BRITISH AMERICAN TOBACCO

Nicandro Durante, CEO

Half year performance

Q: How do you view the 2017 first half performance?

A: First half was very good. We had a volume decline of 5.6%, but it was mainly impacted by the timing of excise in Pakistan, and overall industry decline in Pakistan, plus a strong comparator, mainly due to Ukraine. But if you eliminate Pakistan from the numbers, our volume decline will have been 2.6%. that's pretty much our historic levels of decline.

Share was quite strong. We had 30 basis points of share growth, 50 basis points in our GDBs, so quite strong performance, again, in our GDBs. So very happy with that.

Adjusted revenue was up 2.5%. Profit was up 3.2%, all in constant, and EPS was 21% in current, 6.2% in constant. As you can see, the numbers stack up quite well in a year, in a half in which we have invested substantially behind our NGPs, two days ago we announced the acquisition of Reynolds American. It has been a quite a busy and very successful first half.

Markets

Q: You're saying the trading environment is particularly challenging in some of your largest markets. What are you seeing?

A: I don't think that has changed so much from what we saw in the prelims, what we commented in the prelims. It's tough out there, even though we are having a good performance in many, many markets in the world. But you take, for example, if you look at markets by region - let me start with Asia. Asia, very good performance overall in places like Australia, in New Zealand, in Vietnam, in Bangladesh, but I'd like to single out two markets there.

The first one is Japan, where we are doing well in combustible, growing share as we have been growing share over the years, so very good, but the organisation has been delivering glo for us, and has done a fantastic job, and in Malaysia, where the reason for the decline is driven by huge excise increases that you saw in the past that drove the market down, mainly towards illicits. But despite of that, the region has done quite well.

Western Europe is another region that we saw very good performance across the region, building in the momentum that we had in 2016. I mentioned, the full year's result, that you are leaving 2016 with a good momentum. It has continued into 2017. Good share growth in the region in places like Germany, Italy, Spain, Romania, so very good performance. So we are very happy with the share performance in Western Europe.

When you look at Americas as well, America has performed quite well in places like Canada, Chile, Venezuela, Colombia, Mexico as well, but in Brazil, it is very tough. The overall economic conditions in Brazil are not great. Consumers are down-trading, also, to illicit. So the consumers are under pressure there.

You take EMEA which is a region of two halves. You take Russia and South Africa, which is quite tough out there. Russia, we had significant excise increases in the last years that drove prices up. Consumers are under pressure, and in a very competitive price environment, currently. South Africa, I think that conditions are similar to the ones in Brazil. Consumers are also under pressure and trading down, but you look at our market share in South Africa, which has been stable for around nine, 10 months, so not doing that badly. The rest of that region, doing extremely well. In sub-Saharan African and in Turkey, good share growth, good performance overall.

So all in all, it hasn't changed so much from what I have said before, and the countries are performing well.

Global Drive Brands

Q: The Global Drive Brand volumes are down 1.3% after years of good growth. What's behind the decline, and are you satisfied with their performance?

A: Well, the Global Drive Brands, they have been basically the platform for growth of this company, and in my opinion they have done extremely well. We are growing, this year, 50 basis points in the first half of the year, on the back of 100 basis points last year. The Global Drive Brands, if you go back to 2010, they were around 30% of our portfolio. Now they are half of our portfolio. It is a fantastic performance.

The main reason for the volume decline is the overall industry declines in the markets where they are present. But market share of those brands are growing quite well. Kent, Lucky Strike, Rothmans, Pall Mall. The only brand that has declined in market share in the first half was Dunhill, and this is mainly driven by the down-trading we have saw in Malaysia and Brazil, two markets where the brand is quite big, so that is the reason that has been driving its market share down.

But the performance of Dunhill in those markets are improving quarter-by-quarter. I expect a better performance in the second half.

Next Generation Products

Q: How's the roll-out in glo in Japan progressing? Can you talk about the progress you're making in this category?

A: Well, in the case of Japan, with glo we are doing very well. I'm very happy with the performance. You take, for example, Sendai, when we launched it six months ago. Now we have around 8% market share. That’s a remarkable performance, much above our expectations.

So we decided to roll out to Tokyo, Osaka, and the whole Miyagi region, which Sendai is part of, and the results are even better than the ones that we got in Sendai at the same time. After three weeks, we have in Tokyo 3% market share, in Osaka 2.4%, in the whole Miyagi region, 6.1%, which includes Sendai of course, as I said. So the results are really, really fantastic.

What helped a lot is that before launching in these cities, the awareness of the brand outside Sendai was already 25%, which is great. So that helped a lot of course, and will help us a lot when we go national at the end of the year.

We’ve have launched the brand as well, glo, in Switzerland and Canada. Early days. We have very good results, encouraging results, not even taking into account Japan. That is what we have been seeing so far. The conditions in Japan are unique, and it is very difficult to replicate the same level of success in other markets, but they are above our expectations, the results in those two places.

