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QUESTION AND ANSWER PARTICIPANTS

QUESTIONS FROM

Gaurav Jain, Barclays
Owen Bennett, Jefferies
Fulvio Cazzol, Goldman Sachs
James Edwardes-Jones, RBC
Question - Gerry
Introduction & Highlights

Nicandro Durante, Chief Executive
Good morning everyone and welcome to British American Tobacco’s 2018 Preliminary Presentation.

I am Nicandro Durante, Chief Executive of British American Tobacco, and with me this morning is Jack Bowles, Chief Executive Designate and Ben Stevens, Finance Director.

Thank you all for coming to this results presentation, which will be my last before Jack drops the designate part of his title and becomes Chief Executive in April. 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 those of you in the audience to ask questions.

Before I start the presentation, I will take it that you have all seen and read the disclaimer on page 2 and 3.

It is clear that these results have benefitted significantly from the inclusion of Reynolds as a fully owned subsidiary, given this, volume, revenue and profit from operations will presented as though the Group had owned the acquisitions made in 2017 for the whole of last year.

We will refer to the comparison of results on this basis as performance on a representative basis. This comparison will provide shareholders with a better understanding of like for like performance.

I would like to begin with a few highlights from the results. I am pleased to say we have delivered another very strong performance in 2018, with our reported results benefiting from the full year impact of the RAI acquisition.

We exceeded our target of high single figure earnings growth, adjusted EPS was up 5.2% at current rates, but this was an excellent 11.8% on a constant currency basis.

This was driven by the strong growth of our strategic portfolio, which grew constant currency representative revenue 8.5%. Demonstrating the strength of our brands across all four categories.

We continue to consolidate our position in the Combustible market, delivering our 8th consecutive year of share growth, with another 40 basis point increase in market share. This is an outstanding performance.

In NGP - we also double our revenue from THP and Vapour to reach over £900m on a constant currency basis. This was lower than our initial aspirations; it slowed down in the THP category.

All the regions performed well. In the US, good pricing and continued value share growth delivered nearly 6% in adjusted representative constant currency operating profit.

This together with the benefits of the US tax reform, which did not form part of our acquisition assessment, means that the RAI deal is well ahead of our financial targets.

I would like to take this opportunity to acknowledge that a good year for the business in terms of financial performance has not been shared by our investors in terms of the share price. And I would like to thank you for your continued support.

We recognise investors are concerned about the long term outlook for the industry, principally driven by the regulatory announcements in the US and the potential for the regulation of menthol. I want to reassure our investors that we have a long history of successful managing through period of regulatory change. And we believe that any restrictions are years away.

These results demonstrate the business remains in very good shape and we remain confident in the future. This is reflected in the 4% increase in the dividend which we announced this morning.
Looking briefly at the reported results, volume, revenue, and profits from operations benefits from the full year impact of the RAI acquisition and were 3, 25 and 45% respectively.

On a representative basis, our global cigarette and THP volume was down 3.5%. In our key markets, which represent around 80% of global volume and where our investment is focused, we outperformed the industry with a decline of 2.7% against an industry estimated to be around 3.4%.

However, excluding the one off effects of the inventory movements in the supply in Russia and the impact of size increase and supply disruption in the Middle East, underlying volume declined just 1.9%.

In 2019 we expect the industry volume to be down around 3% and you would expect it to outperform the industry.

Constant currency adjusted revenue was up 3.5% on a representative basis, driven by robust price mix in cigarettes of 6% and an overall price mix of 7%.

Our Transformation Tobacco agenda delivered another strong growth across THP, Oral and Vapour. And we are making good progress building global brands across all the three categories.

As you are aware we have a Capital Markets Day planned in two weeks' where we will showcase our products pipeline, which has been in the making for some years. This will demonstrate why we are so confident on achieving our aim of leadership across all those segments.

We continue to expect strong new category growth, leading to revenues of £5bn by 2023, '24.

In 2018 THP revenue increased over 180%, driven by an increasing consumables volume to £7bn, although it's still in the early stages of rollout in many markets, we also saw consistent growth across the other 14 THP markets.

In Oral, our strong portfolio of brands in both the Traditional and Modern Oral categories, drove strategical revenue growth of 11%, on an adjusted representative constant currency basis. In modern Oral our range of low tobacco and tobacco free products under the EPOK and LYFT brands grew revenue 140% on a representative constant currency basis.

In Vapour we saw significant growth in both volume and value across our 15 Vapour markets. Total volume was up 35% on a representative basis with good performances in the world's three largest Vapour markets, the US, UK and France.

Vapour revenue from consumables grew 27%, while total Vapour revenue, including device was up 26%, on a constant representative basis.

We are the undisputed leader in the UK and we have made good progress in the US with the performance of the Vuse franchise and launch of Alto.

So in summary BAT has reported another great set of results. As you can see from these slides, excluding the impact of currency movements this is not a one off. We have an excellent track record of delivering consistent EPS and consistent adjusted diluted earnings growth year in year out.

We have always delivered on our commitment to high single figure constant currency earnings growth and we remain very confident that we can continue to do so over time, particularly as our new categories move from an investment phase to profit growth.

