



British American Tobacco preliminary results 2015

Interviews with Nicandro Durante, CEO, and Ben Stevens, FD

Nicandro Durante, Chief Executive

Performance

Q: How have you performed over the full year, and did the second half come in as strong as you expected?

A: 2015 was a very good year for us, and the second half was very strong, as we anticipated at the interims. We faced in 2015 a very challenging economic environment, and because of that, we had some headwinds in currency, translational and transactional. But if you look on a constant basis, we grew revenue 5.4%. Profit was up 4% -- excluding transactional, 10%, which is quite a strong performance.

Share was up strongly last year in all the segments, Premium, GDBs, so very, very good. And if we look at underlying operating margin, it was 160 basis points up, but because of the impact of transactional FX, we had reported 60 basis points down.

Looking at EPS, it was constant, as well, 10% up. Excluding transactional impact, it would have been 16%, one of the best performances of this company, excluding currency, in the last 10 years. So it was indeed a fantastic year for BAT.

Q: The GDBs had an outstanding year, and Rothman's was the star performer. Can this continue?

A: I think so. If you look at the GDBs performance in the last 10 years, we have doubled the volume. Nowadays, GDBs are more than 45% of our total volume, so it is fantastic, and year after year, driven by innovations, the GDBs have performed very well.

And 2015 was no exception. Volumes are up 8.5%, and all the brands have performed extremely well, growing volume and share, with the exception of Kent, because of its premium position. It's growing the premium segment, but overall, the share was flat, so fantastic, when you look at the overall industry is declining 2.3% and the GDBs growing 8.5%. It is indeed a very good, performance.

In the case of Rothman's, what we're seeing across the world, we have seen some headwinds in terms of some portfolio mix, not in ours, but in the industry, and

Rothman's is playing extremely well in that segment that's growing very fast - that's the value for money segment.

Rothman's has grown 70 basis points last year. It is supplying consumers with a good quality, with very interesting premium SKUs. It's doing extremely well, so I don't see any reason for next year not to have also a very good performance for the GDBs.

Q: Pricing seems strong. Can it stay that way?

A: We had a very good 2015. Price was around 6% up, much higher than 2014, also, skewed to the second half of the year. If you look at February, we have gotten more than 60% of the pricing that we expect for the year, so things look very good for 2016 so far, despite some price competitiveness in the low price segment in some markets, but nothing so different than previous years. So I expect a good year of pricing in 2016.

Markets

Q: How have you performed across your regions?

A: We had a strong year in 2015, as I said it before, and it happened across the four regions. Let me start with Asia. Asia has done extremely well in 2015. If we look at the performance of the 11 top markets in Asia, we grew share in nine out of 11, and in two, we had a stable share. In places like Pakistan, Bangladesh, Japan, Malaysia, Indonesia -- all of those markets have done extremely well.

Of course, the region has been impacted by currency translation and transaction and some competitive pricing in Australia. And moving to Western Europe, also a very good performance, we have a much stronger price environment in 2015 than in 2014. We also had the acquisition of TDR that is going to make our business much stronger in Central Europe, which for me is -- there is a potential of very good growth in that part of the region.

You go to Americas, driven by strong pricing across the region, we have done very, very well on a constant basis, growing revenue and profit strongly. We had good performance across the region in places like Canada where we have seen a fourth year with strong profit growth, in Chile, and in Brazil, as well, despite the tough economic environment there.

But if we look at Brazil, we have a polarization, because Dunhill is doing so well in the premium segment that the brand has grown 120 basis points during the year in the overall market, in a market that we have seen some down trading. So it's quite a great performance with this brand.

If we look at EEMEA, very strong during the year, very strong performance, 50 basis points share growth in places like in Russia that grew one share point exit to exit, in 2015. We had good performance in places like Turkey, so across the region was very good, but also very impacted by transactional and translational headwinds.

Q: But what's your take on the performance and outlook for the emerging markets region?

A: Emerging markets are a very important component of our strategy. We believe that those markets are going to deliver the future growth of these organisations, so we are

very strong there. Overall industry is declining last year, declined 2.3%, and the emerging markets declined more or less at the same rate. But I don't think that we can put all the emerging markets in the same basket.

There are several of them, places like Vietnam, Bangladesh, Iran, Algeria that are still growing quite strongly. So BAT did very well there. We grew share. Half of our profit in 2015 came from those markets, emerging markets, so I'm very confident that we have the right strategy in place - that we are seeing the benefits, and you'll see more benefits in the future.

Acquisitions

Q: You've been quite active on the M&A front. Are you happy with the deals that you've done, and what does this mean for future potential M&A?

A: Well, 2015 was a busy year for BAT. We closed several deals that we had been working for some time, but I think that all of the acquisitions in 2015 were great acquisitions, great investments. I'm going to just mention four of them. If we start with Reynolds American, we decided to keep our shareholding in Reynolds American when they went with the deal with Lorillard, so it's a \$4.7bn investment. As you can see from the results that Reynolds American just published, it was a very sound business for us.

You go to Souza Cruz, which is a strong company. It's a fantastic company, in a country that will grow. You go back to growth, but of course, it faces a challenging economic environment in 2015. It has been tough for Brazil, but as I said with Dunhill, we are doing very well in premium segment, and the portfolio is very strong.

We are starting to integrate the company a little bit more with BAT with the leaf operation, the global leaf operation, with local leaf operation, so we are starting to see the benefits. We closed the Cachoeirinha plant, part of the plans that we have for the country, so the plans are going according to what we expected.

