2020 Half Year Pre-Close Trading Update

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Operator
Hello and welcome to the BAT 2020 First Half Pre-Close Trading Update conference call. Throughout the call all participants will be in a listen only mode and afterwards there will be a question and answer session.
Please note this call is being recorded.
I will now hand over to Mike Nightingale, Head of Investor Relations. Thank you.

Mike Nightingale, Head of Investor Relations
Thank you and good morning everyone. Welcome to our 2020 First Half Pre-Close conference call. With me this morning is Tadeu Marroco, our Finance Director.

I hope you're all well and I would like to take this opportunity to thank you for joining us this morning.

Before we begin I need to draw your attention to the cautionary statement regarding forward looking statements contained in the trading update. And as a quick reminder that in addition to this call, Jack Bowles our Chief Executive and Tadeu will host a fireside chat at the Deutsche Bank Conference at midday today UK time, which will be available on BAT.com as a webcast.

There are no presentation materials for either event.

I will now hand over to Tadeu, who will say a few short words on current trading, before opening it up to questions. Unless otherwise stated our comments will focus on constant currency adjusted measures and volume and share data to April 2020. Thank you.

Tadeu Marroco, Finance Director
Thank you, Mike. Good morning everyone and welcome. I hope you are all keeping safe and well.

COVID-19 is having an unprecedented human and economic impact. It is thanks to the hard work and dedication of our teams around the world that, to date, BAT has been able to navigate these difficult and volatile times and continues to be a highly resilient business.

Our focus throughout this period has been on four key priorities. First, our priority has been to safeguard the safety and security of our people, by implementing safe working practices and acting quickly and responsibly whenever employees have become ill.

Second, we have focused on maintaining supply chain continuity, by building excess stocks at all points in the chain, leveraging our networked manufacturing footprint and implementing well prepared business continuity plans. As a result, we have faced no significant factory shutdowns, aside from where they have been mandated by governments. We are also leveraging our distribution and manufacturing capabilities to support the wider community at this difficult time.

Third, we have continued to invest behind our brands while remaining on top of changing consumer behaviours during the lockdowns, adapting our marketing activities accordingly.

And finally, we have treated our people fairly. We have made no redundancies, nor furloughed any employees as a result of the crisis and we have continued to pay all our employees in full, despite the challenges to the business.

As you can see from today's announcement, this approach is being rewarded by a resilient business performance. While the trading environment is extremely volatile and unpredictable, the business continues to perform well, building on a very strong performance in 2019.

This is demonstrated by the fact that we are growing share in combustibles together with the New Categories across all four regions.

In addition, price mix continues to be strong, elasticities remain unchanged and we see little evidence of accelerated down-trading.

In the context of the continuing challenges of COVID-19, we are on track for a good performance in the context of very challenging circumstances.

We also remain focused on our three strategic priorities; driving value growth from combustibles, investing to deliver a step-change in New Categories, and transforming the business to create a stronger, simpler, more agile BAT.

The progress we have made against these priorities has positioned us well for continued delivery in the current environment.

Around 75% of our revenue comes from developed markets, where results have been strong. Our research has shown that consumption in these markets is trending in-line with, or slightly ahead of last year and pricing has remained strong.

Emerging markets have seen a more pronounced impact from COVID, including in Bangladesh, Vietnam and Malaysia.

In addition, factory closures and other lockdown measures have persisted for longer than anticipated, particularly in South Africa, Mexico and Argentina. In South Africa there is no sign of the tobacco sales ban being lifted despite our ongoing lobbying efforts.

With these uncertainties likely to continue into the second half, we now expect global industry volume to be down around 7% this year.

This, together with the previously announced impact on international travel retail sales, means we now anticipate a total headwind of around 3% from COVID-19 on full year 2020 constant currency adjusted revenue, offsetting the otherwise resilient performance of the business.

As a result, we expect full year constant currency adjusted revenue growth of 1 to 3%, and mid-single digit adjusted earnings per share growth.

The good performance of our business is borne out in our share growth, with corporate volume share up 50 basis points year to date, the strongest performance in recent years, and value share up 20 basis points.

Our global strategic brands continue to support that growth with both volume up 30 basis points and value share up 40 basis points.

Demand in the US remains resilient, fewer consumers are switching from combustibles into vapour and gas prices are lower, with sales to retail volumes down around 2% year to date May.

We now expect US cigarette industry volume to be down around, 4%, compared to our previous guidance of around 5%, and have not seen evidence of an acceleration in down-trading or in the growth of the deep discount segment.

