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Good morning, everyone. I am Nicandro Durante, Chief Executive of British American Tobacco. With me this morning is Finance Director Ben Stevens.

This morning we'll be talking -- we'll be taking you through the interim results. Like last year, following this presentation there will be the opportunity for you to ask questions.

And now, to the headlines. Once again, I am very pleased to say that British American Tobacco has performed strongly. Although currency translation has impacted our reported numbers, on a constant-currency basis this is a good set of numbers, with good growth in revenue; profit; operating margin; and earnings per share.

Our volume decline in the first half has moderated from the rates of decline we have seen over the last few years. Cigarette volume was down just 0.4%. This is against an industry we expect to be down 2% to 3% for the full year.

The GDBs have continued their good performance, with a strong growth in volume of 5.7%.

As we highlighted at the prelims, the timing of the price increases this year is more weighted towards the second half, when compared to last year. So far, we have achieved more than 75% of our planned pricing; and we remain on track to achieve our revenue growth targets for the full year.

Although industry pricing remains good, we are growing strongly in the developing world, leading to a lower price mix. As a result, revenue grew 3% on a constant basis.

We have continued to deliver good growth in the operating margin, which was up 30 basis points to 39.2%; and constant-currency operating profit grew 4%. This was achieved despite a significant transactional ForEx impact.

Adverse currency translation led to a 7% decline in reported EPS. However, I am very pleased that on constant basis we have again delivered on our commitment to high single-figure earnings' growth, with an 8% increase in EPS.

Although we continue to face significant ForEx headwinds, I am very happy with how the business performing. And, I am very confident we are on track for another year of good constant currency earnings growth.

I will now hand over to Ben, who will take you through the numbers in a little bit more detail.

Ben Stevens - British American Tobacco plc - Finance Director & Chief Information Officer

Thank you, Nicandro; and good morning, everyone.

Looking at the Group's performance by region, Group cigarette volume was down 0.4%. This was driven by good performances from AsPac and EEMEA, as well as a moderating volume decline in the Americas.

Western Europe volume continued to be impacted by industry declines. It was also affected by one-off trade inventory movements, which will unwind in the second half.

Three of our four regions contributed to the good increase in revenue and profit, which, at constant rates, was 3% and 4% respectively.

Western Europe revenue was 4% lower. This was largely driven by industry volume declines; inventory movements in Denmark; and ongoing VAT and partial excise absorption in Italy and France.

Adverse exchange rates affected all regions, resulting in reported revenue and profit down 10% and 9% respectively.

Before we look at the regions individually, I'd like to briefly cover the impact of foreign exchange on the results.

Currency headwinds have continued to increase since half 1 last year. This was driven by the weakness of most of our major operating currencies, including the Brazilian real; Australian dollar; South African rand; Canadian dollar; and Russian ruble; against sterling.

This masks an otherwise very good EPS performance, with the underlying business growing 8%.

Predicting foreign exchange rates is a risky business, but I normally give some guidance on the impact on the full-year results. If FX rates stayed exactly where they are today, the currency headwind on EPS would be around 12%.

Now turning to the regions.
Asia Pacific posted another good set of results. Revenue at constant rates was up 5%. Profit was up 6%. Due to adverse exchange rate movements, mainly in Australia, Japan and Malaysia, revenue and profit at current rates were both down 8%.

Volume in the region grew by 3.6%, largely driven by Pakistan, Bangladesh and Indonesia; partly offset by declines in Australia and Vietnam.

The GDBs continue to perform well, and were up 9.2%, driven by Dunhill and Pall Mall.

Australia saw strong profit growth at constant rates of exchange, as a result of higher prices and good cost savings. However, volume and share continued to decline, due to competitor activities at the lower end of the market, which intensified following the excise-driven price increase in December, 2013. We've taken steps to correct this with the launch of Rothmans.

We consolidated our leading positions in Bangladesh and Pakistan, growing strongly in both profit and share.

We continue to grow share in Vietnam. Profit was lower as a result of higher marketing investment and volume decline.

In Malaysia profit was up strongly at constant rates, despite lower volume driven by higher pricing.

Indonesia remains a key investment market. The continued strong performance of Dunhill Mild drove a 6% increase in volume, against some industry decline of 2%.

In Japan, we grew share, and our volume was stable. However, profit was impacted by adverse exchange rate movements.

In the Americas region, revenue and profit, at constant rates, grew by 5% and 4% respectively. Ongoing adverse FX, notably the Brazilian real, Canadian dollar, and Venezuelan bolivar, meant that we reported revenue and profit in the region were both down 14%.

In Venezuela, we’ve translated the half-year results using the new SICAD rate of VEF50 to the US dollar.

Volume in the region was 1% lower. This was largely due to market contractions in Brazil and Canada, following excise-driven price increases.

