

# Chief Executive's review

## Nicandro Durante Chief Executive

### A winning strategy

After 37 years at BAT, eight of them as CEO, I will retire in April 2019. I have seen BAT evolve and grow throughout my career, and am confident that this will continue during the dynamic period of change the industry is going through today.

When I became CEO in 2011, we articulated a strategy to put the consumer at the heart of our business, and a vision to be the best at satisfying consumer moments in tobacco and beyond. This strategy has enabled us to deliver consistent outstanding year-on-year growth and shareholder returns, while at the same time establishing a successful and diverse potentially reduced-risk products (PRRP) business designed to meet the evolving and varied preferences of today's consumers.

Thanks to this strategy, the Group continues to perform well. Our 2018 reported revenue and profit from operations are up 25% and 45% respectively, and while this is of course due primarily to our first full year's inclusion of results from the US, we have nonetheless again exceeded our target of high single figure adjusted diluted constant currency EPS growth with an increase of 11.8%. This was driven not only by the strong performance of our combustible business, but also by the near-doubling of THP and vapour revenue.

Notwithstanding these results, it is clear that the market has concerns in relation to the impact of the changes the industry is going through and in respect of threatened regulatory developments. I am, however, confident that the business is in extremely good shape and that these changes, in reality, present significant opportunities for future growth. With our core combustibles business outperforming the industry, and with a strong and broad multi-category portfolio of PRRPs capable of meeting the evolving preferences of consumers around the world, I believe we are in a good position to deliver long-term sustainable growth.

### A strong portfolio of both combustibles and PRRPs

Our results in 2018 reflect the successful performance of all elements of our portfolio, and highlight the importance of expanding consumer choice across all of our categories.

In combustibles, Group market share was up 40 basis points, driven by another strong performance from the Strategic Cigarette and THP brands, which grew volume by 5.8%.

In THP, our revenue increased to £565 million or £576 million, at constant rates. Our glo brand has achieved 4.7% market share (20% category share) in Japan, and continues to grow market share in South Korea, Romania and Italy.

The Group's vapour portfolio performed strongly with significant growth in both volume and revenue across our 15 vapour markets. Momentum increased, with growth weighted towards the second half of the year driven by new market and product launches. Total vapour volume was up by 35% on a representative basis with good performances in the world's three largest vapour markets – the US, the UK and France.

In oral tobacco we continue to grow value with strong performances from modern oral products such as Epok in Sweden, Norway and Switzerland, as well as traditional products such as Grizzly in the US, where revenues were £931 million, an increase of 3.1% on an adjusted representative basis.

### Reynolds American Inc. (RAI)

RAI is delivering strong financial results for the Group. In 2018, revenue was up 128% (as a result of the full year effect). This was an increase of 1.5% on a representative constant currency basis, and was driven by robust price mix and a 25 basis points growth in value share, despite a decline in total volume. With adjusted operating margin up 180 bps, adjusted profit from operations was up 5.8% on a representative, constant rate basis. Annualised cost savings resulting from the acquisition are now running at over US\$300 million per year, and we are on track to deliver at least US\$400 million per year in cost synergies by the end of 2020.

While FDA regulatory proposals have driven some uncertainty in the US operating environment, our long track record of success in the face of regulatory change and our strong portfolio of brands give us confidence that we will be able to manage these issues. We are additionally reassured by the fact that, in order to withstand judicial review, any regulation of menthol in cigarettes must be developed through a comprehensive rule-making process, be based on a thorough scientific review and consider all unintended consequences.

### Handing over

I am extremely pleased that the Board has chosen Jack Bowles as my successor. I have no doubt that his broad-ranging experience and expertise, combined with his energy, passion and drive for success, will help ensure the future growth of the Company.

I am tremendously proud of what we have achieved in the last eight years, and would like to thank all of my colleagues across the Group for their part in this.



# Jack Bowles

## Chief Executive Designate

### An exciting time for BAT

It is an exciting time for me to take over as CEO. Our industry is evolving and with this comes great opportunity.

With our depth of talent, our iconic brands and our range and pipeline of PRRPs, I am confident that we will take full advantage of these opportunities as we accelerate the transformation of BAT into a stronger multi-category tobacco and nicotine products company.

### Strong foundations

It gives me great comfort to know that the fundamentals of our business are in such good shape. Our combustible business continues to deliver strong year-on-year growth. Our acquisition of RAI has made us a truly international tobacco and nicotine products business, and our PRRP business is firmly established and growing.

Our current strategy, with its aim of being the world's best at satisfying consumer moments in tobacco and beyond, remains as relevant today as it was when it was first rolled out in 2012. The consumer is, and will continue to be, at the heart of everything we do. We know that our consumers' tastes and preferences are evolving and fragmenting, and it is to satisfy these varied preferences that we have developed a broad range of different products with the potential to provide lower risks than combustible cigarettes.

### Accelerating the delivery of our strategy

With confidence in our multi-category approach, we are now focused on our need to accelerate the delivery of our transforming tobacco ambition. Notwithstanding our great success to date in establishing our PRRP business, we acknowledge that we are at the start of a long journey. As the number of our consumers grows, our focus will be on accelerating our strategy to ensure that our products are able to satisfy the preferences of those many millions of adult smokers who are still looking for a satisfying but less risky alternative to their current products.

In order to further enhance the focus on our consumers we have created two new Management Board roles. Our new Director of New Categories will have end-to-end accountability for driving growth, innovation, world-class brand building and consumer insights for our PRRPs, while our new Director of Digital and Information is tasked with responsibility for enhancing our digital consumer capabilities.

### Vision for success

I am excited about the challenges and opportunities that lie ahead for us. We have the right strategy, the right foundations, the right vision, and, most importantly, employees with the right skills and attitude to enable us to keep growing the Company for many years to come.

