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Hello, everyone, and welcome to British American Tobacco’s 2018 Interim Results presentation. I’m Nicandro Durante, Chief Executive of British American Tobacco. And with me this morning is Ben Stevens, Finance Director. As always, a warm welcome to those of you who are listening on the conference call or listening via our website BAT.com. As usual, after taking you through the results presentation, there will be an opportunity for you to ask questions.

Before I start the presentation, I’ll take it that you have all seen and read the disclaimer on page two and three. It’s clear that these interim results have benefited significantly from the inclusion of Reynolds as a fully-owned subsidiary. Given this, volume of revenue and profit from operations will be presented as though the group had owned acquisitions made in 2017 for the whole of that year. We’ll refer to comparison results on this basis as performance on a representative basis. This comparison will provide shareholders a better understanding of like for like performance.

Moving now to the interim results. Overall, we had another good start to the year in 2018 with the group performing well. Once again, we have delivered on our commitment to high single-figure earnings growth, with adjusted diluted EPS up over 10% at constant and 2% at current rates. Our strategic portfolio, which covers our key combustible, oral tobacco and NGP brands has grown strongly in the first half with revenue up over 8% on a representative constant currency basis.

You’ll see over the next few slides that our combustible business which remains 94% of our business continues to perform strongly and industry fundamentals are robust. The US remains a great opportunity, and Reynolds is performing well. And finally, that we have a great opportunity in next-generation products, and it has been demonstrated that our multi-category strategy driven by consumer needs is the right strategy and we have the capabilities and products to win.

Turning now to the results highlights. Reported volume, revenue and profit from operations obviously benefited from the inclusion of Reynolds as a wholly-owned subsidiary, and were up 11%, 57% and 72% respectively. On a representative basis, volume was down 2.2%, again outperforming the industry. We expect the industry volume to be down around 3-4% this year. Constant currency adjusted revenue was up 1.9% on a representative basis. However, 2017 revenue in the US benefited from a number of one-off items recognised by Reynolds prior to acquisition. Principally, the sale of Natural American Spirit inventory to JT as part of the disposal of the international brand rights. Excluding this, adjusted revenue would have grown by 2.6% on a representative constant currency basis.

Tobacco price mix was a robust 4%, which reflects improved pricing held back by the negative mix effects of strong volume growth in Pakistan following the excise change in mid-2017 and down trading in the GCC. Excluding the one-off effect of NAS inventory sale, price mix would have been close to 5%. We continue to expect a stronger second half with full-year price mix ahead of last year. Despite the recent slowdown in the THP category in some markets, including Japan and South Korea, we remain confident of exceeding the NGP revenue of £1 billion in 2018 as we expect a range of new launches to re-energise NGP category growth in the second half.

As we said at the full year, we expect profit growth to be weighted to the second half driven by improving price mix, continued share growth and a strong growth in NGPs. Foreign exchange was a headwind of 8% EPS for the six months of the year and is estimated to be a headwind of 6% for the full year, assuming rates stay where they are today. I am very confident of another good year of adjusted earnings growth at constant currency, driven by strong underlying profit growth, with the benefit of the US tax reform enabling us to accelerate investment behind our NGP business.

Group market share grew 40 basis points driven by another strong performance from our strategic brands. Kent, Lucky Strike, Pall Mall and Rothmans all grew share globally. Dunhill held up very well in the premium segment and share was down only 10 basis points. Record share in South Africa and growth in Brazil were offset by declines in Malaysia, South Korea and the GCC due to excise driven market contraction and down trading. Kent grew 50 basis points. The brand had a strong performance in Japan driven by THP and grew share in Russia, Brazil and Turkey, where Kent is the fastest growing brand in the market. Lucky Strike was up 10 basis points, driven by Indonesia, Colombia and Japan. Pall Mall grew 30 basis points with strong results in Pakistan and the GCC where the brand was launched ahead of the significant excise increase last year to authorise the needs of down trading consumers. Rothmans continues strong performance and was up 80 basis points driven by good results in Russia together with an excellent performance in Malaysia, where the brand grew 260 basis points. The brand also benefited from migrations in Poland, Brazil and Colombia.

In the US, the strategic brands continue to perform well. Natural American Spirit and Newport shares were both up 10 basis points, while Camel declined by 10 basis points following the gains made last year. Pall Mall was down 10 basis points, reflecting some
increasing competitive discounting. Overall, the strategic brands had an outstanding performance growing shares by over 160 basis points.

In the US, industry volume decline remains within the historical range, and Reynolds is performing well. Looking at sales to retail, which are a good measure of consumer trends. First half industry volume was down 5%, mainly due to the impact of state excise increase in California in April 2017 and higher US gasoline prices. We expect US industry volume to be down around 4.5-5% for the full year.