The GDBs delivered another outstanding performance, up nearly 14%; driven by Pall Mall in Chile and Mexico, and Dunhill in Brazil. In Brazil, share increased, with Dunhill continuing to perform strongly.

Volume declined due to contractions in the overall market. This, together with adverse exchange, impacted profits.

In Canada, Pall Mall continued to grow strongly. And although overall share was down, we are growing in key segments. Volume declined following excise increases at both the federal and provincial level, leading to lower profit.

Mexico delivered another great performance, with strong growth in volume, revenue, profit and share. Outstanding performances from both Pall Mall and Lucky Strike helped drive the strong increase in share.

In Western Europe, the macro environment remains difficult. However, employment in the region is starting to improve, albeit slowly, and the economies are showing early signs of recovery.

Revenue and profit at current rates both declined, due to lower volume; delayed pricing; and adverse FX. In constant terms, profit and revenue declined 2% and 4% respectively.

Market contractions in Denmark, Poland and Romania resulted in cigarette volume declining 8.1%; offsetting good performances in Italy and Spain. Volume was also impacted by trade inventory movements.

The global drive brands grew share. Good performances from all the drive brands, in particular Rothmans, Lucky Strike and Pall Mall, helped grow GDB share by 10 basis points across the region. GDB volume was down 3.5%.

Romania delivered another good profit performance, due to higher pricing. Dunhill and Pall Mall continued to gain share, with Pall Mall the fastest growing brand in the market.

Elsewhere, Germany, the Netherlands and Belgium delivered strong profit growth.

Share grew in Poland, Sweden, Belgium and the UK. However, regional share was marginally down, mainly due to declines in Denmark, Spain and Germany.

In the UK, we have strong share growth momentum, driven by a good performance from Rothmans.
Within the fine cut segment, our volume declined 1%, primarily due to market reductions in Spain, Italy, France and Poland; offsetting good performances in Germany, Hungary and Belgium.

EEMEA delivered another excellent financial performance. In constant terms, revenue grew 4% and profit increased 7%, despite significant transactional FX headwinds. At current rates, revenue and profit were down 11% and 9% respectively, largely due to adverse exchange rate movements in Russia and South Africa.

Volume in the region was up 0.4%, driven by growth in Ukraine, Turkey and the Middle East.

GDB volume in the region was up 6.8%, mainly due to the good performances of Rothmans in Russia and Ukraine; Lucky Strike in Russia; and Pall Mall in South Africa.

In Russia, BAT continued to grow share, driven by the excellent performance of Rothmans. Profit at constant rates was up, due to higher pricing. Volume was down significantly, as a result of industry contraction, following the large excise-driven price increase.

Profit in Ukraine was up strongly, due to volume growth and significant share growth, driven by Rothmans.

Good profit growth in the GCC was a result of higher pricing and cost savings. However, volume was slightly lower, and market share declined.

In South Africa, Peter Stuyvesant and Rothmans continued to grow share. At constant rates, profits and volume were stable.

In Turkey, volume and market share were up. Profits were lower, due to pricing activities at the bottom of the market.

Turning now to operating margin. We grew our operating margin by 30 basis points to 39.2% in the first half. This was achieved through ongoing reductions in our cost base; good pricing; and the rollout of our global operating model.

In the Asia Pacific and Americas regions, there was excellent progress in a number of markets. However, the regions were impacted by transactional effects, in particular, in Japan and Brazil.

Western Europe increased operating margin by 50 basis points, through strong cost management. The main drivers of strong 80 basis points margin growth in EEMEA were Russia, Ukraine and GCC.

As you know, we aim to grow operating margin by an average of 50 to 100 basis points per annum. I'm confident our full-year performance will be better than the first half.

Earnings per share were 7% lower, at 101.8p. Excluding the impact of exchange, EPS was 8% higher, at 117.8p; driven mainly by good profit growth; a strong result from our associate ITC; and the share buyback program.

The underlying tax rate was 30.7%, which is marginally above the same period last year, but in line with the full-year rate for 2013. I would anticipate a similar rate for the full year.

Now, on to cash flow. Overall free cash flow is GBP567 million, which is GBP245 million below the same period last year; driven by exchange rate movements.

Depreciation is the main component of non-cash items. Working capital outflows were lower than this time last year.

I would like to point out that the timing of working capital movements tends to absorb cash in the first half. This is largely driven by the timing of leaf purchases, although stock builds do also have an impact. As usual, I expect the increase to partially unwind by the yearend.

Net capital expenditure increased, mainly due to the accelerated rollout of the SAP program, and a low comparator. I continue to expect CapEx to be in the range of GBP750 million to GBP800 million over the next two to three years, as a result of the SAP deployment and ongoing investment in innovations and next-generation products.

Pension fund outflows related to shortfall funding for UK schemes, and are in line with last year.

Finance costs were slightly higher, due to higher net debt, and as a result of the share buyback program.