We have built a great foundation for continued future growth. We have pursued a multi-category approach from the outset, because different consumers want different products and these results demonstrate that this continues to be the right strategy.

Over the last 8 years we have made substantial investment in these new categories, building new capabilities, new brands, new products, and a great product pipeline.
As I had over the reins to Jack, I’m leaving the Group in a strong position. I’m sure he’ll continue to build the long term sustainability of the business. Jack now will take you through the business performance in a little bit more detail.

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**Business Review**

Jack Bowles, Chief Executive Designate

Thank you Nicandro, good morning everyone. Firstly let me start with the Combustible business, which continues to perform very well. This provides the oxygen which will fuel our growth in new categories.

Group market share grew another 40 basis points on top of the 40 basis points achieved last year. This was driven by another strong market share performance from our strategic brands, which were up 200 basis points.

All the brands performed well and in particular Kent and Rothman were outstanding, growing share by 50 basis points and 110 basis points respectively.

To give you more colour, Kent has had an excellent performance in Japan, mainly due to the growth of THP consumables. And there was also good growth in the cigarette category. In fact, we are the fastest growing company in THP and consumables.

In Russia, Kent regained leadership in the premium segment; Kent Nanotech capsules reached a record share of 1.9%, driving Kent to its highest share level in Russia over the last four years.

In Turkey Kent is the fastest growing brand in the market.

Rothman’s market share continued to grow strongly and was up another 110 basis points over the year. Volume grew nearly 20% to reach just over 99 billion sticks, driven by good performance in Ukraine, Russia, Nigeria, and Bulgaria and migrations in Poland, Brazil, and Columbia.

In Brazil, the Minister to Rothman’s migration was the largest ever in the Group.

In Italy the brand was the fastest cigarette brand in the market, reaching and exit share of more than 9% in December.

In Russia Rothman’s in now the number two brand, with leadership in the capsules and demi segment.

Lucky Strike and Pall Mall also grew share, demonstrating the strength of our differentiated brand portfolio and diverse geographic footprint. Dunhill’s overall share was stable, despite the down trading in many of its key markets.

In the US our premium brands, Natural American Spirit and Newport both grew share and went up 20 and 10 basis points respectively. Camel’s share was stable and Pall Mall was down 20 basis points, due to the growth of the non-big three discount brands.

Overall this was a very good performance of our Combustible business.

In tobacco heating, Glo has performed very well in Japan. While we continue to see the THP category developing at different levels across markets globally, Japan has experienced tremendous success, although growth slowed during 2018.

However, in Korea the category is less than half the size of Japan and to date Europe has seen much lower levels of growth. This is why we have focused our efforts in 2018 in Japan, it is the most competitive THP market and we have grown faster than any other competitors.
Our share of the total nicotine market has now reached 17%, an increase of 160 basis points over the year, reflecting the good health of both Combustibles and the THP business.

Glo national share reached 5% in January this year, growing consistently over the second half. Our share of the category is now 22.4% and our estimated share of the gross margin pool is 26.7%, up from 19.1% and 23.1% respectively.

This is a growth story which is translating to strong financials. During 2018 we launched NEO, our premium range of consumables, priced above Kent, with higher nicotine and capsules. NEO has grown to a 1.5 share points, driving growth for glo and mix improvement.

We are the only THP player in Japan to offer capsule variants, which together with our wide range of flavours provide more choices to consumers than any other competitors.

In South Korea the THP category returned to growth in the second half of the year and represents 9% of the tobacco market in December. Glo continued its share improvement with an improved mix and better activation model, following the relaunch in August.

In other markets, particularly in Europe, glo is still in the early stage of expansion, but with some encouraging results over the year.

In Romania, glo has performed well, with strong month on month growth and in Russia device penetration reached record levels in December. Glo's global footprint continued to increase during 2018 with a number of new market launches in the second half, including Greece, Serbia, Croatia, Ukraine and Kazakhstan. We remain confident in our glo product pipeline and support plans, with a number of launches and activities planned for 2019.

In Vapour, in a representative basis volume was up 35% and revenue was up 26%. In the US the overall Vuse family has grown both volume and value, despite the 20% growth in revenue Vuse value share was down 14 percentage points over the year to 18%, as the category continued to growth rapidly, although not always where we are willing to market our products.

Performance was also impacted by the Vype product recall, importantly, I am pleased to say, that with the Vuse family has now returned to share growth in the last part of the year. With the successful launch of our pod mod, Vuse Alto and the reintroduction of Vuse Vype.

In addition our share in starter kit sales, which is a very good indicator of consumer uptake, is growing rapidly, with the latest Vuse share at 27.4%. The introduction and phased rollout of Alto, since August has progressed very well. It has grown from zero to a national value share of 4.6% and continues to growth.

Share of cartridges measured in millilitres equivalent is increasing at an average of 1.5 percentage points in recent months and currently stands at 5.5%, while Alto's share of starting kits has grown to 10.8%, reflecting significant growing consumer interest in the product.

The growth of the category slowed during the second half of 2018 and we are making good progress in improving our market position, as the category begins to consolidate.