Against this positive market backdrop, our business is performing strongly, and we expect strong constant currency revenue growth in the US in 2020.

Volume and value shares are up 10 basis points and 30 basis points respectively, and US corporate share reached a record 35%, the highest since the Reynolds acquisition.

Our premium brands Natural American Spirit and Newport continue to drive this growth, with value shares up 10 basis points and 30 basis points respectively.

Moving on to New Categories, we continue to invest in New Categories and expect to make further progress towards our £5bn revenue ambition during 2020, but growth this year will be slower as a result of COVID-19.

COVID-19 has disrupted consumer activation plans in New Categories, reducing overall industry growth rates. It has also led to the scaling back or postponement of some launches, as well as some supply disruption and out of stocks earlier in the year.

While the Vapour category continues to recover following the global slowdown in the second half last year, the US market remains below historical levels.

However, traffic to our New Category websites is up significantly and internet sales have more than doubled. As a result, we now anticipate reaching the £5bn New Category revenue target in 2025.

Nevertheless, I am pleased to say that we continue - are committed to see the benefits of our multi-category approach and sustained investment in the business, with share growth in all three categories.

Not least in Vapour, with Vuse growing value share in all key markets, expanding on our leadership position in France and Germany.

In the US, total Vuse brand share has grown to 26.2%, with Alto share up 570 basis points, to stand at 21.1% share.

Meanwhile, in the UK Vype continued to gain share, and in France and Germany it expanded its leadership position. Vype also remains the fastest growing brand in Canada.

We are also growing volume share in THP. We recorded a strong performance in Japan, with glo total nicotine volume share up 30 basis points to 5.4%.

glo Pro has been an important source of THP growth, and the recent digital launch of glo Hyper has also been encouraging, with it already reaching 40 basis points of volume share after less than a month.

glo Hyper has also been soft launched in Italy, Romania, Russia and Spain, with good early results, and it will be fully activated in Japan in Q3.

Lastly in Modern Oral, we have continued to strengthen our global position, with further volume share growth in Sweden and Norway.

In the US, Velo is holding share in the sub-6 milligram segment at 29% with total volume share at 9.5%. Our activation plans for Velo in the western states have been disrupted by COVID-19.

Turning now to the balance sheet, we remain firmly committed to reducing leverage. We continue to expect strong operating cash flow conversion in excess of 90% for 2020 and to make progress over the year to reduce leverage.

With the impact of COVID-19 lowering EBITDA growth in 2020, we now anticipate net debt to EBITDA to reduce to around 3 times by end 2021.

To summarise, the business continues to perform well, given the extremely volatile and unpredictable trading environment. Despite the unprecedented challenges we all face, we expect to deliver mid-single figure adjusted diluted EPS growth on a constant currency basis.

If FX rates were to remain as at June 5th, full year adjusted diluted EPS growth would face a currency translation headwind of around 1% at the half year and around 2% for the full year.

We are delivering on our priorities. We are driving value growth in combustibles, we are continuing to invest behind this growth and in the New Categories, and we are transforming the business.

In the context of a very challenging year, we are on track for a good performance and remain committed to our 65% dividend payout policy.

Thank you and I will now open the call to questions.

Operator
If you would like to ask a question please press *1 on your telephone keypads and please ensure your line remains unmuted.

The first question in the queue comes from the line of Adam Spielman from Citi. You are now unmuted. Please go ahead.

Adam Spielman, Analyst, Citi
Hello thank you and good morning. First of all thank you for a very clear press release.

I suppose I have two sets of questions. One of the questions is really around this question about the lockdown impact versus the recession impact. In particular you called out slower growth in emerging markets, and I'm talking about not due to the lockdown in South Africa, when you were talking about Malaysia, Vietnam and Bangladesh. You say that you're not seeing accelerated down-trading, but can you explain exactly what's happening there, because it would - I would guess at least that with higher unemployment, lower wages, particularly for casual workers you would see basically reduced demand. And so a little bit of colour on that would be very helpful.

Then I have got a separate question on glo, but we can come to that.

Tadeu Marroco, Finance Director
Okay, Adam what we are seeing in those particular markets is pretty much the disruption caused by very stringent lockdown measures. You have to remember a number of those markets are stick sales markets. And then when we have stringent measures like curfews, that we saw in a number of markets, it just promotes market disruption of the distribution and sales of these products in the market.