Vapour category growth appears to be driven largely by new consumers and new behaviours, and we’ll continue to see limited impact on US cigarette industry volume. Reynolds shipment volume to wholesale was down 5.5% broadly in line with the industry. Revenue was £4,525 million which was flat on a constant currency representative basis. However, this was against a comparator which benefited from a number of one-off items, principally related to the sale of NAS inventory to JT of approximately $100 million. Excluding this, revenue would have grown 1.8%.

Pricing in the US is robust and despite some increasing competitive discounting, the price environment remains good. Delivery of the cost synergies is ahead of plan with annualised cost savings now running at almost $140 million at the half year point. We are well on track to deliver the target of at least $400 million in cost synergies by the end of 2020.

We have submitted our comments to the FDA on its ANPRMs on nicotine and flavours. There is a large and diverse quantity of material, and this is likely to take some time for the FDA to digest given the complexity of the issues. As we have said, these are the first steps in a lengthy process as to whether the FDA issues a product standard on these issues.

Our new product applications for the FDA are also progressing well, and we are very pleased that clearance for the SE application for the improved Eclipse, our carbon tipped tobacco heating product has now been received. The scale of the opportunity for THP in the US remains uncertain and heated tobacco products will attract full cigarette excise. However, we’ll be testing the potential of the improved Eclipse in the US during the next 12 months.

We filed the SE application for glo in February. The application is currently under scientific review with the FDA potentially completing its review by the end of 2019. We will also continue work on our plan to submit an MRTP application for glo.

The Camel snus MRTP application is also proceeding well and the TPSAC as it is meeting in September will review the application.

In oral tobacco, the business continued to grow strongly. Total first half revenue grew over 11% on a constant currency representative basis, driven by strong performance in the US, Sweden and Norway. In the US, oral tobacco industry volumes were broadly flat in the first half, with American Snuff Company volume in line on a representative basis. Grizzly saw strong first half revenue and profit growth driven by good pricing. Market share was down 30 basis points against a comparator which benefited from gains made during the USST product recall in Q1 2017.

Outside the US, the white pouch market is the fastest growing oral tobacco segment. In the first half, the category grew by more than 120% against same period last year and now accounts for 3.5% of European oral tobacco category, with margins up to two times that of premium cigarettes.

Across the north, where Epok is the fastest growing premium oral brand. BAT continues to grow share with a 12% share of the market in Sweden and an 8% share in Norway. In Switzerland, Epok has grown to 14% of the total oral tobacco category just 10 weeks after its launch. This is a profitable growing business with very attractive margins.

In tobacco heating, glo continues to perform well. In Japan, glo national share is 4.3%, up from 3.3% at the end of December having added a full share point over the year-to-date. Our share of the total tobacco market in Japan is now 16.2%, up 80 basis points since December, benefiting from share growth in both THP and cigarettes. We are the fastest-growing company in Japan across both categories. However, it is clear that the THP category has plateaued over the last four months as the category expands into more conservative consumers barriers to adoption are higher and growth naturally slows. We know that one of the greatest barriers to consumer adoption is the price of the device. We have been focusing on driving down the production cost of the current glo device and have been passing these onto the consumers through increased device discounting.

In the coming months, we will be launching different devices and consumables at different price points. For example, we have recently launched a new premium priced range of consumables with higher nicotine and different flavours. The second half will benefit from these initiatives and from new consumer activation plans, including a consumer hyper care conversion programme.
In South Korea, the THP category has grown to 12% of the tobacco market in June although this has plateaued over the last four months. Glo continues to grow national share and now has a share of 0.7% and a category share of 6%. Following the successful launch of two capsule variants in mid-April, we are now relaunching the brand with a revised marketing mix and upgraded device. Outside Japan and South Korea, category growth has been mixed. However, glo’s presence has continued to grow with Italy joining the existing markets of Canada, Russia, Switzerland and Romania.

We are now unconstrained on device supply and have a strong pipeline of activity. We have a number of new market launches planned for glo in Q3 together with a significant uplift in activity in Japan. We maintain our view that the category could represent 30% of the Japanese market by 2020. We remain confident in glo’s potential, and as new offers enter the category and products improve, growth should return. On this basis, we remain confident of exceeding £1 billion in NGP revenue in 2018.