In January we commenced our full national support campaign, having successfully scaled up production capabilities to meet anticipated demand. We continue to see good evidence of Alto's strong product performance across both our own product trials and among vapour experts and feedback from consumers. We remain very confident in its ability to drive share growth in the US.

In the UK the market grew by almost 26% and BAT Vapour retail value grew by 20 basis points to 41%. Vype ePen3 was launched in the UK after an extensive pilot programme with excellent results. Whilst it is still early days, initial indications from the launches are very positive and ePen3 has already achieved a 3.9 national value share in retail in the UK, as well as has been voted Product of the Year by consumers.
We continue to perform well in our other markets and we are the market leader in Poland and in Germany. Our global footprint continues to grow, including new market launches in New Zealand and further product rollouts of ePen3 in France and Canada.

In France Vype has moved from being the number 5 brand in retail to take market leadership with an overall retail exit share of 13.7%. This has been driven by a strong performance from ePen3, which just eight weeks after launch has already achieved 7.1 value share in retail in January.

Vype now accounts for over 23.7 of all closed system sales in the retail channel.

Our new product Vype iSwitch was launched to a test market in the UK in December. iSwitch represents first to world heating blade technology, replacing the traditional coil and wick system. Value share in VIP stores in situ is 23% after five weeks.

The Oral tobacco category is becoming an increasing relevant category, and has two distinct sub categories, Traditional Oral includes moist snuff and traditional snuff products, the Modern Oral category comprises very low tobacco or tobacco free white pouches products, where we have EPOK and LYFT, which both experienced significant growth in 2018.

In the US strong pricing in Traditional Oral drove good growth in revenue and profit. Grizzly market share was down 40 basis points, largely due to lapping of a tough comparator which benefited from gains made during a competitor's product recall in Q1 2017. In addition in the last part of the year Grizzly returned to share growth and was up 50 basis points in Q4.

Camel snus also performed well and we remain very hopefully of a positive outcome as we continue to await the results of our MRTP application.

In Modern Oral EPOK is performing extremely well across the whole of the Nordic markets and is the fastest growing premium brand in the overall Oral market. As a result we continue to grow share in Oral and now have a December exit share of category of 8% in Norway.

In Switzerland EPOK has also delivered strong growth to achieve 17% exit share of category in December, after launching in Q2 of last year.

LYFT our tobacco free product was launched in Sweden in Q3 of last year and finished the year with a market share of 4.5% in handling just after four months.

A pilot is now currently underway in the UK with encouraging early results.

Moving on to the regions, where for clarity I will focus on the constant adjusted representative numbers.

In the US Reynolds performed well, adjusted profit was up 5.8%, reflecting growth in revenue and good pricing, as well as cost reductions since the acquisition.

Cost synergies are progressing well with annualised savings of over US$300m delivered to date. The Group continues to expect to deliver over US$400m of synergies by the end of 2020.

Industry volumes were estimated to be down around 4.5% in 2018, partly due to the impact of higher fuel prices on disposable income, the growth of the Vapour category and the residual effect of the change in excise in 2017 in California.

It is important to note that the market decline moderated in the second half of the year from 5.3% to 4.1%. This year we expect industry volume in the US to do better than last year, down around 3.5 to 4.5%.

BAT cigarette volumes were 5.3% lower in part due to a strong comparator, following the new variant launches for Camel and Newport in the first half of 2017. Importantly, overall value share grew 25 basis points, driven by the continued growth of the premium brands.
The FDA announcements during the year have clearly generated significant investor uncertainty. However, we have a strong portfolio of brands with a great consumer profile, while we believe FDA restrictions are years away, we have successfully navigated through menthol restrictions in other markets and I’m confident that we can do so in the US.

In APME, revenue in the region grew 5.7%, the strongest performance since 2013, driven by good pricing and the growth in THP volumes.

Profits from operations was up 1.2%, this was driven by strong growth in Japan and increases in Australia, Pakistan and Bangladesh. This growth was partly offset by a reduction in Saudi Arabia, caused by down trading following the excise increase mid-year, although share increased significantly following the successful launch of Pall Mall in the low priced segment.

Volume was up 0.7% driven by recovering volume in Pakistan and THP growth in Japan and South Korea. Market share in the region grew strongly and we up 110 basis points. The strategic brands had an excellent performance with volume up 6%. Share was up 120 basis points, mainly driven by Pall Mall in Pakistan and Saudi Arabia, as well as a good performance from Dunhill in Indonesia.

In AMSSA, revenue grew by 5.6% as good pricing across the region more than offset the lower total volume and the negative mix impact of down trading following the significant excise led price increase in a number of markets.

Volume was down 5.4%, mainly due to the growth of illicit trade in Brazil and South Africa, the termination of a third party licence agreement in Mexico, together with market contractions in Canada, Columbia and Venezuela. Despite the challenging macroeconomic environment and excise increase pricing remained strong.

Profit grew strongly and was up by 6.5%, driven by good performances in Nigeria, Mexico and Chile, partly offset by a lower duty paid market and down trading in South Africa. We continue to await the outcome of the Class Action appeal in Canada which is expected tomorrow evening.