The reduction in tax outflows is primarily due to exchange rate movements in some key markets, as well as the timing of tax outflows in others.

Restructuring outflows has increased, as a result of the continued costs of rolling out the new operating model and SAP implementation.
Dividends from associates were lower. These include the proceeds from the Reynolds share buyback program, which closed at the end of May. This delivers free cash flow of GBP567 million.

Finally, I'd like to touch on shareholder returns and the recent acquisition announcement in the US. In line with our policy, our interim dividend will be one-third of the prior-year final dividend, which is an increase of 5.5%.

If we followed our current payout rate for the full year, based on prevailing exchange rates, this would lead to a decline in both the final dividend and the total dividends for the year.

However, we've always said that we see the 65% payout ratio as a floor not a ceiling and I reiterate our commitment to growing the dividend in 2014.

As you know, we intend to maintain our investment in the enlarged Reynolds American if their acquisition of Lorillard receives regulatory and shareholder approval.

For this reason and to maintain flexibility in the balance sheet, we've decided to suspend the buyback with effect from the end of July.

We've always said our first priority is to give our shareholders an increase in the dividend; then to strengthen the business by making financially and strategically-attractive acquisitions. To the extent that we have further balance sheet capacity after these, we will deploy this in the form of a buyback.

Thank you. That's all for now. And I'll hand you back to Nicandro.

Nicandro Durante - British American Tobacco plc – Chief Executive

Thank you, Ben. And having gone through the detail of the numbers, I would now like to take you through the few highlights for the year so far.

Firstly, volume. Our volume is improving as we grow share and the overall industry decline rates begin to moderate. We are continuing to outperform in AsPac, with a strong growth in Pakistan, Bangladesh and Indonesia.

In the Americas, the volume decline in Brazil is moderating as the large excise-driven price increases are now behind us and illicit trade begins to stabilize.

In EEMEA, we have grown volume driven by strong performance in Ukraine, the Middle East and a better share position in Turkey.

In Western Europe, we are starting to see early signs of an improvement in market volume, as the economies begin to recover. Although our volume in Western Europe was down 8% in the first half, excluding the inventory movements, mainly Denmark, underlying volume was down (technical difficulty), similar to the rate of the industry decline.

However, trading conditions remain challenging and we don't expect meaningful improvement in the region until probably the end of the second half.

Nevertheless, overall Group volume is on improving trend. At the same time, industry pricing remains good, with good price increases taken in Brazil, Russia and Australia, benefiting the first half.

Recently, there has been some low price activity in a few markets.

Turning to revenue, revenue in constant terms was 3% in the first half, with price mix of 3% as a result of good pricing, partly offset by negative geographic mix as we grew volume and share in the developing world.

At Q1, we said we expect the timing of price increases to be more second-half weighted compared to last year; and we have already announced price increases that will benefit the second half in a number of markets. We continue to expect price mix to build in the second half of the year.

I am very pleased that the strong share growth momentum we saw last year has continued. Share of premium grew 40 basis points, once again growing faster than our coverage share, which was up 20 basis points.

Innovations remained a driver of share growth, with innovations volume up 19%. We continue to lead in the capsules segment with a 44% share in our top 40 markets.

The rollout of tubes is generating encouraging initial results, with good share momentum in Turkey, Japan and the Ukraine.

We strengthen our leadership position in the additive-free segment in Western Europe, driving overall growth in the segment, which continued to grow despite the industry contractions.
Our recent additive-free launches in the Americas region are also showing excellent results. Our success in innovations is one of the key drivers of our premium share growth.

Overall, we saw continued share growth in our top 40 markets. In AsPac share was up in Pakistan, Bangladesh, Japan and Vietnam.

In EEMEA, overall share was up 50 basis points, driven mainly by Russia, where we grew share by 40 basis points; and Ukraine, which was particularly strong with share growth of 110 basis points.

Despite a small share loss in Western Europe, we are starting to see some improved momentum, with good share performances in places, such as the UK, Poland, Belgium and Sweden.

Elsewhere, in the Americas region, share in Brazil continued to grow, reaching a new record high of 78.1%. And the good story in Mexico continues with share growing 200 basis points to 37.7%.

A key driver of our strong corporate share performance has made a continued excellent performance of the GDBs. Once again, the brands performed strongly in the first half, with overall volume growth of 6%, an outstanding share growth of 60 basis points.

Dunhill, Pall Mall and Rothmans, all grew share and volume. Lucky Strike and Kent held share, but volume was down due to contraction in their key markets.

Now turning to each of the brands in a little bit more detail. Dunhill delivered another excellent performance, with volume up 5%, and share up 10 basis points.

Dunhill Mild Kretek continued its great performance in Indonesia, and has a 2.6% share of market, and a 3.9% share in Hungary.

In Brazil, Dunhill grew volume and market share rose to a record 11%, consolidating its leadership in the premium segment.