In vapour, on a representative basis, volumes were up over 16%, and after excluding the impact of US Vibe product recall, revenue grew by 8%. In the UK, the market grew by almost 26% and BAT’s vapour retail share grew by 20 basis points in value to 41.1%. We remain market leader in traditional retail in closed systems. Earlier this month, ePen3 was launched in the UK after an extensive pilot programme with excellent results. ePen3 represents the cutting edge of current vaping technology providing a more intense, satisfying vape experience. While it’s still very early days, initial indications are very positive. In our VIP vapour stores, ePen3 has achieved the highest rate of sale for any VYPE device to date. With higher margins than ePen2 and refill purchase rates the highest achieved for any VYPE product to date, the early signs are encouraging.

In the US, the category has continued to grow rapidly and is up over 20% in the first half driven by a significant increase in the size of the consumer base. Vapour revenue was down 4%, but up 12% after adjusting for the impact of VUSE Vibe recall. The overall VUSE family which has featured nicotine salts technology since 2012 continued to grow volume and value. However, share was down 10 percentage points to 21% due to the growth in the vapour category. In Q2, VUSE vapour volumes were absorbed as negative sales. However, both VUSE Ciro and VUSO Solo have captured a significant proportion of the volume lost by the recall. Recall costs have not been material.

In August, we will be launching VUSE Alto in the US, our first pod-mod product. These will be available in four variants, and will feature an innovative ceramic wick. Like other VUSE products, Alto has a 5% nicotine concentration liquid and is a nicotine salt product. Our research shows that Alto rates significantly higher than any other nicotine salt pod-mod products on a number of key consumer attributes and purchase intent.

We continue to perform well in our other markets and remain a market leader in Poland and in Germany in closed systems. We also recently launched ePen3 in Canada and VYPE in Greece. The opportunity in the category remains significant. When you look at total nicotine consumption, we continue to see a growing market for nicotine with new consumers and behaviours driven by the growth in the vapour category. With a strong product pipeline, we are well-positioned with our multi-category approach to be a winner.

So, in summary, we are continuing to deliver on our commitment to high single-figure earnings growth. Our combustible business is outperforming the industry and we are generating strong revenue growth from the strategic portfolio. In the US, the business is performing well, and synergy delivery is ahead of plan. Our potentially reduced risk products continue to grow strongly. We have significant additional investments in NGPs planned as well for the second half, and expect to see the THP category grow again in Japan. Given this, I continue to believe we can deliver in excess of £1 billion in NGP revenue this year, more than doubling the size of our business over the course of 2018. We are on track for another good year of earnings growth at constant currency driven by strong underlying profit growth and with the benefit of the US tax reform allowing us to accelerate our NGP investments. Overall, the business is performing well.

I will now hand you over to Ben, who will take you through the details of the results.

**Ben Stevens**

Thank you, Nicandro, and good morning, everyone. As Nicandro said in his opening, reported volume, revenue and profit from operations were up 11%, 57% and 72% respectively, benefitting significantly from the inclusion of Reynolds as a wholly-owned subsidiary. As we said earlier, for clarity, I will now focus on the adjusted representative results which are all against a comparative base that assumes full ownership of Reynolds and other acquisitions throughout 2017. This doesn’t affect comparisons made on an EPS basis.

Representative volume was down 2.2%. This was mainly driven by trade inventory movements in the GCC and industry volume decline, in particular in the Ukraine, Brazil and Russia, partially offset by growth in Pakistan and THP volume, which reached 3.3 billion sticks in the first half.
Adjusted revenue was down 6.4% at current rates but was up 1.9% on a constant basis. As higher pricing across the majority of our markets, was partially offset by negative geographic and portfolio mix of around 3%. Adjusted profit from operations was up 2.4%, excluding the impact of currency translation. On a current basis, it was down 5.4%. Adjusted diluted EPS was up more than 2% at current rates and over 10% on a constant basis, exceeding our high single-figure EPS growth objective.

Turning now to the regions, revenue in the US was in line with the prior year on a constant currency representative basis. Good pricing in both the cigarette and oral tobacco categories and higher VUSE consumable volume was offset by the reduction in cigarette volume and the impact of the Vibe recall. Excluding the one-off items in the revenue comparator, which principally related to the NAS inventory sale in 2017, revenue grew 1.8%. Operating margin of 41.4%, or 46.2% on an adjusted basis, benefiting from synergies achieved since acquisition and the timing of expenditure. As a result, adjusted profit from operations was up 5.6% on a constant currency representative basis.

In APME, adjusted revenue on a constant rate representative basis grew strongly and was up 5.6%. This was driven by pricing, volume growth and the benefits of higher revenue THP volume, which more than offset the negative mix effect of downtrading in GCC and the growth of illicit in Malaysia. Volume was up 3.5% with strong growth in Pakistan, Bangladesh and THP outperforming the industry, which was down around 3%. Market share in the region grew strongly and was up 110 basis points. On a representative constant currency basis, adjusted profit from operations was down 5% driven mainly by the impact of inventory movements and down trading in the GCC and increased investment behind THP.