The strategic brands reached a record share in the region and was up 720 basis points, this was driven by good performance in Brazil, where the strategic brands almost doubled volume, helped by two very successful migrations.

Finally, in ENA, adjusted revenue grew 3.5%, and profit was up by 1.8%, following significantly increased investment behind our new category launches in the second half. [Short gap in audio] was down by 5.3%, Turkey, Egypt, Poland and Romania, were offset by declines in Russia, Ukraine, Italy and France.

Market share in the region was stable and the strategic brands delivered another good performance with volume up 5.2%.

So overall it was a good performance across the regions. We are committed to investing in and developing strong brands across categories and continue to improve our execution. I am looking forward to our Capital Market Day in March, where I will talk in more detail.

I will now hand you over to Ben, who will take you through the financials.

Financial Review

Ben Stevens, Finance Director

Thank you Jack. Good morning everyone.

So while on a reported basis EPS declined by 86%, due to the impact of the RAI transaction accounting treatment in the prior year, adjusted diluted EPS was up more than 5% at current rates and nearly 12% on a constant basis, exceeding our high single figure EPS growth objective.
As we said earlier for clarity I’ll now focus on the adjusted representative results, which are against a comparative base that assumes full ownership of Reynolds and the other acquisitions throughout 2017. This doesn’t affect comparisons made on an EPS basis.

As you’ve seen the regions performed strongly in 2018, with Group adjusted operating profit growing by 4% at constant rates. As we stated previously our 2018 results enjoyed a benefit from the US tax reform, which we initially estimated would be equivalent to around 6% on EPS, around half of which we said would be invested into increased support for our next generation products.

So I’m pleased to say that even excluding that benefit constant currency EPS would have grown around 9%, meeting our high single figure growth target and adjusted operating profit would have increased by around 7%, excluding the incremental spend funded by the tax reform. So this was a very strong performance.

Turning now to operating margin, on an adjusted basis margin was up by 150 basis points, benefitting from the inclusion of Reynolds - as a fully owned subsidiary, excluding this our operating margin increased by 40 basis points to 42.6%.

Changes in the business, including pricing, cost savings, and synergies with Reynolds drove underlying margin improvements of 180 basis points. This was offset by higher investment in NGPs, which represented a headwind of 140 basis points.

We expect our net investment in new categories to be about the same in 2019 as last year.

We will continue to make good progress with our margin on an underlying basis and remain confident in our ability to deliver 50 to 100 basis points of margin improvement on average over the years.

Now onto cash flow, overall adjusted cash generated from operations was £8071m, which is £4789m higher than last year; this was primarily driven by the full year impact of the RAI acquisition and also assisted by the early MSA payment in December 2017 of £1.4bn.

The timing of this was the major contributor to the £1.7bn reduction in working capital year on year. However, underlying working capital was also lower. As a result operating cash flow conversion increased by 34.5 percentage points to 113% versus 2017. Excluding the early MSA payment, operating cash flow conversion would have been 100%.

Depreciation is the main component of non-cash items and excluding the MSA payment working capital inflows of £287m were significantly better than 2017, which was an outflow of £93m.

Net capital expenditure was £78m higher than 2017, largely due to investments in next generation products. We expect net capex in 2019 to be around £850m.

Net interest paid was higher at £1533m, driven by the full year impact of costs related to financing arrangements for the acquisition of Reynolds.

Tax outflows of £1891m, have increased by £215m from 2017. This reflects the inclusion of RAI as a subsidiary for a 12 month period and the increase in profits across the Group.

Lower dividend payments to minorities are attributable to lower profit in Malaysia in 2017.

This delivers adjusted cash generated from operation of £8071m.

Restructuring and settlement outflows were lower at £601m, largely due to no further payments linked to the Quebec Class Action lawsuit.

Dividends from associates of £214m have reduced significantly from 2017, due to the acquisition of Reynolds, and now comprises primarily receipts from ITC.
This delivers free cash flow of £7684m.

Adjusted diluted EPS of 296.7p was up 5.2%, despite a currency head of 7 percentage points. On a constant basis EPS grew 11.8% driven by growth in operating profit, the contribution from Reynolds and the benefit of the US tax reform.

Net finance costs increased, driven by the full year interest charge incurred on borrowings as a result of the RAI financing. We continue to expect the full year net finance charge to be around £1.5bn in 2019.

The contribution from associates was down due to the removal of Reynolds as an associate company, partly offset by an increased contribution from ITC in India.

Our effective tax rate was lower at 26.4%, mainly driven by the impact of US tax reform.

Non-controlling interests were marginally higher driven by profit growth in Bangladesh.

On currencies, if rates were to stay as at 27th February, last night, the translational FX impact on full year results would be a headwind of around 0.8% on operating profit and 0.9% on EPS.

The Group’s net debt to EBITDA metrics are both stated on an adjusted basis. Net debt to EBITDA stayed at four times in 2018, purely as a result of the impact of exchange rates on net debt at the 31st of December, and EBITDA at average rates during the year. And I’ll show the impact of this on the next slide.