In Romania, Dunhill grew both volume and share and remains the leading brand in the premium segment.

Dunhill continued to be one of the key drivers of the Group's strong 40 basis points growth in the premium segment.

Kent share was stable in the top 40 markets. Although volume was down 3% due to industry volume declines in Russia, the brand saw a strong volume growth in Japan, the Middle East and Uzbekistan.

In Russia, Kent share was marginally down, but the brand maintains leadership of the premium segment, and early results from the rollout of Kent tubes are encouraging.

Kent posted another strong performance in Japan, growing volume and share strongly.

Innovations continued to grow strongly, with volume up over 8%, now accounting for 81% of Kent volume, driven by tubes, capsules and slims variant.

Lucky Strike share was flat, across the top 40. The brand's volume continued to be impacted by market contractions in Western Europe, although this was partially offset by strong performance in Mexico and in Spain.

The launch in Russia, in September 2013, is showing good results, with share already at 0.4%.

Innovations grew strongly, good performances in Germany, Mexico and Brazil, in the additive-free segment. Capsules also continued to perform well in Argentina, France, Spain and Italy.

Pall Mall posted another excellent result, with share and volume up strongly. Volume grew over 7%, driven by Pakistan, South Africa, and by good performance in a number of markets in the Americas.

Top 40 market share grew 20 basis points, with growth in three of our four regions. The brand had an outstanding performance in Pakistan, where volume was up strongly, and share reached 28% of the market.

Elsewhere, Pall Mall achieved good shares in Mexico, Canada and Argentina. Pall Mall Innovations volume including capsules, additive-free and slims also grew strongly, and was up nearly 40%.

In addition, Pall Mall continued to grow volume and share in the fine cut segment, consolidating its position as the number one fine cut brand in Western Europe.

Rothmans delivered and excellent performance with growing nearly 33%, and share growing 30 basis points. This was driven by strong performance in a number of markets, including Russia, Italy, Ukraine and the UK.
In Russia, the brand now has over 3% share of the market, driven by its slimmer variants.

Top international brands grew volume by 2.6%, together with the GDBs, account for over 58% of BAT volume.

Turning now to other highlights, I was very pleased to have recently announced our intended for GBP4.7 billion investment in our associated company, Reynolds American. This will maintain our 42% holding in this new-enlarged company, and helps fund the proposed acquisition of Lorillard.

We are fully supportive of the deal. The US remains an important market and it is the largest profit pool outside China. This deal makes Reynolds a clear number two in the market, with a stronger portfolio; better growth prospects; and significant cost savings opportunities.

Obviously, it is subject to shareholder's approval, for the other parties and regulatory approved in the US.

This is a good deal for Reynolds shareholders and for our shareholders. I am confident that this is a good use of cash and does not rule out other opportunities, should they become available.

I'm also very pleased to report that we are continuing to make good progress on our next-generation products development. Our e-cigarette Vype, has been on the market for nearly a year. As I have said before, the reason for launching Vype early was to learn more about the emerging consumer behaviors in the category.

Immediate market share growth was never our short-term objective, but I'm pleased with the brand's initial results. This is a fast-moving category and consumer behaviors are evolving rapidly. As the category evolves, so do our products.

For example, we have just announced to the trade a launch of Vype rechargeable packs, which should allow the consumer to have a fully-charged stick all day. Together, with a new flavor range, this will start to appear in stores from mid-August.

We also have a good pipeline of further product development for Vype.

And, let's not forget, we remain the only Company product seeking regulatory approval through the MHRA in the UK. We believe we are close to obtaining approval for one of our products.

In addition, we have an exciting pipeline of product development for tobacco heating device, which should be test marketed over the next one year to two years.

I'm also very pleased by our recent agreement to expand our existing cooperation, Reynolds, to cover future NGP research, product development and commercialization. As I have always said, we aim to lead the category by developing a range of NGPs offering consumers a choice of products to satisfy their needs across the risk continuum.

In summary, the business continued to perform well; volumes improving. We have strong share growth momentum, driven by good performance of the GDBs, as well as a good underlying constant currency and its growth, achieved despite the transaction of FX impact.

The rollout of SAP and our tight focus on costs is driving good margin expansion, and do remain confident of achieving our targeted 50 basis points to 100 basis points per annum.

Industry pricing remains good, despite some lower price activities in certain markets and price mix expect to improve in the second half.

Our continued growth in the developing world is leading to a lower price mix in the short-term and this puts the Group in an excellent position for profit growth in the long term.

Although currencies will remain at the future of our reported numbers, I'm confident of our ability to deliver high single-figure earnings growth on a constant currency basis, which we'll recognize with an increase in the dividend.

Thank you. And now, I open it up to questions. Who would like to start first?
Firstly, I was hoping you could expand your comments on the NGPs, and in particular two elements of that. One, a little bit more about the products that you have nearing hopefully MHRA approval, whether that's Nicodex or Oxette?

