



## **BAT preliminary results 2014**

### **Interview with Ben Stevens, FD**

#### **Financials**

**Q: How do you view the financial performance for the full year?**

A: I'm very happy with the financial performance of British American Tobacco in 2014. 2014 was a pretty tough year for many, many companies, but we've performed extremely well.

So revenue at constant currency is up 3%, profits up 4% and earnings per share is up 8%. And on top of the translational exchange, of course, we had a transactional FX hit as well. And if you add that back to earnings per share it grew by 9.5%, which is right at the top of our guidance range.

**Q: At the interim results you talked about substantial FX headwinds. What kind of impact have you seen in the second half?**

A: Yes, at the interim results we said that if exchange rates stayed where they were then we'd face something like a 12% headwind and it's turned out to be pretty much the effect.

So FX has been significant in 2014 and I think it'll continue to be significant in 2015. Again, if rates stay where they are today it'll have an effect on EPS at the translational level of 5%, but also transactional FX will get worse as our hedges roll off for the year. And we're expecting a transactional FX hit of around 5% this year as well.

**Q: The results show a margin improvement of 50 basis points and this is at the lower end of your 50-100 basis points' range that you indicated. Are you satisfied with that performance?**

A: Yes. We guide people towards an operating margin improvement of 50-100 basis points per annum on average. We never promise it in any individual year. I think the 2014 increase in operating margin of 54 basis points is very good, actually, because the transactional FX obviously hits operating margin directly. Again, if you exclude for that we'd come in well over 100 basis points for the year.

## Cash and debt

**Q: How do you feel about operating cash and the strength of the balance sheet at the year end?**

A: BAT is a very cash-generative company. So if you look at our operating cash flow it was at the 90% level to our operating profit, which is where we like to keep it. Slightly low at the free cash flow level because of the asbestos settlement we had on Flintkote and the Fox River settlement. But these things are one-off that relate to non-tobacco businesses and very many years ago as well.

So if you take that out our free cash flow to adjusted earnings was very close to the 80% that we target for the year and that allowed us to maintain our credit rating.

**Q: Do you have any plans to restart your share buyback in 2015?**

A: No. When we announced our intention to invest in maintaining our shareholding in Reynolds American after the acquisition of Lorillard then we said we would reconsider starting our buyback in 2016.

Of course, since then we've announced that we may well be making an offer for the minorities in Souza Cruz and if that goes ahead and if it's fully completed I think we'll be reconsidering our buyback starting again in 2017.

**Q: Now based on current spot rates BAT is facing another year when FX means that sterling EPS growth is modest. And given the dividend payout ratio rose in 2014 are you comfortable with it rising again in 2015?**

A: Yes. We said at the start of the year when we were facing a big FX headwind that we would continue to increase the dividend in sterling terms and that's what has happened this year, as we're proposing a dividend increase of 4% and we certainly have both the balance sheet flexibility and the cash to keep increasing the dividend in sterling terms even if we face FX headwinds both in 2015 and beyond.

**Q: So how is 2015 looking for the business?**

A: Yes, I think 2015 will be a strong performance for British American Tobacco. Obviously, we face some difficulties in terms of foreign exchange.

And because our hedges will have rolled off during 2015 the transactional impact of foreign exchange if rates stay where they are - and of course that's very uncertain - will be in the region of 5% on operating profit and at translational level on EPS about 5% as well, so quite a significant headwind this year.

But underlying performance I think will remain very strong so I'm looking forward to 2015 with some confidence.

[End]