I did want to emphasise that even at these unfavourable exchange rates our credit rating remains stables at BBB+/Baa2, just one notch with Moody’s from our long term target of BBB+/Baa1. Our interest cover remains high at over seven times, and we remain committed to paying a dividend which increases every year in sterling terms, moving gradually to a payout ratio of 65% as we pick up an FX tailwind.

We have historically generated a free cash flow after dividends of around £1.5bn every year, and we expect future EBITDA growth to benefit from our cost cutting programmes and we begin to make a return on our new category investments.

I’m also guiding towards an effective tax rate of 26% this year, down from the 2018 level of 26.4%.

As noted on the previous slide the Group’s net debt to EBITDA metrics are both stated on an adjusted basis. As you can see from the chart translating our closing net debt at the same rates as the closing net debt for 2017, and translating our EBITDA at constant rates to 2017, our net debt to EBITDA would have been 3.6 times, in line with our deleveraging target of 0.4 to 0.5 turns a year.

Translating our EBITDA at the 2018 average rates, i.e. including the FX headwind of 5%, increased the ratio by 0.2 turns. Translating net debt at 2018 closing rates also increased the ratio by 0.2 turns. However even today FX is moving in our favour and translating the 2018 net debt and EBITDA at today’s rates would give a net debt to EBITDA of 3.9 times.

FX rates will move where they will. The most important number is around the £1.5bn of free cash flow after dividends that we generate every year, and this gives me confidence that we’ll deleverage back to our target of 1.5 to 2.5 times.

So in summary the business performed well in 2018. On a constant representative basis adjusted revenue grew 3.5%, profit by 4% and adjusted diluted earnings per share 11.8%, exceeding our high single figured earnings growth target whilst investing in new categories.

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

Nicandro Durante, Chief Executive
Thank you Ben. So 2018 saw another strong performance across all categories. This was driven by continued strong growth in our strategic portfolio showing the strength of our brands. Our new doubling of NGP revenues and the improved financial performance across all regions, notably the US driven by pricing and value shared growth of Combustibles. Overall the business is performing well, we exceeded our high single figure target delivering constant currency earnings growth of nearly 12% while investing for the future.

Looking ahead to 2019 we are confident of another good year of earnings growth. Our confidence in the future of BAT is reflected in the continuing increase in the dividend, up by 4%.

I will now open it up for questions.

Questions and Answers

Gaurav Jain, Barclays
So I have three questions. One is on the US volume outlook which you have said is minus 3.5% to minus 4.5% for FY’19 which is better than FY’18, and I think Altria has said minus 3.5% to minus 5%. So can you please help us understand why volumes are improving?

Question two is that you are in both the product categories, THP and Vaping, and much more than any other company is. So when you look at this country category combination around the world, in how many countries do you think vaping will be successful, and in how many countries do you think THP will be successful?

And the third thing is that when Altria has done this Juul transaction they have spoken about promoting Juul in several ways including packet inserts and better retail placement and things like that, so why can’t you do a similar thing with your existing cigarette portfolio and your views and by-products? Why can’t you promote them with new Newport or Natural American Spirit? Thank you.

Nicandro Durante, Chief Executive
I’ll try to grab the questions. Maybe Jack he wants to jump into the third one later.

The first two, let me try to answer the US outlook. It’s very difficult to predict how the industry is going to play but the three main factors that we had last year that affect the volume in the US, was the overlap of the Californian excise size we don’t have this year.

We had the huge growth of vaping in the first half of the year, and the growth of vaping in the last quarter of 2018 has stabilised.

And the third one was significant fuel price increase in US that you’re not seeing now. So they are three factors here that shows that you have probably a better volume environment.

It has been shown in January; in January if you think of sales to retail was down 2.7%. It doesn’t mean that I’m going to change my outlook for 2019; I still think that should be around 3.5 to 4.5. But these are the indicators that you have to be a little more confident in the outlook for 2019.

And on top of this the environment in the US is a little bit better. We just announced as you know a price increase. Our announcement was $5.50, a very solid price increase $5.50 per thousand. So it just shows that this was ahead of plan. It was ahead of last year. So I think that we have a better environment. I hope that I answered your question but it’s very difficult to predict those numbers, but our indications show that probably we’ll have a stronger ’19 than ’18.

Regarding your second question about how many countries THP and vaping. Well you know from the outset as I said in my presentation, since 2011 we always said that these categories were going to develop in different ways in different markets. I’m very glad that now the industry is coming close to our
direction, very happy with that. But anyway we said from the outset that the four categories were going to be very important. And one example of that, we launched one of our new products in Switzerland six months ago against a THP product that was there for a couple of years. The market share on those products is higher than the THP product in Switzerland. You saw that the categories are going to grow at a different pace.

The number of countries in which the categories are going to be successful, if you go back to the investors day that we went through in 2017 we had a chart in which we said in five, ten years' time how we think the categories are going to evolve. And it showed the most prevalent category in five, ten years' time. I don't think that our view of the categories changed dramatically so I recommend you go back, it's on our website. But in two weeks' time instead of me going through country by country now we have a capital markets day, there will be a presentation again. We will have that chart appearing again and we are going to explain how we think those things are going to develop.