And then secondly, how you see the category evolving and I think you mentioned a heat not burn product. How -- what do you see as the drivers shifting the category around and where do you see consumer preferences developing? Thanks.

Well, let me start with your question on Vype, on MHRA. Yes, we have a product -- in reality we have two products that are undergoing evaluation by MHRA for approval. We think that the first one is going to be Oxette. We are -- we understand it that we are the only Company that is going through this process right now. It's a process; we are defining the protocols for approval, so it's a lengthy process. It's taking a little bit longer than everybody expect at the beginning.

We think that you are near the completion of the approval of one of the products and we think that we can launch it next year, at least pilot the beginning of next year. But of course it's subject to the approval by MHRA.

The second product is still under the process. We don't have a timeframe for approval.

Regarding Vype and regarding tobacco-heated devices, I think that these are two different categories. One is cigarettes, is a category that has been well-developed already; we have a lot of products in the market as you know.

We launched Vype, and we have learnt a lot through the launch of Vype, through extensive consumer research, in order to allow us to have the development of the products to enter the category.

As I said in the -- six months that go, this category is around 1% to 2% in Europe; in some of the markets goes up to 5%/6%, like in Poland. Some other markets are smaller than that, much small than that.

We see the rate of growth is slowing down. The reason for that is the one that I raised several times before, we don't believe that the products that are in the market delivering what the consumer -- delivering to the consumer expectation.

But I think that what we have learned so far through the launch of Vype, which gave us a lot of insights, not only from the supply side; the product design; how to retail; how to build our online capabilities.

I think that the products that we are going to launch in the next 12 months, we have several products in our pipeline, we think that we can grow the category and we can lead in these in the future.

Regarding tobacco-heating device, well, this is a new category; we haven't -- neither us or the competition has launched the product yet. We don't know if the products are going to meet consumers' expectations.

We have three platforms behind this category. We should be piloting some of these products in the next 12 to 18 months in some of the markets around the world. For competitive reasons, I'm not going to go explicit on the kind of the products, and the markets and the timing.

But it's a category that we have to wait and see if the products are going to deliver or not, because, at the end of the day, this is going to be the decisive factor if the category are going to fly or not.
Just a couple of things. First of all, on the pricing front, obviously, you had previously said that pricing will be second half-weighted. But given some of the down-trading in the market, such as Australia and Turkey, do you remain as confident as previously that pricing will significantly pick up in the second half?

And then secondly just on Australia, could you give us some idea of the difference in unit profitability between the Rothmans launched brand and the Winfield and, indeed, the Dunhill products within Australia, just how big a difference is that unit profitability within Australia now?

Nicandro Durante - British American Tobacco plc – Chief Executive

Well, let me start with the pricing question. Yes, we are confident that the price is going to be more skewed to the second half for a lot of reasons.

First of all, you look at how the prices have been implemented in 2014 against 2013. We have a lot of pricing going through the end of the second year/beginning of the third quarter.

So we have seen these in places like Russia, South Africa, Ukraine, GCC and Germany. We have seen this happening between May, June, July, so we know that the price is going to be more weighted towards the second half.

Regarding the price skirmishes that we have in several places in the world, like Turkey or like in Australia, well, we have seen this before; this is not new in our category.

In some of these price skirmishes we react, some of our other brand franchise is strong enough, we don't need to react.

But in the case of Australia, we have seen brands undercutting our portfolio for more than one year. We decided to react now with the launch of Rothmans which, by the way, is performing extremely well.

We don't think that this is relevant enough in terms of affecting our profitability in Australia or on a global basis. We still think that Australia's going to deliver a very solid and very strong profit growth in 2014.

Regarding your second question about the margins by brand, well, I don't have the information here, but we can talk about this outside this call.

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

Yes, we're not going to quote individual margins for individual brands in Australia. But I think you can be reassured that it's not going to impact our Australian results.

Jon Leinster - UBS - Analyst

But Rothmans, it would not be break-even, it would -- Rothmans would be a profitable brand?

Nicandro Durante - British American Tobacco Plc - Chief Executive

No. Rothmans is a very profitable brand in Australia. How much more profitable it is against the others, I cannot be precise. No, it's not a break-even brand, no.

Jon Leinster - UBS - Analyst

Okay. Thanks very much.

Operator

David Hayes, Nomura.

David Hayes - Nomura - Analyst
Just, firstly, on pricing in the EEMEA region, you reported I think about 2.9% in the first half. We saw one of your competitors today obviously with the Russian pricing coming in with about 20%. I know there's obviously other markets in that mix.

I just wondered whether you could be a bit more specific about why that pricing was perhaps a little bit lower than we were anticipating, where the dilution effectively is coming from.

The second question was on the US agreement with Reynolds. As we understand it from Reynolds’ discussions yesterday, you're still putting the fine detail together on agreement.

