEA if you exclude Venezuela from the figures – sorry, from Americas, if you can exclude Venezuela from the numbers.

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**James Bushnell - Exane BNP Paribus - Analyst**

Great, yes, thank you.

The second question I had was on pricing in Europe.

Now, clearly your volumes were pretty good by historical standards, but the price mix you commented, that pricing seems to have normalised there. I just wondered if you could maybe talk a bit more broadly about why your pricing is still 'only', if I can put it that way, +3%. And in particular, there was a comment in the release about trade margins in France being up, and I just wondered if you could elaborate on that a bit more please?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Well, pricing in Western Europe in general this year has been much more aggressive than it was last year, so it is a much more stable price environment in Western Europe.

It's very difficult to talk about pricing in the middle of the year, but I still see the possibility for more pricing to come in Western Europe in the second half. So, I see a very solid environment for pricing, not only in Western Europe but across the world to be honest.

We have an exception; we have some competitive pricings in places like Australia.

But in general, you see that there's a very strong pricing environment. 5.3% pricing mix this year in general is quite a solid one, if you compare to the last five, seven, eight years. So, the price is in a good place.

Talking a little bit about France. In France, the reality is – I see that this likely change in trading margins is five base points; 0.05 percentage increase. This is basically a plan that was introduced by the government that was a five-year plan that started in 2012 to 2016. This was to compensate the loss in market volumes impact in border retailers, but because we don't have pricing in January 2015, we end up absorbing this increase in the margins, but it was minimal.

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**James Bushnell - Exane BNP Paribus - Analyst**

Okay.

And perhaps on that same subject, I was wondering if you could give any opinion as to whether you thought some of the current proposals to increase that trade margin a bit more substantially had any traction with the French political establishment? Do you think that's a risk that trade margins could be significantly hiked in France?



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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

Well, I don't see nowadays any plans to increase trade margins substantially in France, and I haven't heard anything about that. If you are asking the question, 'Is this going to happen?' I really don't know, but we haven't heard anything about it.

So it's very difficult to answer this question for you, because I think that the risk of having – trade margins being increased in France is the same as the increase in trade margins in any other country in the world, but I haven't seen anything – we haven't seen any changes in the last couple of years. The ones that we saw in France are minimal, 0.05; it was a specific issue with cross-border trades indication from the Retailers Association. I think that it was a one-off.

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**James Bushnell - *Exane BNP Paribus - Analyst***

Okay, that's fine. Thank you very much.

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**Operator**

The following question comes from Michael Lavery from CLSA. Please go ahead, your line is open.

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**Michael Lavery - *CLSA - Analyst***

Good morning.

I just wanted to get an update on Australia. You just mentioned the pricing pressure there. Is that primarily mix related in terms of just more downtrading, or is there actual, like, you know, pricing being reduced or tax increases not being passed on? Can you just give us some sense of the dynamics there?

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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

The question as I understand it, is that: what is going on in Australia about down trading. Did I understand well your question, Michael?

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**Michael Lavery - *CLSA - Analyst***

Yeah, could you just give a sense maybe of what you're seeing competitively, or – some of what your expectations are for the second half?

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**Nicandro Durante - *British American Tobacco Plc - Chief Executive***

Okay Michael.

The situation, Mike, in Australia is that, as you know, we had – I have to go back in time a little bit to answer your question – we have a low price segment that was occupied for the last five, six years by one of our competitors, and we decided not to go there. Neither us, neither the other competitor as well, because we didn't want the segment to grow.

But because of substantial excise-driven price increases that we saw in Australia in the last three or four years, this segment has started growing, and because of these price increases you saw some widening of the price gaps in the market. So we had to compete there.

That's why we launched Rothmans – I think that was around 18 months ago – and Rothmans is doing extremely well. So our market share in Australia that was above 40, went down to 37, or 37-something; now it's back above 40.

So we are in a very good position in Australia: good market share, good portfolio, our brands are working. Winfield, that's the main brand in Australia, is not losing share any more. So, I think that's in a good shape.

The issue in Australia now is to get price through. So we have an excise increase, the third one of the four ad-hoc excise increases in Australia, at 12.5% per annum. That's going to happen I think, in September. Usually when you have an excise increase, you have a price increase. We will have to wait and see how things are going to move.

But we saw some down trading, but the down trading was caused by the industry to be honest, by launches in the low price segment, so we had to react. We launched Rothmans there. Needless to say, with the capabilities that we have in the market – and this is a very strong brand – the brand did extremely well. Our market share with Rothmans is above 13% already after 18 months. So fantastic performance.

So, now we have to see how the prices are going to evolve, and it's difficult for me to tell you what's going to happen with pricing. You know, the pricing is something that happens with all the competitors and how the people are going to move. We have to see how it is going. It's a very competitive market anyway, so we have to see how it's going to go.