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In Brazil, although there are signs of improvement and no new excise increases are currently planned, the weak economy continues to affect industry performance and drive further growth in illicit trade. While pricing was good and premium share was up aided by a good performance from Dunhill, revenue and profit declined impacted by lower volume. In South Africa, revenue and profit were also lower as volume was down due to the continued growth of illicit trade and VAT and petrol price increases. Strategic brands performed well, driven by share gains for Rothmans and Dunhill, which reached a record share of 15.7%. Canada posted another strong performance with revenue and profit growth driven by continued good pricing. Strategic brand volume was up nearly 30% driven by growth in Mexico as well as migrations in Brazil, Colombia and Nicaragua.

In ENA, adjusted revenue on a constant representative basis was up 1.3% driven by improved pricing and mix in Germany, Romania and Russia, partly offset by the impact of lower volume and continued excise absorption in France. Volume was down 3.9% driven by Russia, Ukraine, France and Italy, which offset good performances in Turkey and North Africa. Adjusted profit from operations at constant rates on a representative basis was up 2.2%, with good performances from Germany, Ukraine and Romania.

In Russia, volume declines were offset by good pricing and cost savings. Rothmans and Kent both grew share and Kent remains the number one premium brand in the market. In Germany, BAT is the fastest growing total tobacco company. Volume was down, but constant currency revenue and profit grew driven by pricing and improved mix.

A good performance in the Ukraine saw revenue and profit increase driven by improved pricing and share growth. Rothmans is the number one brand in the market with a 17.3% share. In France, share was stable despite aggressive competitor pricing activity.

Strategic brand volume was up 11% with strong performances from Rothmans in Russia, Ukraine and Poland, Pall Mall in Egypt and Kent in Turkey and Russia. The first half also saw a great performance from our oral tobacco business in the region. Volume grew 29.6% driven by Epok, outperforming the industry which was up 6%.

Turning now to operating margin, on a reported basis, margins were up 340 basis points, benefiting from the inclusion of Reynolds as a fully-owned subsidiary. Underlying margin improved by 180 basis points. This was driven by pricing, cost savings and synergies with Reynolds. This was offset by higher NGP investments which represented a headwind of 130 basis points. Adjusted operating margin
Adjusted diluted EPS of 137.2p was up 2.1% despite a currency headwind of 8.3 percentage points. On a constant basis, EPS grew 10.4% driven by growth in operating profit, the contribution from Reynolds, the benefit of US tax reform and an improved result from ITC. Net finance costs were up, mainly as a result of the Reynolds acquisition and the financing of the transaction. We continue to expect the full-year net finance charge to be around £1.5 billion. Despite profit growth from ITC, the contribution from associates was down due to the removal of Reynolds as an associate company.

Our effective tax rate was lower at 26.9% mainly driven by the impact of the US tax reform. I would continue to expect a tax rate of around 27% for the full year. Non-controlling interests were marginally higher as profit growth in Bangladesh, Sri Lanka and Pakistan was partly offset by decline in Malaysia. On currencies, if rates were to stay where they are today, the translational FX impact on full-year results would be a headwind of around 5% on operating profit on a representative basis and a headwind of around 6% on EPS.

Now on to cash flow. Overall adjusted cash generated from operations was £2,953 million, which is £1,983 million higher than last year. This is mainly due to the benefit of higher adjusted operating profit driven by the six months of contribution from Reynolds and the early MSA payment of $1.8 billion or £1.4 billion made by the group in December 2017. As a result, operating cash flow conversion was up 27 percentage points to 97%. Excluding this early MSA payment, operating cash conversion would have been approximately 68%, which is in line with the prior period.

Depreciation is the main component of non-cash items. Excluding the MSA payment, working capital outflows of £1,611 million were significantly higher than 2017, which was an outflow of £899 million. This is primarily due to non-recurring stock builds. As always, I’d like to caution that the timing of working capital movements tends to absorb cash in the first half, largely due to the timing of leaf purchases.

Net capital expenditure was £44 million higher than 2017, largely due to investments in NGPs. We continue to expect gross capex in 2018 to be around £1.1 billion.

Net interest paid was higher at £723 million due to the financing arrangements for the acquisition of Reynolds. Tax outflows were higher at £813 million and now include tax outflows related to the Reynolds business. Dividend payments to minorities were slightly lower compared to 2017. This delivers adjusted cash generated from operations of £2,953 million.

