



Nicandro Durante, CEO

2013 Half-Year Results

Q: *How's the company performed over the first half of the year?*

A: Very well. Despite the fact that we are facing very difficult economic environment, forex headwinds and some industry decline in some markets around the world, we have delivered our high single digit EPS growth as per our strategic metric. The GDBs are growing. Our market share is very robust; pricing is also very solid. So it was a very good first half of the year.

Q: *As you say, you've had a strong start to the year on pricing, and this seems to be continuing. What's the outlook though on pricing, given the current economic environment? And particularly in Western Europe?*

A: We have delivered so far more than 7% price mix, which is a very solid result and similar to what we have delivered in the previous two years, even a little bit better. We have delivered more than 100% so far, with what we expected for 2013, and more than we had at the same time of last year. I don't see this changing. I see out there a very solid price environment.

Q: *Industry volumes, though, seem to be coming under pressure. How do you see this developing over the year?*

A: 2013 has been a very tough year, as I said before, because of the current economic climate that we are facing. Industry's declining around 2.5% to 3%. Our volume, underlying volume for the first half, if you exclude one-off trade inventory movements in Brazil and the GCC and leap year is 2%. We are having a better performance than the industry because we are growing market share.

Brands & markets

Q: *How are you performing in your T40 markets?*

A: The performance in top 40 markets has been very good. We are growing market share, a strong market share growth. And more importantly, we are growing market share where it matters. If we look at our share in our premium segment, it's growing 0.7 percentage points. And I mentioned I think that some months ago in the same interview with you guys about some markets that we were facing some headwinds, such as Indonesia and South Korea, and I'm

very glad to say that we are doing very well in both markets. You look at South Korea, we have eight months of consecutive share growth and in Indonesia we have stabilised market share, it's starting to grow again on the back of outstanding performance of Dunhill Kretek.

Q: *And how are your GDBs performing, and will they continue to grow faster than the rest of your portfolio?*

A: Well, the GDBs, the underlying performance of the GDBs in the first half, is 3.5%. In a market that is declining 2.5% to 3% it's a very solid performance. It's not all on the volumes, it's also on the share sides. Out of the four GDBs, three out of four are growing market share strongly. Dunhill, Lucky and Pall Mall, and the share on Kent is stable. It is a very solid performance. I see the GDBs outperforming our portfolio in the coming years on the back of our innovation pipeline.

Q: *Now illicit trade seems to be accelerating, again particularly in Western Europe. What's behind this?*

A: Well, every time that you see a deterioration of the economic situation, every time that you see unemployment going up, disposable income coming down, there is an opportunity for illicit trades to settle. So we have seen this in the Western European markets. Some of the markets have seen substantial growth of illicit trades.

But on the flipside, we also see markets in the world in which illicit trade is coming down, which is good news. Places like Canada, like Pakistan or like Mexico. Overall our reading is that illicit trade is going up 1 percentage point on a global base, which is a very relevant number, but is within the historical figure.

Q: *Now the market for e-cigarette seems to be accelerating, and there's momentum there. Do you see this as a threat or an opportunity for the industry?*

A: Well, I see this as an opportunity for BAT, no doubt about that. There is consumer interest on the e-cigarette segment. But it's a very small category. If you look at Western Europe, for example, that's the biggest market outside the United States. The size of e-cigarettes is 0.5% to 0.8% of the overall tobacco segment. So it's very small, but it is something that, as I said, consumers are demonstrating interest in. So we want to play there. And we are playing there - we launched in UK our e-cigarette brand Vype. We have big hopes for the product. It's a very good product. If you look at our competition in the market I think that we have a superior product. And this is part of our long-term strategy to manage this category. Look at two years ago, we created Nicoventures. Last year we bought CN Creative. So that's a category that we want to play, and we think that we have all the tools that we needed to win there.

But let's put it into perspective. It's a very small segment. I don't think there's going to be a huge source of profitability for the organisation in the coming years. But that's something for the future, and we want to play there.

Regulation & excise

Q: *Now what impact is plain packaging having in Australia? And do you see this kind of regulation spreading?*

A: Well, nowadays the only country that has implemented plain packaging regulation has been Australia. We know that UK and New Zealand have decided to postpone implementation until having the hearing at the WTO. And I know as well that Ireland is drafting regulation to submit to the Parliament next year. But so far the only country that has introduced plain packaging regulation is Australia. Let's look at Australia after seven, eight months that it has been introduced. The impact so far has been none. The industry has been declining the same rate that it *usually* declined before. The only thing that I'm seeing there might be some down-trading. But that's something that we saw in Australia before, more as a result of the competitive pricing in Australia, in the ultra-low segment, than anything else. So the impact in Australia so far from my point of view is none.

Q: *The excise environment has been relatively benign over the last few years and it's been described as more considered and reasonable. Do you think it's going to stay that way?*

A: It's very difficult to predict the future. But the excise environment has been predictable, if I can say. If you look at the last two years, 2011 to 2013, we haven't seen many excise shocks in the market. So the environment is better than it was before. What we have seen, though, in 2013, is excise increases that were a little bit above what someone would expect in places like Brazil or Russia. But those excise increases were part of a multi-year excise plan that the government have announced some years ago. So it was expected.

In the case of Brazil, we've seen significant industry decline in 2013 on the back of two price increases that it took in the last two years, but excise increases in the coming years is going to be a little bit lower. So we know what's going to be the size of any excise increases. And in the case of Russia, the change in excise system has taken the industry to raise price in the low price category much more than in the premium category. That is driving around 7% industry decline in Russia this year.

Outlook

Q: *So how are you feeling about the full year?*

A: We have delivered a very good first half of 2013. I think that we are in a good space. Our brands are growing, our market share is very strong, as I said, not only overall market share, but premium share, that's quite important for our business. And I think that we're in a good place to deliver a high EPS growth according to our strategic metrics.