But can you give us some kind of idea, do you think, in terms of when the Vuse product may be available for sale in your markets.

And then again, similarly on the NGP product development, when you might be thinking that the US would be open for you to enter from that perspective? Thanks very much.

Nicandro Durante - British American Tobacco Plc - Chief Executive

Okay, David, I understand that your first question is about, because the line was not very clear on your call -- the first question is about Russia, pricing and mix dilution. I think that is your question.

If it is the question, we have a very strong price in Russian in 2014. Yes, we have some skirmishes at the bottom of the market. But the reality is, because of the way that the excise increases are restructured, we see the bottom of the category moving prices much faster, a much higher percentage than in the premium segment.

So what we see some upgrading from the low-price segment to the value for money. And you'll see some downgrading from the premium to aspirational premium. So more concentration on the value-for-money aspirational premium segment.

Despite all these movements, the business in Russia in our case is extremely solid. We are growing 40 basis points, very strong profit growth and our brands are performing quite well.

Rothmans is having a stellar performance. Kent is still the leader of the premium segment. And, Dunhill had a good start. So we are very happy with the Russian business.

The second question is about Reynolds if I understood well your question; as I said the line was a little bit cut. You're talking about the cooperation agreement.

Well, we are very happy to have agreed to expend our existing cooperation with Reynolds. That will cover future research, product development commercialization of each other's next-generation products in both e-cigarette and tobacco-heating device.

I think it's a very great -- a very good opportunity for both companies. I think that's the answer for your point.

David Hayes - Nomura - Analyst

Just in terms of the timing, I guess, it's early days. But can you be more specific about where those products may be swapped over between the two parties, in terms of, I'm guessing, Vuse from Reynold's perspective; and then, to your point, your product developments in the US?

And just following on from the US point actually, one of your competitors has said that they will seek modified risk status from the FDA before launching any heat not burn products, or next-generation products.

I wonder whether at this stage you can again talk about what regulatory approvals you would seek before going into the US market with new product development. Thank you.

Nicandro Durante - British American Tobacco Plc - Chief Executive

David, we are sitting now with Reynolds to discuss in detail how this cooperation is going to work. We have already a framework for technology share in Reynolds. We want to enhance this and use each other's capabilities for launching products in respective markets. 
But, more importantly, it's to leverage our capabilities in terms of research and development and technology sharing. I cannot be precise now in terms of timing for launch. But, as I said, we think that you hear a lot about that in the next 12 months. So you have already some good plans in place, but there is some way to go to finalize all these agreements.

**David Hayes - Nomura - Analyst**

Thank you very much. Thank you.

**Operator**

Adam Spielman, Citi.

**Adam Spielman - Citi - Analyst**

Can I follow up David's question with a specific question. You say you've got three platforms with heat not burn and one or more will be test marketed in the next 12 to 18 months.

I wonder if you could say whether that is basically Eclipse 2.0, i.e., a build from the Reynolds' product. So that's one specific question.

The other question really is for Ben. Can you say if the implementation of SAP in Asia, and in some other markets, has had any effect on these results, or -- and, if so, what it was? And if you could interpret these results to mean, I suppose, the whole of calendar 2014 that would be great? Thank you.

**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Okay, let me answer the first question about heat not burn.

As I said, we have a good pipeline in tobacco-heating device. We have, in reality, four products under development now. We are going to test probably two out of the four in the next 12 to 18 months.

But, as I said, for competitive reasons I don't want to be specific about the products and the markets. But you will see in the next 12 to 18 months the pilot of these products.

As soon as we launch them we will be releasing a statement explaining what they are about; how they are going to work. So I don't want to be precise right now.

**Ben Stevens - British American Tobacco Plc - Finance Director & CIO**

Just going on to the SAP rollout. The benefits of SAP have been realized through a number of years in BAT, as we put in common processes; as we put in shared service centers; as we put in centers of excellence, where we standardized the skills for, say, taxation or treasury in individual places.

We're already on a global treasury platform in SAP. And now, about 26% of our volume is actually already fully working in SAP. So there've been benefits coming through; benefits in Asia, but benefits in the rest of the world as well.

We expect to continue to see benefits, both in the rest of the world and more benefits to come through from Asia in terms of cost reductions from SAP.

**Adam Spielman - Citi - Analyst**

Are you able to quantify that in any way at all.

**Ben Stevens - British American Tobacco Plc - Finance Director & CIO**

No.
Adam Spielman - Citi - Analyst

Thank you-ish. Thank you.

Operator

Thank you. Our next question comes from the line of Celine Pannuti of JP Morgan. Please go ahead, your line is now open.

Celine Pannuti - JPMorgan - Analyst

Yes, good morning. In fact, it's a follow-up question on the cost savings. Whether you can comment on there will be other cost savings coming through in the second half of the year in order to back the margin expansion?