Turning now to financing, we are targeting net-debt-to-EBITDA of around three times by the end of 2019, with further leveraging thereafter returning to the higher end of our historic net-debt-to-EBITDA of 1.5 to 2.5 times. Closing net debt was £46 billion at 30th June 2018. Our target rating remains BBB+/Baa1 with S&P and Moody’s, with the rating currently standing at BBB+/Baa2. This rating is driven by our net-debt-to-EBITDA ratio and we are focused on managing this down with no share buyback programmes or significant debt-financed M&A until leverage returns to appropriate levels.

So, in summary, the business has performed well in the first half. On a constant representative basis, adjusted revenue grew 1.9%, profit 2.4% and adjusted diluted EPS 10.4% exceeding our high single-figure earnings growth target. We continue to outperform the market and have once again grown share powered by the continued strength of our strategic brand portfolio. With a 48.8p quarterly dividend based on our previously announced annual dividend growth rate of 15% in 2017, backed by EPS growth, we have demonstrated our continued commitment to growing shareholder returns over the long term.

Thank you, and I’ll now hand you back to Nicandro.

Nicandro Durante

Thank you, Ben. So, in summary, in our combustible business, the fundamentals are strong, and we are outperforming the industry. Reynolds is performing well in the United States and our multi-category NGP strategy with the consumers at its heart is the right strategy. Looking to the second half, we expect stronger profit growth driven by improved price mix, continued share growth and a strong growth in NGPs offset by increased investments in NGP rollouts. I am confident we are on track for another good year of constant currency earnings growth.

And, we’ll now open up to questions. So, who’d like to start?
Operator
Thank you very much. Ladies and gentlemen, if you would like to ask a question, please press zero one on your telephone keypad. You can press zero two at any time to withdraw your question. And, our first question comes from the line of Jonathan Leinster of Berenberg. Please go ahead. Your line is now open.

Jonathan Leinster
Thank. Good morning, gentlemen. A couple of questions, if I may. First of all, the US market – obviously, your market share experienced a slight decline, which is quite a marked shift from where we’ve seen in the past. Is that because you’re concentrating more just on two or three brands and letting some of the tail brands decline at perhaps a faster rate? Or has there been perhaps a more noticeable shift or deceleration in the market share growth of Newport and NAS?

Nicandro Durante
Well, Jon, the answer for this question is that we are coming from a very strong growth in 2017 of our market share. The market share in US is slightly down around 10 basis points, but the strategic brands – the two truly premium brands in the US market – that they are Newport and Natural American Spirit – the share is up. We expect to have a very strong second half, and we expect that we’ll have a much better performance. But, we are against a very strong comparator against the first of last year. But, the full year we expect to have a different performance. But the share is 10% down. You see the low-price brands – the tail brands – declining but the strategic brands growing. So, the performances – I think that’s quite good in the current environment. But, the full year, as I said, we expect some improvement because we expect a second half much stronger.

Jonathan Leinster
Okay. Thanks. Secondly, I wasn’t quite sure, on the carbon-tipped cigarettes within the US market, are you saying that the SE application has now been cleared with the FDA? Or does that mean that actually the whole thing has been cleared and, therefore, you can launch onto the market as and when you want?

Nicandro Durante
We are delighted to be the first tobacco company to be able to launch a THP proposition in United States, who have clearance to launch the product.

Jonathan Leinster
Right.

Nicandro Durante
But, as I said before, a word of caution. We don’t know the size of this category in United States. We will pay full excise. The financials are not going to be as good as in some other markets. But, yes, we are looking at – we have plans to test market these in the next 12 months to understand a little bit better the potential. But, yes, we have clearance to launch. So, we are delighted with that.

Jonathan Leinster
Right. And lastly, with the Alto product, just to be clear, therefore, again with that one, it’s clearly being launched. So, this is not a new product. This is something which has already got clearance with the – So, when you say you launch this product, this is not something that requires a pre-market approval from the FDA, this is something you can launch straight onto the market, including nicotine salts variants? So, this is – you’re suggesting, therefore, that this is a sort of variation on an existing product in the market prior to August ’16. Is that the correct interpretation?

Nicandro Durante
Jon, this product has been grandfathered in August ’16, but they were not widely available in United States. There are a lot of products that were grandfathered at that time, and I can say that they were not widely available, because to be grandfathered, it could be in the market in one store, two stores only or the whole country. So, it was grandfathered. Now is the time to launch the product in scale. And I think that is going to be – we are going to launch two pod-mods in the next 12 months even before the end of the year. The first one’s going to be the Alto that you’re going to launch now in August. Consumer testing, the results are very good in several consumer attributes. The product has rated superior to other pod-mods in the market – 5% nicotine with nicotine salts. So, we are very optimistic about the launch, but, you know, with any launch, you have to wait and see. You take some time. But we’re going to
launch this in August, and the second one probably towards the end of the year in different price points, by the way. This is going to be more of a premium proposition. We are discussing the second one where this is going to be positioned.