So very glad that you see that everybody is coming to the same conclusion. Very glad to see that because we started earlier we will have a better portfolio to face this. I think that Jack highlighted extremely well in his presentation about the first world heating blade technology that we call Vype switch. We are just piloting this in our Vype stores. In our Vype stores it has reached 25% of market share after a couple of months. It just shows that the portfolio that commercial place now, in all these categories there is new products that we're launching in Switzerland, this product that we are launching here in the second half, where you're coming for a hybrid product in Japan, all these things are coming to fruition now and I think that we - starting earlier is always the best way to be innovative in any place.

In two weeks' time as I said during the meeting we will showcase the innovations that we have. We said last year that most of them were going to be executed at the beginning of this year. They are. The THP for example, the majority of the launches was the second half last year, September, and I think that we'll see the results this year. So I'm very optimistic about that. But you'll have a little bit more detail in two weeks' time but I have to stop here, if not I will kill the Capital Markets Day.

Jack Bowles, Chief Executive Designate
What was the last question?

Gaurav Jain, Barclays
What I was asking is that Altria have spoken about helping Juul on THP shelves with their placement, also putting pack inserts of Juul within Marlboro packets. So why can’t you have a similar strategy around your vaping business and helping your vaping products with the strength of your cigarette portfolio?

Jack Bowles, Chief Executive Designate
It’s a very good question. We are looking at the moment at all the different options for us to accelerate the development of our portfolio. And especially related to Alto we have seen a very good performance.

What we do with Alto is gradually to increase the pressure especially in terms of consumer engagement because we had some shortfalls in terms of availability of products. And we are now going full blast. As we said in the presentation the results are extremely good, they are more than 5%, and we want to continue that. And we’re exploring all the different avenues really to the best way to promote our products.

Owen Bennett, Jefferies
The question on the outlook for NPG, particularly for 2019, if you could give any more visibility on a sales target this year?
And then the 5 billion a few years out, I mean that could be seen by the market as slightly underwhelming when you consider where consensus expectations are for '19 at one of your competitors now. And just considering the market has concerns around your PRRP outlook I was just wondering do you think that number is somewhat conservative for 2023? Thank you.

Nicandro Durante, Chief Executive
If you put the numbers together since we did 900 million in 2018, and by the way we did 900 million reducing significantly the stock level that we had at the trade at the end of '18, just to highlight this point, because we have a huge pipeline of innovations coming in 2019, we saw the slowdown of the category in Japan, so we reduced the stock level at the end of '18. If we had kept the stock level that we had planned initially our numbers would be much higher than 900, but just to highlight this point because there was a question that came in today about that.

Having said that if you put the 900 and you look at 2023, 2024 you are talking about a growth of around 30% to 50% every year on average. And we still think that it’s feasible. We will have in two weeks' time as I said, if you keep your question, we have all the plans detailed in terms of how we are going to achieve this 5 billion, why we are confident about that, the rate of growth that you have by category, modern Oral, vaping and THP, and we try to explain in much more detail what we expect.

I’m not going to give you a target for '19 but I think that average, 30% to 50% growth every single year, is a number that we believe that’s achievable. I think that some years are going to be better than that, and some years it depends on the growth of the category in a specific country like Japan. 70% of the category in Japan, you saw the slowdown last year, of course there is an impact in terms of growth. But in two weeks' time you’ll have much more detail in these new categories, one by one, what we expect for growth in the next five years and how we are going to achieve that powered by innovation and portfolio.

Fulvio Cazzol, Goldman Sachs
Just a couple from me. You normally give us a bit of a sense of how you see the pricing environment in Combustibles, for example how much of your planned price increases you have already taken by around this time.

And then my second question is on the modern Oral tobacco which you commented quite a lot about your developments in Europe. Can you maybe give a bit of a comment on the US, what your plans are there given that one of your competitors seems to be growing quite nicely in that market? Thank you.

Nicandro Durante, Chief Executive
I’ll take the first question and Jack will take the second one.

The first question is about pricing. Listen the pricing environment is very solid. Last year we had a price mix of 7%. 6% came from Combustibles. I remember we had that question last year that all the price was driven by new categories, that’s why we split the numbers because we think that’s very solid. I don’t see this changing for 2019. As you know the majority of the pricing usually happens in the first half of the year so it’s very solid.

In terms of the pricing that you have got so far, I think that is around the same one that we had last year around this time, around 60%. So very solid, we have good expectations, the pricing environment is very solid but this is an aggregation of a lot of different markets, you know 200 markets. But talking about something that already happened because I cannot talk anything about what’s going to happen, but US for example came ahead of plan in terms of timing, came ahead of last year and a very solid price increase of $5.50 per thousand. But it’s a solid price environment that I see out there.
Jack Bowles, Chief Executive Designate
In terms of modern Oral, first on Oral, what is interesting is that the consumers are younger, the consumers are more educated and the consumers are with more income. So it’s an extremely interesting category.

And the second point related to the different first developments that we had in Scandinavia and in Switzerland, plus the test that we are doing in the UK at the moment, they are very encouraging in terms of the ritual and the understanding of the consumer.