And as well I saw in your slide you commented on the level of marketing investment in the first half. Anything you can say as well on that for the second half of the year, please? Thank you.

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

Yes, Celine, what we said is we expect operating margin to be in the range that we're shooting for, for the full year. That means the profitability in the second half will be higher than profitability growth in the first half.

Part of that is because, as Nicandro said, price increase coming slightly more weighted to the second half of the year than the first half. But also, I think we put a little bit more marketing investment into the first half to drive some of the very impressive share growth that we've had.

So you can feel confident that that, plus the cost-savings program, will generate a good improvement in operating margin for the full year.

Celine Pannuti - JPMorgan - Analyst

Thank you.

Operator

Martin Deboo, Jefferies.

Martin Deboo - Jefferies & Co. - Analyst

I guess it's a question for Ben that sort of relates to Celine's question. It's on transactional FX. I can see what the overall FX impact on margin was in H1.

But, Ben, if you could give any color on how much transactional FX was in H1. And then how you'd expect transactional FX to play out in H2, both of those on margin.

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

We didn't have much transactional impact at all in the first half of last year; it was about zero. So if you want to get a rough feel for operating profit growth including transactional FX, add about 1.5% to the growth rate in operating profit for the first half.

Second half, we'll see more transactional FX come through. But because we had quite a chunk of transactional FX in the second half of last year, the increase in transactional FX hit, if you understand me, is a little bit less in the second half.

Martin Deboo - Jefferies & Co. - Analyst

Okay, yes thanks, Ben.
Operator

James Bushnell, Exane.

James Bushnell - Exane BNP Paribas - Analyst

I have two questions. The first is a bit of a follow-up on the transactional FX question, particularly around Brazil. You mentioned that it impacted Brazil.

I just wondered if you could clarify for us exactly how that dynamic works; and whether that's the main reason that margins in Brazil were a little bit lower in H1 than one might have thought from looking at the pricing going through?

And then secondly, if you could just update us on the situation with illicit trade in both Canada and South Africa, and in terms of how that's trending and any enforcement actions and what effect they're having?

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

Yes, I don't think illicit trade -- sorry, transactional FX affected Brazil any more than anywhere else in BAT. So I'm not really calling out Brazil as hit by transactional FX. So, obviously, the real has declined during the course of the year. So it has been a significant weakening of FX.

Of course, the impact flows through in terms of the significant leaf business we have in Brazil. But I wouldn't highlight any specific discontinuity in the results from Brazil in transactional FX.

James Bushnell - Exane BNP Paribas - Analyst

Okay. When I was asking about Brazil margins, I guess I'm obviously looking at the reporting of Souza Cruz. But the cigarette EBIT margin, so not including the leaf, seem to be down in H1. And I just wondered if you could give us any color as to what that might be; and whether it's something we could expect to continue?

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

No, I wouldn't expect that to continue. We had a few provisional leases in the first half of last year in Brazil, which affected the first-half comparator results. So I wouldn't want you to read too much into that half-year result from Souza Cruz.

James Bushnell - Exane BNP Paribas – Analyst

Okay.

Nicandro Durante - British American Tobacco Plc - Chief Executive

Okay, on the question on illicit trade. As I said several times, illicit trade is always -- there is two sides of the coin here. Because every year we have some markets in which illicit trade goes up and some markets that illicit trade goes down.

This is mainly due to the governments acting effectively against illicit trades, because the best tool against illicit trade is law enforcement. And that's something that the governments have to do, not the operating companies.

But talking about the two countries that you just mentioned, because of South Africa, we saw in the first half of the year, a significant decline in illicit trade.

Illicit trading, when I was talking to you guys six months ago, was around 27% in South Africa. Now we talk about 20.5%, so it's a significant decline of 6.5%; so good work from the government.

There is a long way to go. It's still 20% of the market, but a significant improvement. And this can be felt in terms of the volume that the volume in South Africa was almost stable, despite the price increases that went through.
In the case of Canada, we have some tax increases this year. The gap between illicit-trade products and duty-paid products increased. So the illicit trade in Canada was slightly up. I would say stable, slight flattish, was 0.5% up.

We estimate it now that it's around 21% to 22% and six months ago, you are talking about around 21%. So it's slightly up, almost stable.

James Bushnell - Exane BNP Paribas - Analyst

Great, thank you very much.

Operator

Rey Wium, Renaissance Capital.

Rey Wium - Renaissance Capital - Analyst

I just want to get a brief overview, just in terms of if we can talk about pricing. You indicated that with an acceleration to the second half now.

Now, I just want to know, previously you hinted price mix in the range of 5% to 8%. But I'm just curious if you would be able to achieve the lower end of that range. Or is there a faster growth in the developing markets actually going to have a negative mix impact on that?