Jonathan Leinster
Okay. Well, thank you very much.

Operator
Thank you. Our next question comes from the line of Fulvio Cazzol of Goldman Sachs. Please go ahead. Your line is now open.

Fulvio Cazzol
Good morning, gentlemen, and thank you for taking my question. I’ve got two on price mix. I know you highlighted that geographic and product mix had a negative 3% impact in 1H ‘18. I was just wondering if you can give any comments on how you expect that to moderate in the second half that you will be lapping the key anniversary dates for events in Saudi Arabia, Pakistan, and also the US volume trends have also improved. So, that’s my first question.

And then my second is on pricing. You highlighted that 70% of the price increases that you had budgeted so far in 2018 have been implemented. Can you remind us what the comparable figure was in 2017, please?

Ben Stevens
Hi, Fulvio. It’s Ben here. Yeah. Look, we expect price mix to improve in the second half. As you say, we’ll be lapping some of the more difficult markets from the first half of the year. So, we believe that pricing is improving in the industry and we expect a higher price mix in the second half. I’d remind you also that the 4% price mix that we’ve reported is actually 5% if you exclude the NAS net turnover because that was at zero margin. So, decent price mix in the first half, improving in the second half. And, in terms of pricing, we’re broadly the same as we were last year in terms of the percentage of pricing that’s gone through.

Fulvio Cazzol
Great. Thank you.

Operator
Thank you. Our next question comes from the line of Michael Lavery of Piper Jaffray. Please go ahead. Your line is now open.

Michael Lavery
Good morning. Thank you. I was wondering if you could just touch a little more on Natural American Spirit back in the US. What’s driving the declines there? That’s obviously historically had very strong positive growth even typically double digits. Can you just touch on what’s different that’s driving that negative now?

Nicandro Durante
Well, there is nothing negative in Natural American Spirit. We are growing market share 10 basis points. The volume is probably a consequence of the industry decline. So, in the first half of the year, volume is 4% up in an industry that was declining 5%. So, the growth is against the industry’s 9%. So, it’s a fantastic performance. And to look at historical numbers for Natural American Spirit, the size of share growth that you have experienced is similar to in the past. So, the brand is growing very strong. We have extremely strong first half of last year. We are still growing 10 basis points. It’s the most premium brand in the United States. And if you consider all of this, I think that has been a great performance for the brand. So, nothing wrong in that.

Michael Lavery
So, could I just clarify? I’m looking at the release and it says that share momentum continues. That is up. But, then it says with volume lower by 4% on a representative basis. Is the volume actually down?

Nicandro Durante
Well, I can come back to you, Michael. But the number that I have here is that the number is up and the market share is 10 basis points up. But, can I get back to you?

Michael Lavery
Yeah, sure. Thank you. No problem. And could you just touch on Korea with the Korean FDA I think creating a little bit of confusion for consumers around the risk reduction for tobacco heated products, how significant of a challenge have you seen that in the market for consumers? And what if anything do you feel like you can do to counter that?
Nicandro Durante

Well, honestly, there are a lot of reasons why Korea has stabilised at around 12.3%. To be honest, I think that the main reasons for the stabilisation in Korea is because the dynamics of Korea and Japan that they are the two biggest THP markets – are completely different. For example, in Korea, you have different touch points of consumers. We cannot do sampling. You have different hyper care needs. The way that you engage with consumers requirements and restrictions on one-to-one engagement with consumers. The number of sole users in Korea is much higher than – sorry – the growth of sole users, we don’t see this happening in Korea the same proportion that we see in Japan. And when you have a higher percentage of dual users – and we always have a high percentage of dual users in Korea – there is a tendency that they – because of product satisfaction, there is a higher percentage of people going back to the combustible category.

So, I think that these are the main reasons for stabilising in the range that it has. It has grown very fast to 12%. But honestly, I think the category will go back to growth. Because one of the main reasons for the category not growing is product satisfaction. There will be a lot of launches in the second half from BAT and a lot of competitor activity to be honest. We are launching new devices. We are launching glo 2.0. We are launching glo mini at the end of the year, in terms of device. We have capsules in the market, we have for example – in Japan now, we are just launching new premium consumable with a higher nicotine, with different flavours. Because of the new launches in the market, I expect the category to go back to growth.