In the US it’s a very interesting category because the mature category of traditional Oral is already there. There is a great opportunity for this category moving forward. Why? Because in a lot of places the occasions and the opportunities for the smokers to use the products are reduced. And in big cities there will be some possibilities to develop those kind of products. More and more people are trying these products and we’re putting a lot of effort into our US business to develop that category as fast as possible.

Ben Stevens, Finance Director
Might be worth just adding that we already have a modern Oral product with a PMTA approval for the US, so we are in a position to test market that pretty much immediately.

James Edwardes-Jones, RBC
Can I ask about your attitude towards your stake in ITC? Obviously your indebtedness is a concern amongst investors at the moment. Under what circumstance if any would you consider disposing of all or part of that ITC stake to allay those concerns?

Ben Stevens, Finance Director
I don’t think it’s something that we necessarily need to consider. First of all our stake in ITC is a strategic stake for us. There’ll be more Indians than Chinese out there in a few years' time. The segments in India are quite attractive. There’s a big Oral segment in India for example. And we thoroughly support the ITC strategy going forward and they’re doing a very, very good job.

And secondly we’re not particularly concerned about deleveraging. We generate more than £1.5bn of free cash flow every year. It’s enough to take 0.4, 0.5 off our net debt to EBITDA figure. So we’re very comfortable with that as well.

So I don’t think it’s two things that you should necessarily put together. Deleveraging will happen because of our strong cash generation, and we are fully supportive of ITC and our shareholder unit.

Question
Three questions if I can. First if all this is just for Jack. What are you going to do differently? Then I’ve got some other questions.

Jack Bowles, Chief Executive Designate
I can start with this one. Do differently, first of all is what I think is very important for the business. What is very important for the business is we have a strong strategy that we have to more and more execute to a level where we can harvest more of the results moving forward. We have been extremely good in the Combustible business, and the Combustible business is the most important category because it pays both for the development and it helps us to deleverage the company. So that’s a very important business. We have a certain market share and we are growing for eight years market share every year.
The second point is the new categories, as Nicandro referred to more and more people are speaking about the right approach of being multi category, and we are going to continue to push in those multi categories. We’ll continue to develop what we spoke about in terms of Oral, also in THP we’re focused in Japan and we put the right level of investment in order to make sure that we are successful in Japan which we are. We have started in Q4 to take some positions in Western Europe specifically and we’ll continue to do so.

In terms of e-cigarettes we have launches like Alto and others to come in the second half of the year. So we will stay true to the category. The strategy is right. We’re expanding our footprint and we are going to continue to push for the delivery of the results. But I think it will be much easier on the 14th to go more into detail in the plan and to explain what are the differences and the accelerations that we’re going to have.

Question
And I just want to make sure that I heard two things right. I think you said right at the beginning you expect to be market leaders both in heated tobacco and e-vapour over time.

And I also think I heard but I may have got this wrong, that the total sort of amount of investment in NGPs is going to be about flat year on year. So we’re not expecting another margin sort of reset, so you’re fundamentally thinking that both the investment is correct and it will lead to market leadership in the various categories. Have I got that right or am I mis-hearing?

Nicandro Durante, Chief Executive
I think that you have because I have been saying that for the last eight years. I’m just saying something now that I said every single year, because BAT doesn’t get into business like that, should be the number two or number three. We have shown in Combustibles our capabilities. We are the only company that has grown market share eight years in a row and consistently. And if you look at just our global dry brands as compared to the global dry brands of the competition, we have grown more than 500 basis points in eight years.

So I think that you can replicate this kind of performance in the other categories. Yes the objective is to be the leaders in each of the categories. In Vaping by the way we are global leaders already with a small market share. But if you look at the performance of the United States, the recent performance, this doesn’t happen because wake up in a single day and say now we need to do better in the US, we have been developing a portfolio to be able to have this kind of performance in the last six months.

If you look at the target segments that we are in the United States we have been leading there for some time. So I think that you can do the same in THP. I hope that in two weeks' time you guys will feel as confident as I am feeling that this is going to be achieved. In Oral we are global leaders as well if you consider the position that you have in the US.

So you heard quite well, I have been saying this for eight years, and I won’t be here next year but I’ll have high expectations as a watchful shareholder and a big shareholder of BAT that Jack will keep saying that. And I hope that you achieve this as soon as possible. That’s the first question.

Question
And did I understand Ben's point that margin isn't going to be reset again?

Ben Stevens, Finance Director
We invested quite a lot more in the next generation products category this year compared to last year. During 2019 it will be roughly a similar result from next generation products. There won’t be the drag on margin that there was last year as a result of increasing the investment in next generation products.

NGPs will then move to a position of being a net contributor to the Group and that’s why I’m confident, one of the reasons anyway I’m very confident we’ll continue to grow our operating margin 50 to 100 basis points a year.

Question
And that turnaround will be 2020 you hope?

Ben Stevens, Finance Director
Well we’ll start - it’s increased investment last year, flat this year and then it starts sort of turning up beyond that yeah. It does depend on the opportunities we see. Obviously if we see a bigger opportunity to go faster in modern Oral in a particular country then we will put investment behind it.