And then just on the volume front, a very good performance obviously in the first half, down 0.4%. But I just want to know in terms of the second half, if there are any specific markets that may cause a bit of a deviation in this first-half trend. Thank you.

Nicandro Durante - British American Tobacco Plc - Chief Executive

Yes, let me start with the pricing question. We believe that we are going to reach the range that we have discussed previously. It's going to be in the low side of the range for the year. It's our estimation a lot of prices should come through, so we'll have to wait and see.

One of the main reasons is that price has been very solid. But if you look at the geographic mix of our performance so far, we have been growing very fast in markets in which we have lower margins.

So, that's why the mix impact in our numbers, just because of geography, has been hitting us a little bit stronger this year as compared to last year. So, pricing very strong; we should be reaching -- price mix should be hitting 5% to 8%, probably in the lower range of it.

Regarding the volume, well, in the case of volume, we think that the overall market -- overall industry decline for the full year is going to be down to 2% to 3%, as I have said before.

And there is no doubt for me, because of the strong growth that you are having this year on top of the strong growth that we had last year and the previous year, we are going to keep growing market share for this year. And by consequence, we will be declining less than the industry.

It's very difficult to be precise with you now what's going to be the size of the market decline or our decline in the year; our volume performance in the year. But we start with -- we have a very good start with 0.4% for six months.

I think the concerns that I have for the second half of the year is -- one of the concerns that I have is, for example, Russia. We have significant price-driven excise increase at the beginning of the year. The market is down around 9% to 10%.

We are going through a new price increase now in the mid of the year, so I'm a little bit concerned what's the size of market decline in Russia, despite the fact, as I've already said before, we are doing quite well.

And when I was talking about share, we are doing quite well, but we are doing quite well as well in the segments that we want to be. Our GDBs are growing 60 basis points and our premium share it is growing 40 basis points. So, we are growing where we want to grow.
So, all in all, this has been a very good six months for the year. However, I'd like to highlight that, despite the fact that industry's decline is strong in Russia, profit is growing extremely well, because we are moving on with pricing.

So, industry's decline 9% to 10%, but profitability of the Russian market is extremely solid.

Rey Wium - Renaissance Capital - Analyst

Thank you.

Operator

Michael Lavery, CLSA.

Michael Lavery - CLSA - Analyst

I was wondering if you could just clarify one remark that you made about the margins.

Obviously, the margin expansion in the first half was below the target. But you said it would accelerate in the second half. Does that mean it might not hit the target but accelerate? It, obviously, could pick up and still miss or do you think it actually still is on track for the full year to be in the 50 to 100 basis points range?

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

I think I said I was confident that we'll be in the range this year.

Michael Lavery - CLSA - Analyst

Okay, good, I just wanted to clarify. And then one other question just on the Reynolds deal. I realize you said it helps to fund the deal, but yet other shareholders weren't contributing to help make that happen, even though everyone benefits.

Can you just give some sense of your thinking on how you -- why you approached it that way and it's, obviously, at the cost of suspending the buybacks and taking on some debt.

So, what's the thinking there? Is it something you can elaborate on a little bit more, about why you'd be interested in that?

Ben Stevens - British American Tobacco Plc - Finance Director & CIO

I think the first question is probably better directed at Reynolds.

On the buyback question, you've got to understand, obviously, with the significant strength in sterling, and a lot of our debt is in euros, in dollars, in sterling. So FX is pushing up our net debt to EBITDA, and we like to keep that in the 1.5 to 2.5 times range.

We've also said that we will increase the dividend in sterling terms, probably by pushing the payout ratio up if FX continues to be such a headwind this year.

Reynolds will have cancelled their buyback. We want to maintain flexibility for other transactions that may or may not come along during the year. I'm not signaling other transactions are out there, but if they do, we'd want the ability to move quickly and decisively for those.

And, we've got to rustle up $4.7 billion to invest in Reynolds.

So, those are the reasons why the buyback was cancelled from the end of July.

Michael Lavery - CLSA - Analyst
That's very helpful. I guess what I meant, the first part of it too, was just obviously one option could have been to be -- to allow your stake to get diluted instead of contributing the additional $4.7 billion.

Did you consider that and how do you compare that versus the approach that you're proposing?

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**Ben Stevens - British American Tobacco Plc - Finance Director & CIO**

Well, look, we're very happy with our investment in Reynolds. We support the management; we support the strategy that they've got and we think that our shareholding should stay as it is. So, it was never really a debate for us.

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**Michael Lavery - CLSA - Analyst**

Okay, thank you very much.

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**Operator**

Thank you. I'll now return the call to Nicandro Durante for closing comments.

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**Nicandro Durante - British American Tobacco Plc - Chief Executive**

Okay, guys, thank you very much for joining this call. And we're more than happy to discuss outside this line; and Mike and our team here will be more than happy, as I said, to have -- for the discussions. Thank you very much for joining us.

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