BAT full-year 2016 results

Nicandro Durante, CEO

2016 performance

Q: Let's start with the results. How would you assess the performance of the business over the year?

A: 2016 was a great year for BAT, as you can see from the numbers. We have delivered very good revenue growth of 7%, mainly driven by the corporate share gains that we had in the market. We had slight growth in volume and market share growth of 50 basis points, and also a very good price mix for the year of around 6.5%. So a very good year indeed.

The Global Drive Brands performed extremely well, 100 basis points growth, another 7.5% volume growth. Another outstanding year for our Global Drive Brands.

Profit-wise, very good, 10% in current terms, 4% in constant terms. And if we look at the EPS growth for this year it was nearly 19%. And 10% at constant [rates of exchange] was an excellent result and that's why we have decided to have a dividend increase this year following the EPS constant at 10%.

So, indeed, it was a great year for BAT.

Q: Are there any markets that you are particularly excited about, or indeed, concerned about?

A: In general, we had a great performance in all the four regions in BAT and that's why we had such a fantastic underlying performance. But if you go region by region, if you take Asia, for example, we had Japan, another year of share growth, an outstanding result in the Japanese business. Kent has performed extremely well there. South Asia, for example, Pakistan – share growth, profit growth, outstanding numbers. And I think in general Asia had a good performance. We had the downside of Malaysia this year because we had a huge excise increase at the end of 2015 and you had huge declines in volumes last year because illicit trade went up. But, in general, the region performed extremely well.

Americas, we cannot talk about Americas without talking about Brazil. It was another difficult year in Brazil because GDP was down. Disposable income in

the country was coming down as well and I think that was a tough year for our business there. Despite that, we had a very good underlying performance in our portfolio. Our brand Dunhill was growing market share in a market that is declining, the premium segment, by 50 basis points. Lucky Strike had very good growth and our share in the 'value for money' segment has increased during the year. So it was good underlying performance for Souza in a tough environment.

Canada, another great year after many years in which we had some problems there in terms of profitability for that organisation. It was the fourth year of profit growth. And I could talk about other markets such as Chile, Venezuela, Central America. Good performance overall in a region that was under a lot of pressure in terms of the market economic environment.

In EMEA, we had another good year after an outstanding 2015. You take Russia, for example, share was up 140 basis points with very good profit growth. We were growing volume in a market that was declining. We had a great performance in Turkey, the third year in which we were growing market share strongly in Turkey. And then we had good performance in places like Ukraine. So very good indeed.

In Western Europe, a great year. We had share growth in Western Europe. [If you look exit against exit it was even better.] We had great performance in places like Germany, Romania and France.

So overall in BAT, it was a great year for the regions and the markets.

Q: You mentioned the performance of the Global Drive Brands. How confident are you that you can maintain growth here and continue to take market share?

A: Well, that's a question that we are asked all the time because the Global Drive Brands (GDB) have performed very well for a number of years. If you take, for example, 2010 to 2015, GDBs were growing around 6% per year. That's in an industry that was declining around 2%, 3%, so a great performance and we did it again in 2016. GDBs were growing 7.5%, 100 basis points in a very difficult environment. The industry was down 3%, even though the GDBs had this kind of performance.

I think that we have the right brand portfolio there with Dunhill, Lucky Strike, Kent, Pall Mall and Rothmans to drive the growth forward based on a fantastic pipeline of innovations and we have a lot of things in our pipeline for the coming years.

So I'm very confident that the GDBs will continue to outperform the market.

Reynolds acquisition

Q: Last month you announced that you had reached agreement to acquire the remainder of Reynolds American that you don't already own. Can you

explain the rationale for going back into the United States, a market you effectively exited some 12 years ago?

A: Well, in reality, just to clarify, we never left the United States. We had 42% in Reynolds, so we always had a big share of that organisation and we followed Reynolds very closely. That was important for our results as an associate. So we never left the United States. But we thought that it was the right moment, from a strategic point of view and a financial point of view, to go back and make a bid for the remaining 58% that should go for approval for shareholders in the third quarter of this year.

I'm very happy, delighted, that the boards of both companies decided to support this deal which I think is going to be a fantastic deal for both sets of shareholders. It will open up for BAT the possibility to explore with our brands, with our Next Generation Products' pipeline, the United States and also have an opportunity to take some of their brands, some Next Generation Products' pipeline worldwide. So I think that is going to be a great deal for both sets of shareholders.

Next Generation Products

Q: Can you give us an update on your Next Generation Products? In particular, you recently launched glo in Japan, how is that going?

A: It is doing extremely well, above our expectation, to be very honest. We launched this in December (12th month), so 10 weeks ago. In 10 weeks in Sendai, Japan, in the biggest convenience store there, we have 5.4% market share. It is above what we were expecting, so extremely successful. In the second biggest convenience store, we are there for six weeks and we have 4.9% market share. Those two convenience stores, they are 40% of the volume of Sendai, so it is an outstanding start.

The consumers are enjoying the smoke experience of our products, the simplicity of the products and so on and so forth. There are so many reasons that they are enjoying the product and the reviews that we have, the insights that we have, are extremely positive.

We expect to roll this out to the whole of Japan, a national roll-out, in the second half of this year. I hope that's the beginning of the second half, not the end of the second half. We are making plans. We have some improvements already. There is going to be a version 1.2, so it's going to be an even better product that we have. We've learned a lot in terms of the marketing mix, in terms of the product. In spite of being extremely successful, we want to do better. We are already working on generation 2, 3, and 4. So we want to keep the pipeline going for the coming years.

In terms of vaping, BAT is now, after three years, the biggest vaping company in the world outside the United States. We have an overall 8% share in the top 14 markets. That's 90% of the volume and we are doing very well. We just

launched the Vype Pebble in Italy and some other markets in Europe. The first feedback that we have had from the consumers is that the product is doing very well. So we are very excited with our pipeline in both categories.

Q: Looking ahead, what's your outlook for the Next Generation Products category in general?

A: We entered the category because we think that there is a lot of potential there, so it is going to grow. It's going to grow from a very low base. You take vaping, for example, the CPTO consumer price turnover of 2016 is 60% higher than 2015. It's a lower base, but it shows the potential and the growth. So nowadays, outside the United States, this is around $4 billion CPTO. It's very small for the whole tobacco business, but it's growing very fast. So I think that this is going to be an important category in the coming years, and I think that we are very well positioned with our portfolio in vaping and in tobacco hitting products to be successful there.

Outlook

Q: How do you see the outlook for 2017?

A: It's going to be challenging because the currency trading conditions are challenging, but we are going into 2017 with good momentum. We are growing market share across the world. We are coming from a position of strength. It is always better to face the new year in a position of strength. We have a very good pipeline in the combustible business, some innovations that are coming to the market. In NGP (Next Generation Products), we have been very successful with our test market in Sendai, with glo. Vaping is growing. So I think that you are going to have another good year in 2017. But it is going to be skewed to the second half of the year because we are investing and launching some of these brands, some of these innovations in the first half. So it's going to be skewed to the second half. But I think that we have the products and the pipeline to drive another year of good earnings growth to meet our strategic metrics.

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