We had as well the TDR acquisition. I don't need to mention this. I just talked about that, so fantastic acquisition, gives us a leadership position in several markets, such as Croatia, Bosnia, Serbia, either number one or number two position. Fantastic.

And you go for the fourth one was Chic acquisition in Poland, which is quite a good acquisition for us to roll out our pipeline innovation in the vapour category, with Vype. It's a company that has 65% market share, 800 point of sales for their brands, so it's quite a good company in Poland. And if you break the power of their brands and our brands, I think that it will be a fantastic acquisition for us.

For 2016, you have to wait and see if something comes to the market and, if it's financially and strategically attractive, of course, we'll be interested.

Q: Have e-cigarettes already peaked, and will you continue to invest across the risk spectrum, as you've done to date?

A: E-cigarettes is a new category, but in order to answer your question, I'd like to take a step back and talk a little bit about NGPs in general, Next Generation Products. BAT's strategy has always been to play in the three categories, not only in the vapour category. We want to play in the vapour category, tobacco heating products and medicinal licence products.

In the vapour category, we have launched some good products, have invested behind this category for the last five years heavily. We have been able to produce and launch good products in 2015. The last one was eTank, and now we start the geographic expansion across Europe.

We are very happy with the results so far. In the case of case of UK, that we have been in the market for some time, we have 8% market share. You go back six months ago, we had 5%, so it's growing very fast, according to plans. In tobacco heating products, we launched glo iFuse in Romania, also less than two months ago.

The first results are encouraging. We expect to expand the distribution to Romania during the year and expand to other markets at the end of the year, this product is very exciting. And we also have a new product that we'll launch at the end of the year in this space.

Also, we have Vogue as a medicinal licence product. We are the only company in the world to have a licenced e-cigarette, and we expect to launch this during the year, as well.

I think at the end of the day, the consumers will decide which is the best product, and I think that the industry, there will be space in the industry for the three categories.

Outlook

Q: What's the outlook for 2016?

A: We started the year very well. We came from 2015 with very good momentum in terms of share growth. We grew share more than 40 basis points. We grew share in premium segment, 150 basis points, so we are coming to 2016 in a very good momentum. The second half of last year was quite strong in volume and share, so we are bringing this good momentum for 2016.

Of course, we still face some currency headwinds, mainly on the transactional side, but I expect that we will deliver our high single-figure earnings growth that has been our target for many years and we have been delivering for many years.

[End]

Ben Stevens, Finance Director

Earnings

Q: What's your take on the numbers, and can you run through the financials?

A: Yes, I think these are an excellent set of results. Clearly, the strategy is delivering the performance that we've made. We're growing market share, 40 basis points. Our Global Drive Brands growing in volume terms. And that's coming through in the financial results. So our operating profit was up 4% at constant currency, and our EPS was up 10%.

Of course, we faced an FX headwind, as well, so if you exclude transactional FX from that, our operating profit was up 10%, and our EPS was up 16%. So I think these are a really excellent set of results.

Q: But sterling weakened and the dollar strengthened towards the end of last year, so how did currencies impact the business over the course of that year?

A: Yes. We faced quite a substantial FX headwind during the course of this year. It got substantially worse in the second half, so FX moved against us by 24% in the second half of the year. So what was a transactional FX hit of 4% in the first half became 8% in the second half and 6% for the year as a whole.

For translation, what was 7% in the first half became 16% and 12% for the year as a whole, so we had a 24% FX headwind in the second half of the year. And that's why I think these results are even more creditable, given the amount of currency that we've had to fight against.

Margins

Q: Transactional FX had a big impact, hadn't it, on margins in 2015. Looking forward, are you still confident of delivering the 50 to 100 basis points' improvement per annum?

A: I think the growth in underlying operating margin has been very creditable this year. The delivery of the SAP program is starting to bite, so our underlying operating margin grew by 160 basis points for the year. Obviously, we had a very significant transactional FX hit to overcome, something like 190 basis

points in terms of operating margin, and one or two accounting adjustments in the year.

So overall, our operating margin on a like-for-like basis was down 30 basis points, but underlying operating margin grew substantially.

Balance sheet and cash

Q: You've been acquisitive on a few fronts, so where's that left debt and gearing ratios?

A: Net debt to EBITDA is 2.8 times at the end of the year. I think it'll stay around that in 2016, because a lot of the benefits of the acquisitions we've made come through below the EBITDA line. And we're not uncomfortable with that, so 2.8 times in the current low-interest-rate environment is not a bad place to be. We're very comfortable with that.

Q: And could you take us through where you think dividend growth will end up?

A: Well, I'm pleased to say that we've announced a 4% dividend increase this year, and we like to reward our shareholders with a real increase in the sterling dividend, even when we're facing significant FX headwinds, as we faced this year and indeed last year.

So that remains the policy. The payout ratio has grown to the mid-70 percents. If we ever get an FX tailwind, which at some time we will, because sterling is not going to strengthen forever, then we'll move back towards our long-term policy of a 65% payout ratio.

Q: So how do you see 2016 looking, especially in the light of currencies?

A: Well, the strategy continues to deliver. Now, it's very early days to start talking about foreign exchange for 2016, but if rates stayed where they are today, we would have a transactional FX hit of around 7%, so a little bit worse than last year, but a translational hit of only around 1%, so considerably better than last year. So we'll have to wait and see what happens in terms of FX, but I am convinced we will continue to deliver another year of good, constant-currency EPS growth.

[End]