Michael Lavery

That’s very helpful. Just one last follow-up on Jon’s question. Any sense of how soon – I think you said the carbon tip test launch in the US would be in the next 12 months. Is it the sooner end of that or when might we expect to see that?

Nicandro Durante

As I said, we are going to test market the product in the next 12 months, because the size of the category in the US is unknown. And as I said, there will be full excise in the category. So, you have to understand the category a little bit better before a full launch. So, you test market in the next 12 months and dependence on the test market, we’re going to expand this. But I cannot be precise to you in terms of time. We have already stated that we’re going to do that, because we are just working on this now. We have plans and we are discussing the finalisation of those plans.

Michael Lavery

Okay. Thank you very much.

Ben Stevens

Hi, Owen. Ben here. Look, I’m not going to give a prediction on margin for the full year. But we are confident we can grow operating margin, as I say, 50-100 basis points over time, whilst the investment goes up in the second half of the year. Remember we’ve also said that results will be biased towards the second half of the year as well. So, I’m expecting a good performance on margin for the full year.

Nicandro Durante

In terms of US, we are talking about 5% for the first half of the year, and I said 4.5-5% for the full year. So, I do expect that the second half is going to be better than the first half. I’m talking about the industry, because from the Reynolds perspective, I think that you’re going to outperform the industry in the second half because expect share growth. And the reasons for that, as I said, the main reasons for this decline of the industry in the first half was disposable income in US. Gasoline prices went up big time. There is a huge influence in terms of consumption. You have the SET excise increase in California. Those are the two main reasons for the decline in the first half. And the gasoline, for example, you’ll be – it’s the same reason for the full year. But, I think that the second half of the year, Owen, I think that’s going to be better than first half. And I think that Reynolds, as BAT in the second half, will have a very strong second half. We’ll outperform the industry.
Owen Bennett
Okay. Cool. Thanks very much, guys.

Operator
Thank you. Just to remind participants, if you wish to ask a question, please press zero one on your telephone keypads. You can press zero two at any time to withdraw your questions. There will now be a further pause while questions are being registered. And our next question comes from the line of Adam Spielman of Citi. Please go ahead. Your line is now open.

Adam Spielman
Hello. Thank you very much. So, my question comes back to this thing about price mix. If I understand it correctly, pricing must have been about 8%, because I think you said the price mix was 5%, but you have negative 3% mix, leaving 8 percentage points as the price. Is that correct?

Ben Stevens
Yeah. That’s correct, Adam.

Adam Spielman
And as we look – can you sort of say geographically where – I mean because that’s a huge number – more than you’ve done before. I was just wondering sort of geographically, particularly as you didn’t take pricing, my understanding, in Russia, where the biggest movements from that is?

Nicandro Durante
Adam, this is not a number that is much higher than previous years because the price mix last year, while it was 3% this year, it was even higher last year. I think that if you look at the price mix excluding geographic and portfolio mix, I think that the first half of the year was lower than last year. So, I don’t think that 8% is much higher than it was the first half of last year. It’s lower. Look at the first half last year price mix, including geographic and portfolio, that was higher than this year. You see that is a little lower.

Adam Spielman
Okay, and… Okay. Fine. Can you just talk about in terms of volumes, you’ve had a positive surprise – I don’t know if surprise is the right word – but you’ve had a positive one-off in Pakistan and a negative one-off in GCC. Can you say which one is bigger and how much? Can you give any sense of a scale of those two movements?

Nicandro Durante
Adam, to be honest, to do the math is about the impact of each market in terms of volume is not going to be easy. I would be more than happy to come back to you later with the answer for this question. But, in the case of Saudi Arabia, we had the industry declining almost 40%. And if you look at Pakistan, first half against first half of last year, we have the industry declining probably less than that. So, I think that there is a huge impact in the case of Saudi Arabia in the numbers. But, to do the math about the impact of each specific market in the total volume numbers, we can discuss this later, if you don’t mind.

Adam Spielman
Of course.

Nicandro Durante
I will get back to you.

Adam Spielman
And the final thing is in terms of pricing in the US, you obviously had a very strong pricing in the first half; do you expect it to be equally strong in the second half?

Nicandro Durante
Adam, we don’t talk about prices going forward. What I can say to you is that we have a very good price environment in the United States. I haven’t seen anything changing in the last 18 months – 12 months – 6 months. So, it is a very solid price environment. But, I cannot talk about price increases going forward. As you expect that I couldn’t. But, it’s a good price environment. I don’t see this changing. But, you know, we have to wait and see.
Okay. Thank you very much.

