BRITISH AMERICAN TOBACCO

Half-Yearly Results 2014

Ben Stevens, Finance Director

Q: Can you run us through the numbers?

A: Yes, I think these are a very strong set of numbers. We delivered on our objective of high single digit earnings growth in the first half. We've had revenue growth of 3% and profit growth at 4%. Obviously the strength of sterling has had an impact on those results in terms of reported numbers. So we've had a 13% headwind in sterling on net turnover. We had a 14% headwind in terms of operating profit and a 15% headwind in terms of EPS. But overall, I think these are a very good set of numbers for the company.

Q: Can you talk a little further about the impact that sterling's appreciation is going to have on the full year?

A: Yeah, it's always difficult to forecast the value of sterling. It's quite a dangerous business to do that. But if the strength of sterling stayed at its current level for the rest of the year then we'd have an impact on EPS of about 12% for the year.

Q: Now margin expansion is lower in the first half than in previous year. Are you still confident of delivering your 50 to 100 basis points?

A: Yes, we say 50 to 100 basis points over the medium term. We increased our operating margin by 30 basis points in the first half of the year. But that's despite facing quite a substantial transactional FX headwind which we've managed to eat and improve our operating margin. Now the impact of that will diminish in the second half so I'm confident we'll be improving our operating margin for the full year.

Q: Now given that you're well advanced in your global SAP implementation, do you expect your operating margin growth to accelerate in future years?

A: Well of course the benefits of the target operating model and the rollout of the SAP programme are already being felt around the group. We're already live in Asia, for example, and for the last few years the standardisation of processes that we've done has led to an improvement in operating margins. So some of that improvement is already baked in, but of course there's still more to come.

We don't finish the rollout until 2017. So you'll see further improvements of operating margin on the back of that SAP rollout.

Q: Why did you decide to stop the share buyback when you announced your investment in Reynolds American's acquisition?

A: Well of course the strength of sterling affects our net debt to EBITDA. We like to keep our net debt to EBITDA in the 1.5 to 2.5 times range. Of course our EBITDA tends to come in in softer currencies, whereas our net debt is in sterling, in euros and in dollars. So that has an impact on our net debt to EBITDA. We've also committed to increasing our dividend in sterling terms, despite the FX headwind we're facing. That will have an impact as well.

So when it came to the investment in Reynolds American, we thought it was prudent to stop the buyback at the half-year stage.

Q: Your cash generation is lower than last year. Where are the drivers and what do you see as your priorities for the uses of cash?

A: Well the operating cash flow was obviously again hit by the sterling strength. So in constant currency terms, we increased operating cash flow for the half year. We're expecting to increase operating cash flow in constant currency terms for the full year. We're still investing money in the rollout of SAP, we're investing money in the innovation programme. So all of that has an impact on cash flow. But by and large this remains a very cash-generative industry.

Q: Now you've indicated that you're still expecting a strong second half. Is this still going to be the case and do you still remain confident of delivering on your high single figures EPS in 2014?

A: Yes, we've always said that we expect pricing to be stronger in the second half than in the first half of this year because some price increases were delayed to the second half. Also the impact of transactional FX which has been stronger in the first half, that'll moderate during the second half. So I remain confident that in constant currency terms we can deliver high single-digit earnings growth for the year.

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