Another factor is that a lot of the consumption in these markets is social consumption. So you to go Vietnam for example, one of the markets that you are referring to, and a number of the consumption happens in HoReCa, pubs, restaurants where people get together and smoke and they were all completely shut down. So that is the - and some of those measures took longer than we were expecting.

So it's in that context that we highlight some of these particular challenges that we face and we are still facing in some markets.

Adam Spielman, Analyst, Citi
I suppose the follow up question to that is to what extent are you concerned that with lower income, particularly for informal workers, particularly in emerging markets, we'll start to see an impact on demand in the second half?

Tadeu Marroco, Finance Director
We are - I think that the best way to approach that is to reflect on our portfolio. We have - this is not the first recession that we have been through, we had something similar - or the same dynamics - let's put it that way, ten years ago. And from that to today I would guess that we are much better prepared today. Because in the end we have a much more balanced portfolio than at that time. Our global drive brands now represent something like 68% of our total portfolio. We have very strong brands in each of the different price points, so we have very good brands in low and value for money. So we are well prepared in that aspect.

The other point that we'll be making use of more and more is the capability that we have created over the last few years in terms of revenue growth management and having databases of consumers' information with price elasticity that we can price differentiate by different geographies in a particular country.

We have been doing that very extensively in developed markets like Australia and the US. We can even price differentiate by postcode for example in some of the cases in those markets. And we are rolling out this capability now for emerging markets as well.

And on top of that - you have to consider that a lot of support has been given, fiscal stimulus by governments and we have in some of those markets a big problem related to illicit trade.

So in those markets - some of those markets actually we are seeing a benefit of some of those lockdown. If you go to Brazil for example where you know that illicit is a persistent problem for many years now, most of these products come from Paraguay and with the border closed and the lockdown in place we are seeing actually an increase in volumes in the Brazil markets as a consequence of that.

So there is a lot of dynamics, different dynamics in place.

Adam Spielman, Analyst, Citi
Okay thank you very much for that.

And then separately can I turn to glo Hyper? Is there any colour you can give on it, and specifically it has always seemed to me an incredibly important launch for you, you know, is it living up to expectations? Is it exceeding them? Any colour on glo Hyper would be very appreciated. Thank you.

Tadeu Marroco, Finance Director
Yes the answer is yes we are very excited with this launch. We just achieved - I mentioned 0.4, up to reading that we had at the end of May, the latest reading actually is 50 basis points growth in something like six weeks and just on a digital activation, because we were most of the time in the emerging plan in Japan, so we couldn't really activate properly the brand.

All the insights that we have been receiving from consumers in terms of conversion, in terms of satisfaction, they are much ahead of the current products that we have in the market, even glo Pro which was a rather bigger exercise compared with the previous version of glo.

So we are excited about this launch, we are rolling out now in places like I mentioned before, in Europe, in Russia. And yeah the only problem that we are facing, as I mentioned, is the disruption in terms of activation. So from one side this helps us to be even better in terms of our digital activation, and on the other side it's difficult sometimes to convert consumers when you don't have the pop up stores up, or your stores open and it's very difficult to contact consumers more directly. But in terms of the product we believe that it's really a step change from what we had so far.

Adam Spielman, Analyst, Citi
Okay thank you very much, that's all from me for now.

Tadeu Marroco, Finance Director
Thanks Adam.

Operator
Thank you, the next question comes from the line of Gaurav Jain, from Barclays. You are unmuted. Please go ahead.

Gaurav Jain, Analyst, Barclays
Good morning.

Tadeu Marroco, Finance Director
Good morning.

Gaurav Jain, Analyst, Barclays
I have three questions. My first question is on South Africa. Can you please dimensionalise the impact of that? And also for how long are you factoring in the ban on your guidance on volumes, on revenue and on EPS?

Tadeu Marroco, Finance Director

Gaurav, South Africa is - by the time we released the RNS in April we were expecting the ban in cigarettes and tobacco in general to be lifted by the 1st of May, because this had been announced previously by the president of the country. So a few days later and we saw that by the time we were reaching that 1st of May deadline, they decided to extend the ban and there is no sign, as you know, to be lifted.

We are now in level 3, we were expecting them to be released in level 3 from the 1st of June and this didn't happen. And are now the only product actually that is being banned in South Africa. So as you can imagine the illicit trade has taken over the country, because they had already a previous problem with illicit trade.

We don't mention financials on individual markets, but just to give you an idea and you can work backwards from there, the government is losing, in terms of tax collection, approximately 1.5bn rand on a monthly basis from the industry. So this is, you know, at current exchange rates, approximately £75m, in a very needed period of time.