Operator
Thank you. Our last question comes from the line of Rey Wium of SBG Securities. Please go ahead. Your line is now open.

Rey Wium
Good day, Nicandro, Ben. Yeah, I just want to start off by just saying, compliments on the improved disclosure. It really helps. I just want to quickly just come back to the next generation product investment into the second half. I mean, if my calculations are correct, it looks like based on that margin chart it was about £160 million odd that you spent, which was the hit on the margin. And correct me if I'm wrong, but I think the guidance is about £500 million for the full year. That's just my first question.

Ben Stevens
Yeah. You wouldn’t be a million miles away with those numbers, Rey. But, remember, the combustibles business will improve in the second half as well; so, that will give an offsetting effect on the operating margin.

Rey Wium
And then, I just want to touch on Japan or the target of £1 billion for the next generation products. I mean in the first half it was £427 million on a constant currency basis. Just correct me if I’m – on this – but as far as I have it, the capacity constraints have now to come an end in terms of your production. So, is it fair to assume that that market share of yours that have been sort of stable — around about the 4.2% in Japan — could probably now get a benefit from the improvement in your capacity issues?

Nicandro Durante
Well, we have grown market share from 0.9% mid-last year. And since we went national in October, we came from 0.9% to 4.3%. In December, we were at 3.3%. It has been stable in the last three months. The last reading that I have with me in May. That’s true. But, we have seen strong growth. We became unconstrained in June, as I had said before. So, we start shipping July. To see the impact of this and the impact of the new launches in the market — we have just launched a new device, the glo 2.0. It’s a much better premium device. We are launching new variants. We are launching new consumables at a higher price point, new flavours, high nic, plus the unconstrained device. We expect to grow market share. We wouldn’t be doing all of this if we are not expecting significant growth in market share.

And you are right, Japan is extremely important for us to grow in our NGP, because, I have said before, if you look at the THP category, we have Japan and South Korea, the two biggest markets. So, you have to make inroads in Japan to meet our numbers. We are very optimistic about our portfolio. We are very optimistic that we are going to grow market share in a growing market because all this competitors’ activity should drive volume.

But, in order to achieve our NGP numbers, THP is very important; but vaping is also very important. And I have not talked about vaping enough. The launch of Alto in the United States is something quite important for us. As I said, the brand — the product has performed extremely well in our research against the comparable pod-mod products. And also, the launch of ePen3. We have test marketed ePen3 in the first six months of this year, and the results have been quite great. Just to have an idea, in the case of ePen3, one of the chains that you have never been able to go through being big tobacco is the vape stores. In the 2,500 vape stores in the UK, during the first half of the year, we provided product for testing, and we had a call to buy 2.4 out of 2.5 vaping stores, which progresses as soon as production allows during the second half of the year.

So, all the indications with ePen3, Alto and at beginning of next year with iSwitch — that’s what we used to call Raptor. We are very optimistic about our vaping portfolio, very optimistic about THP portfolio, and that’s why we’re optimistic that we can reach our targets. Long answer, but...

Rey Wium
Good. And maybe just a quick little final question. Just on Australia. It’s surprising. I mean, I think you indicated — I don’t know if share and revenues or profits are up, but as far as I have, the market was sort of down 10% in the first half of the year. So, I’m just curious about your performance in Australia.

Nicandro Durante
The main reasons for that are two-fold. First of all, in Australia, we have done quite well in terms of market share. So, we have been growing market share in the last couple of years. We grew in the first half of this year 30 basis points in Australia. So, it’s quite important. We have a very strong position with our portfolio there. Second, price has been quite solid in Australia in the last 18 months.
We remember that two or three years ago, we saw a lot of down trade in the market. We discussed this several times in the past. Now that the market has stabilised, we see very good pricing coming through and we have a very strong portfolio. And those are the two main reasons for outperformance in Australia. We are quite confident about the business.

Rey Wiium  
Excellent. Thanks very much.

Nicandro Durante  
The declining volume, as you know, you have these ad hoc excise increase, and when you pass a significant excise increase through pricing, you have a declining consumption. And unfortunately, in Australia, illicit trade now is almost 15% of the market. What drives significant excise increase is growth of the illicit trades. So, this is the downside of the Australian business. But on the other side, there are so many upsides.

Rey Wiium  
Thank you.

Operator  
Thank you. As that was our last question. I’ll return the call to Nicandro Durante. Please go ahead.

Nicandro Durante  
Okay, guys. Thank you very much for joining this conference call. We look forward to seeing you again, to talk to you again in February during full year’s presentation. Thank you.

Operator  
This now concludes our call. Thank you for attending. Participants, you may disconnect your lines.

---Conference call ends--