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**Michael Lavery - CLSA - Analyst**

No, no, that's very helpful.

I guess maybe specifically I was trying to follow up on the reference you just made a moment ago, when you said there's a solid price environment almost everywhere in the world, but that Australia is the exception.

Can you just elaborate? Is it the risk that the next price increase doesn't come, or is it discounting that you're seeing versus price increases that have already been taking? What are some of the details behind what you meant there?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Well, from 2012 to 2015, so far in the last three years, we saw prices going up around 35% in Australia. So it's steep price increases, that's one of the reasons for widening the price gaps and for having some down trading as well.

But I cannot elaborate anything on pricing going forward. As I said, it's a very competitive market and that's something that – pricing, we don't predict. We have to see how things move, how our brands perform, how the competition reacts. We have to see how things evolve.

So, in this one, I have to say that we have to wait and see.

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**Michael Lavery - CLSA - Analyst**

Okay thanks.

And just on the heating product launch that you have – you mentioned for later this year: any more details that you could offer on that?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

In terms of product launch, for competitive reasons I cannot explain which markets, which brands, so I don't know what else I can say.

What I can tell you is that we have a very strong pipeline, and we think that this is the moment to give value to the consumers. As I said before, we believe that we have to keep investing in our premium portfolio. Our premium is performing very well. We grew share in premium more than 100 basis points in the first half of the year; that's a fantastic performance.

And I'd like to highlight here, when I quote market share, it's retail audit share supplied by Nielsen, which is quite a set of reliable numbers, so we're extremely happy with the numbers. I don't think that they happen by luck; they happen because we work hard and invest in the right markets, in the right segments with the right brands.

So we are going to have a very strong pipeline for the second half, as we have in the first half, as we had last year. That's why, if you look at – for the last five years, BAT has grown 130 basis points' market share, overall market share, which is a fantastic performance.

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**Michael Lavery - CLSA - Analyst**

No, no, that's great. Just on the heat-not-burn product: could you say if that's a product you've developed with Reynolds, or is that your own internal development? Anything referencing, kind of, what the product might be like?

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**Ben Stevens - British American Tobacco Plc - Finance Director**

That's an internally developed product.

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**Michael Lavery - CLSA - Analyst**

Okay.

And then just one very last quick one: are you subject to the same requirements in Indonesia to have a 7.5% free float, and do you have any plans to accommodate that by January?

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**Ben Stevens - British American Tobacco Plc - Finance Director**

We've had our discussions with the Indonesian regulators, and as far as we're concerned we're compliant with all the requirements of the market.

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**Michael Lavery - CLSA - Analyst**

Okay, great, thank you very much.

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**Operator**

And the last question for today comes from the line from Fulvio Cazzol from Goldman Sachs. Please go ahead, your line is open.

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**Fulvio Cazzol – Goldman Sachs - Analyst**

Yes, good morning gentleman. Thank you for taking my question.

I had two hopefully very quick questions.

First one is on Russia. You highlighted that you grew market share. I was wondering if you can give us some detail on exactly how much market share gains you've seen? And you've also stated that volumes were lower due to market contraction, and I guess I was interested in knowing what the market contraction number was that you're seeing in Russia?

My second question is just very basic housekeeping: guidance for CAPEX this year was £750 million given in February; is that still the number we should be thinking of for the full year?

Thank you.

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

In terms of volume decline for this year: as I said, the industry should be declining the first half of the year around 3.5%; I think that for the year it's going to be around 4%.

In the case of Russia, the first half of the year the industry declined around 8–9%. I think for the full year it's going to be a similar number.

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**Fulvio Cazzol – Goldman Sachs - Analyst**

Right, and how much market share did you gain?

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Well, market share in Russia for the first half of the year was up 10 basis points on top of a very good performance in terms of market share in 2014.

But more importantly we grew very strongly market share through Rothmans, and we lost some shares in the tail brands, that's below Rothmans. So I think that the quality of the portfolio is much better, but overall market share was 10 basis points up.

Then there was a final question that I understand that it was Forex, that you asked the question? We didn't get it?

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**Fulvio Cazzol – Goldman Sachs - Analyst**

Oh no sorry, CAPEX spend; CAPEX spend for the full year. I think it was £750 million?

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**Ben Stevens - British American Tobacco Plc - Finance Director**

Yes, we think – Fulvio, we think gross CAPEX will be about £650 million for the full year this year.

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**Operator**

As there are no further questions, I will return the conference back to you for the final comments.

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Okay guys, I would like to thank you for calling us for this call. We appreciate all the questions that you have asked. Thank you very much, and see you again in year-end. Thank you very much.