Q: How’s the vapour business performing?

A: Vaping, we are doing well, as I said before. We are global leaders of vaping outside the United States. With the acquisition in the United States now, we are global leaders in vaping, because VUSE is quite an important brand in Reynolds’ portfolio, doing extremely well. So we are very happy, and I think there will be a lot of synergies between portfolios and markets that we can explore for the future.

I think that this is going to be quite an important category for the future, because the penetration of the category is much higher than tobacco heating products. The number of users is much higher. The problem that we have is depth of usage. This is driven by the quality of the products. So we are improving the products on a day-by-day basis here, working very hard with our new portfolio.

We are launching ePen 3 at the end of the year. We are launching Raptor in the first quarter of next year, and I think these products are going to be much better than ones that are in the market, and I think they can take advantage of the growth of the category.

Reynolds acquisition

Q: You mentioned Reynolds American just then. Can you just give us a brief update?

A: Well, as I said, we complete the acquisition two days ago. I have been talking to management, of course, in the last few days, and their results in the first half were very good. Revenue is quite strong, volume as well. We see some market declines there, around 4% for this year, but we our brands are doing well. Share is stable, but our Premium Brands, Newport and Natural American Spirits, are growing quite well.

So I’m very happy with that. Profit was also very good in the first half. So all the numbers indicate that the company is in very good shape, and we are very glad to have Reynolds American now with acquisition being completed, as I said.

Now, the focus for Reynolds American is about integration and getting the synergies, and this will be our focus for the second half.

Outlook

Q: So, what's the outlook, then, for the second half and for the rest of the year?

A: As we were discussing, the first half was very good, in my opinion. Expect a good second half as well. Share is up. That should drive our performance. I think that you're going to keep growing share, because we had seven years of share growth. It is the seventh consecutive year of share growth. I don't see this momentum stopping. I think that the volumes are going to look better in the second half. I expect an industry decline around 4%, and as usual we are going to outperform the industry, because we are growing share.

So I think that we will have a good second half. We always said that profit would be weighted in the second half. I still think this will be the case, although we are going to scale up our investment behind NGP because of the early successes of the launch. So I expect, for the year, a good year in constant currency earnings growth.

[end]

Ben Stevens, Finance Director

Financial Performance

Q: What are the key financial highlights to these half year results? And is the business performing as expected?

A: Yes, I think these are a very good set of results against a strong volume comparator last year, and very much in line with what we said at the prelims. So, revenue was up in constant terms at 2.5%, profit was up over 3%. We had a growth in operating margin. It's nice to see operating margin growing again after a couple of years of reporting declines.

We had a very strong performance from our associates both Reynolds American and ITC. And that means that our EPS is up over 6% in constant currency terms and a very good 21% at reported level. So I think these are a very strong set of results and we are very pleased with them.

Q: Can you outline the transactional and translational impact in the light of sterling's continued weakness against major currencies?

A: We faced a transactional headwind of 3% in the first half of the year. It moderates slightly in the second half, but we still expect to see a transactional FX headwind of about 2% for the full year.

On the translation it was slightly different. We had a 13% translation tailwind in the first half of the year. Obviously that moderates as we lap the Brexit decline in sterling. And if we include Reynolds American going forward then we'll see a tailwind, if exchange rates stay where they are today, of about 9% favourable on operating profit and about 8% on earnings per share.

Margins

Q: Will the underlying margin improvement continued to be delivered in this current environment? And will the further investment in NGP undermine your margin delivery? Put another way is margin guidance going to have to change in any way?

A: No, I remain confident we can continue to grow operating margin 50 to 100 basis points a year. We don't give operating margin guidance for any one particular year. But over time we continue to expect operating margin to grow. And we are doing things today that will deliver operating margin growth in the future.

So despite the 2% transactional FX headwinds that we expect to face this year I'm still expecting to grow operating margin. We'll get a one-off leg up with operating margin from Reynolds American, of course. And we'll be focusing on delivering the synergy benefits as a way of delivering operating margin growth in Reynolds going forward. But, yes, over time I'd confidently expect us to be able to continue to grow operating margin 50 to 100 basis points a year.

Financial outlook

Q: How should we think about the addition of Reynolds American for the full year?

A: We'll be reporting the USA as a separate division of BAT, so you'll be able to see the performance of Reynolds American going forward. We expect to achieve at least $400 million per year of synergy benefits. We'd expect the cost of achieving those will be about $350 million. Synergy benefits will start flowing through from the start of next year. And we expect the deal to be accretive from its first full year of operation, but accretion will be limited this year obviously because we are quite close to the end of the year.

Q: So what's your financial outlook for the full year?

A: We've delivered a very good set of results I think at the half year. It remains tough out there. We've got some markets with quite tough pricing competition in there. But the success, the strength of the Global Drive Brands, the strength of the innovation program that will come through in terms of our results for the year. So I'm confident that we are going to deliver another good set of results this year.

[end]

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