So we, in our projections, we are giving a range, exactly to cope with this type of volatility. It's difficult really to predict at this point in time precisely to have a specific date where we're going to resume to sell the product. And so that is the reason we provide a range from now on.

Gaurav Jain, Analyst, Barclays
Sure that's very helpful.

My second question is on the US market. So you have upgraded the volume guidance to minus 4% and you are highlighting that the May volumes are minus 2%, so that will imply that 2H volumes are down minus 6%, when comps are very easy. So why wouldn't the volumes be even better than minus 4%, what are the factors that we should keep in mind?

Tadeu Marroco, Finance Director
Well look the US market is - the consumer - you note the first half it was impacted by consumer pantry loads in Q1. We saw some of this behaviour carry on just - even before - even after March because of the uncertainties in terms of lockdowns in a number of states. Now the whole situation is easing, but we don't know exactly how the consumer mind pattern will be moving forward when we have the lockdown eased.

The other point that you have to bear in mind is that we had an additional trade day in the first half of the year, which is - you know will not repeat in the second half.

And then we note that there is a lot of unemployment in the US, but at the same time there is a lot of fiscal stimulus and there is a lot of reduction in terms of discretionary consumption from consumers, because when they were in lockdown they actually didn't have the chance to go out and go to the cinemas and restaurants and so on.

So it's difficult to predict exactly what will happen in the second half, but if you go back to normality then we would expect some of this fiscal stimulus will not persist longer. And then again the consumers will have other competitive expenses to make it and a bigger noise around the price increase that we might see in the second half as well.

So there are a number of factors now and given the circumstances that we are living in around COVID that makes it very difficult to predict.

But you are right; we will be finishing the first half in a better position then the full year guidance. In the second half it's basically to be prudent to deal with the unknowns of all those factors that I just referred to.

Gaurav Jain, Analyst, Barclays
That's very, very helpful.

And my last question is on the EU menthol ban, which came on the 28th of May, have you seen any major impact on markets like Poland and the UK; any major shifts because of availability of heat not burn products and menthol variants, anything that you can shed light on?

Tadeu Marroco, Finance Director
It's very early days as you mentioned, this just came through now and we haven't seen any major change. We are selling a lot in terms of vaping; I was referring to the vaping industry not coming back to the previous levels that we saw in summer '19 in the US. But that is not the case in the case of UK and France for example the industry has already grown beyond what we saw in 2019.

Internet sales in Vapour also have more than doubled in this period of time and we are very pleased with that. This could well have been boosted by the menthol ban and people searching for different alternatives, consumers searching for different alternatives. But it's difficult at this point in time to know exactly what in a short period of time.

One market that I would like to point out that has introduced a menthol ban since the beginning of the year is Turkey, as you probably know. And our brand is doing extremely well and that's another reference point that we have.

We also quoted Canada before, we said that the level of retention was very high from consumers because they first are smokers and then they smoke menthol. And the level of retention in Canada was more than 90%. The same happened in Turkey. And our share actually is growing strongly in Turkey on the back of Kent. So we are very pleased with the performance in that particular market, we are now number two in the market.

Gaurav Jain, Analyst, Barclays
Thanks a lot.

Operator
Thank you, the next question comes from the line of Owen Bennett, from Jefferies. You are unmuted. Please go ahead.

Owen Bennett, Analyst, Jefferies
Morning guys.

Tadeu Marroco, Finance Director
Morning Owen.

Owen Bennett, Analyst, Jefferies
Just the one question from me. I was just hoping to get some more specifics on the slower New Category sales development to the £5bn getting pushed out. It does appear you're blaming the US category development and I was just wondering is that the case and is it solely Vapour in the US and are you making any changes to your assumptions around market share development in Vapour in that market as well?

Tadeu Marroco, Finance Director
Yeah there are a number of factors playing in that space Owen. We said at the year end results that being a new category and an unregulated category there was a lot that we were learning from that category. So we were seeing disruption from regulatory front and we highlighted that at the year end result.

One that comes to mind is Modern Oral in Russia, that was growing nicely and in August we had a local competitor introducing a product which was a good few times more strength in terms of nicotine than ours, in a completely irresponsible base, and the government decides to ban completely the category. And now we are re-engaging to regulate the product. But this takes time.

The same happened with vaping in Mexico at the back of the Varley crisis in the US. So the regulatory volatility we have pointed out at the year end results.