Question
And then the final question and I don’t know whether it’s easy to answer this. But you’ve obviously set out leverage targets. We’ve got an exciting announcement on tomorrow evening. And I’m just wondering whether that 0.4 to 0.5 reduction in multiple, how litigation plays into that? Could Engle disrupt that? How are you thinking about the ongoing payments you have to make or might have to make for the Engle progeny and potentially putting more money or losing money in Canada?

Ben Stevens, Finance Director
Okay well look we’ll have to wait until tomorrow to see what happens in Canada but pretty much whatever happens tomorrow won’t be the end of the story because it’s much more likely that those cases will be appealed either by us or by the other side to the Supreme Court. I think it’s unlikely that the Supreme Court wouldn’t take a case of such magnitude in Canada. So Canada has probably got many years still before it plays out.

Engle progeny cases are pretty much business as usual now because we have a certain number of cases a year, we lose a certain number, we win a certain number and that’s a cash drain, look I mean has been for a number of years. Whatever happens in Canada it’s sure that we will continue to consolidate the Canadian results. So Canada will gradually build up cash. It won’t be paying dividends to BAT but it lends out money to BAT and it will still be consolidated as part of our results. So I don’t see anything major changing from an accounting perspective after tomorrow, we’ll have to see what the actual outcome of the case is and what legal strategy we pursue beyond that.

Question - Gerry
I have to stand up for my question or maybe it should be an observation. I couldn’t let today pass without saying a few words Nicandro as you move onto your retirement. Ben your turn will come in six months, you’ll have to wait six months. I’ve known you a bit longer than Nicandro so all I can say is I would start worrying now if I was you.

Laughter

Ben Stevens, Finance Director
I've known you some time as well.

Question - Gerry
Yeah but my position is less grand than yours so I can take it.

When I was preparing my comments as to what I would say about Nicandro over the last few days a couple of things kept occurring to me that may preoccupy me. The first one is that when Jack accedes to the role he will be my fourth BAT CEO and I only just missed Patrick Sheehy. And there's a few people in this room who remembers those days, but not many on the investor and analyst side, and there may even be a few on the BAT side who were not around at that time but I was.

But it occurred to me that based on my wife's one woman mission to keep Amazon and the John Lewis partnership going, the recurring theme in my life that is school fees, and the stock price of my employer, that I may be here to see another four BAT CEOs, and that was one of life's more sobering thoughts.

Laughter

The other point that occurred to me was I was paranoid as to whether I would get Nicandro's citizenship correct, as to whether he was Brazilian-Italian or Italian-Brazilian. And I was paranoid about getting it wrong. And then it occurred to me that it didn't really matter. And the reason it didn't really matter was because both football teams are not very good.

Laughter

Now you may recall that Italy never even made the World Cup, and Brazil was beaten by a country with about a tenth of the population, if not less, than itself. Not that there's anything wrong with Belgium but that is nevertheless a fact. And the one thing I did promise myself was I would not mention the Italian rugby team, so I won’t.

Laughter

Moving onto slightly more serious matters I just think it's worth taking a step back and looking at some of the metrics at BAT that have changed under Nicandro's tenure as the CEO. Revenues have gone from £15bn to £24bn. The earnings have gone from 176p to as we've seen today 297 pence. The dividend has gone from 114 to as we've seen today 203. And the margins have grown by 1,000 basis points, from 33 to 43. And the EV of the business has grown from £60bn to £110bn.

If we then move on to consider some more strategic and operational matters a few things occurred to me over the time of Nicandro's tenure. Nicoventures was created and we've seen today that Oral, THP and Vaping have contributed £900m of revenue and more if they hadn’t decided to take some stock out ahead of the launches.

They've launched Glo and Vype. And as we’ve seen today this is the eighth year in a row where global share in Combustibles has grown. You created the JV with the CNTC. You bought in the Souza Cruz minority, a business I know you know very well. You part financed the Reynolds acquisition of Lorillard. And finally you acquired the Reynolds business itself.

So I think it's fair to say or fair to conclude that operationally, strategically and geographically Nicandro leaves the business today, as he said himself, in a very strong position and it’s something I personally concur with.

So with that I’d like to take the opportunity from the investment and analytical community to wish you all the very best in your retirement and very well done.

Applause
Nicandro Durante, Chief Executive
Thank you very much Gerry. You were doing well until raising the football thing. But that’s fine. Okay I really appreciate the words but thank you for listening.

I’d like to take this opportunity to thank our investors for being with us and supporting the business in the last years. And it has been an honour to serve BAT as a CEO. As I said I will remain as a watchful shareholder, so I will be calling Jack on a monthly basis. And I hope that over time I will call less and less and less. But I have a huge amount of shares in BAT and I will keep them. And the reason that I’m going to keep my shares in BAT is because I think that you have a fantastic strategy, you have a fantastic talent across the Group and I truly believe as a shareholder that this business is going to do extremely well going forward under the leadership of Jack.

Okay thank you very much and all the best and you are going to see each other in two weeks' time. I won’t be there but I will get some updates during the day I hope. But it will be a fantastic Capital Markets Day, we have been working for that for some time, and I hope that you guys will enjoy that. Thank you very much.

Applause

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