The second one we were already facing in February the disruption in terms of supply chain coming from China. Today it has completely come back to normality. But at that time we had been disrupted. And then we faced some out of stocks in some geographies that have now completely been recovered.

And then on top of that we were seeing all these activations issues that we are having and the launch plans that we have, mainly on the THP side.

The vaping markets that you are referring to, in the US it's right, it hasn't come back. Really just to give you some numbers today we still are trading on average on a monthly basis something close to 15 to 20% lower than the peak that we saw in 2019. We expect the industry to recovery. We are - in our projection we're going to finish the Q4 40%

higher than we started the Q1 of 2020. But overall this year means that we probably expect an industry down around 9% in 2020.

We are not seeing the same outside the US, in Canada actually - it's another market, I just quoted the UK and France, but Canada is another market that we are seeing higher industry volumes compared with the previous year. But the US is a big market as you know.

So when you pull all this together we think there will be a slower growth this year and the consequence is basically one year that you are losing. And the adjustment that we made just reflects that.

The more important thing is the underlying performance that we are having. We are growing in every single category, in every single market year to date where we are present, with no exception.

So we are extremely pleased with the performance of Vapour. We have more than doubled our share in the US, which is the biggest market and we are very confident that we will continue growing throughout the year in the US.

We are also doing extremely well in Canada, we are just increasing the leadership in France and we are doing well as well in Germany, we are the leaders in closed systems and in the UK we are solid in our performance. So Vapour for us is doing extremely well.

Modern Oral continues to grow, in the Nordics you saw our performance it is already 14% share in Norway and a 4% share in Sweden, very strong strongholds of traditional oral. And we are doing pilots in the emerging markets going for sachets for example where you can sell less quantity, instead of a box of 20 nicotine pods you can sell two or three and make it much more affordable for markets where stick sales of cigarettes is more dominant.

And in THP we have already reached more than 2%, 2.4% in Moscow and around 2% in places like Kiev and we're doing extremely well in Kazakhstan, with more than 30% of the segment share in Kazakhstan. And we had glo Hyper, like I mentioned before to Adam that is very encouraging with the first signals that this relates to.

So on one point I'd like to make that our view is that it would be easy for us to actually hold on to the high single digit figures that we were talking about before. But I don't think that this would be the right thing to do for the business. We have a growth momentum, we want to continue growing and we want to continue investing in the New Categories.

So the reason why we are making all these adjustments is basically to get out stronger than we were getting into this crisis. And I think that is what will be recognised once we go through this.

Owen Bennett, Analyst, Jefferies
Perfect, very helpful, thanks very much.

Tadeu Marroco, Finance Director
Okay.

Operator
Thank you, the next question comes from the line of Jonathan Leinster, from Societe Generale. You are unmuted. Please go ahead.

Jonathan Leinster, Analyst, Societe Generale
Thank you very much, good morning gentlemen. Just a couple of questions. One, you've obviously mentioned that currency translation is a 2% headwind. But is there any significant problems in terms of currency transaction, or is that something that is likely to come through next year?

And secondly, on the cash flow you've mentioned this sort of 90% cash conversion ratio this year would be pretty much unchanged, are the components of that also pretty much unchanged, is there any variations, or would you expect perhaps working capital to be slightly more negative - but reductions in capex, or is that frankly just completely unchanged on prior expectations? Thank you.

Tadeu Marroco, Finance Director
Okay, regarding your currency transaction - we will have a higher currency transaction hit this year; there is no doubt about that. Last year we had £130m, we expect at least to double to this year. And we are - saying that we have much less exposure to currency transaction than we did three years ago because the footprint of BAT is now more exposed to developed markets and less to emerging markets. Remember that emerging markets is more or less 25% of our earnings. So the level of exposure that we have today is much less. Some of those markets we hedge and rightly so, we'll be feeling this impact more towards the next 18 months, or 12 months. And we'll be recovering through price like we always did.

All our numbers I would like to highlight, we don't eliminate transaction FX, all the numbers that we quote includes the transaction FX because we believe that is the right way of doing that.

But the message here clearly is that it's less exposure than before and we'll be managing through hedging, some of those markets are very difficult to hedge and this will be managed through pricing over time.

In terms of the conversation we worked on capex and I mentioned that last year, we were bringing capex to the level of depreciation so there would be no leakage there, this clearly helps.

We will have some pressure in terms of working capital, mainly for the half year, although the half year numbers I wouldn't expect the conversation to be much - dissimilar to the previous year, because we managed to offset that higher supply inventory, basically it's an investment that we are making in working capital to cope with all the uncertainties coming from COVID. We managed to offset that by other measures in the working capital. So conversion for the half year would be pretty much similar to one year ago.

And then for the year we will be managing through capex, that would be another lever and we are always reviewing and putting a lot of effort, as you can imagine, because our focus has been pretty much on the cash generation to reduce the debt and be able to de-leverage the company as fast as we can. So we always try to find ways to offset any type of pressures, so we're not very different this time.

Jonathan Leinster, Analyst, Societe Generale
Okay, thank you very much.

Operator
Thank you. The next question comes from the line of Alan Erskine, from Credit Suisse. You are unmuted. Please go ahead.

Alan Erskine, Analyst, Credit Suisse
Good morning everyone. Two questions from me. The first one is a picture, I mean clearly COVID-19 has a lot of uncertainties attached to it, a number of consumer companies chose as a consequence to withdraw guidance, you didn't, and yet six weeks later from the AGM statement you've had to revise guidance.

I guess my question is can we feel comfortable that in this new guidance that you've built in some, should we call it, wiggle room, for unexpected events. I think Adam mentioned earlier, maybe down-trading getting worse. And so we can feel comfortable in September or whenever you're not coming back with another revision to guidance? So that's my big picture question.

And then just my second question is, when I look at the impact on volume, I mean as you highlight it's largely related to emerging markets. And if anything you know your US business seems to have been a bit better than expected. So I'm just slightly puzzled why the volume impact is also dissimilar at the revenue impact. Are you not seeing a positive mix effect from the way that volumes have played out? Thank you.

Tadeu Marroco, Finance Director
Look Alan you are right, we decided to keep the guidance; we were one of the few to do that. We believed that this would be easier to be more transparent for our shareholders, investors to understand exactly how the impact of BAT was facing from COVID-19.

By the time we released the guidance in April, we had a limited picture mainly on the emerging markets. The situation deteriorated unfortunately over the last six weeks. We spoke about the markets in Asia, but the same happened in Latin America, in Argentina for example the lockdown in the factory took longer than seven weeks and Mexico is still closed. We have to activate a number of contingency plans in those markets. That cost more money in terms of supply chain costs and so on and so forth.

And as I said before we could stick to the guidance that we provided, but we don't think that this would be the right thing to do for the business. Because at the end we are very conscious about continuing investing to leverage that momentum we are facing in many of our New Categories and also in combustible and doing the right thing for the business in the medium term.

So the algorithm that we have hasn't changed at all, our growth algorithm it's the same, exactly the same, we have turned down a bit this year to cope with these unprecedented circumstances that we are facing. But all the focus that we have in terms of the leverage, in terms of dividends, in terms of being able to grow New Categories, to continue a very, very healthy business in combustibles, these are all there, this hasn't changed anything.

So in terms of your questions it would be much more comfortable to have taken it out because then you don't need to actually explain anything in terms of the guidance. But we believe that to provide this transparency is the right thing to do.

Did we create some legroom in terms of the range that we provide? Now for sure we are seeing and we are assessing a very different pattern between markets at this point in time. So developed markets, the likes of the US, Europe, Australia, Japan, Canada, very, very different in terms of the impact, in terms of the emerging markets. So the volumes are pretty much - in that emerging market space, if you see the volumes - if I breakdown these different patterns on volumes, markets you see that the developed markets, the reduction is pretty much in line with historical levels. And the big hit is coming from the emerging markets given everything that I have explained so far.

So I cannot assure you that that's the case because we are in a very unstable situation, we don't know if there will be another peak happening in terms of the virus in some of those markets and very draconian lockdowns again. But with that apart we believe that we create enough space in this range that we just update the market with.

And in terms of the volumes, yeah the price mix is strong, some of these volumes are very rich volumes, like for example GTR, they have a very, very big, heavy mix for us in terms of value and that hits us in the turnover as well. But the 3%, I think that the 3% impact that we are seeing, I think that we could easily distribute this in terms of one third related to the impact of the GTR that we had open before and another third in terms of these emerging markets that we saw the difficulties in terms of stringent lockdowns, in the stick markets in the social consumption that reduced in the likes of Asia that I referred to. And then another third in the likes of extended lockdowns or even distribution bans in South Africa and Mexico and Argentina.

So that is where we get to the 3% overall growth number. We are highlighting a lower number than that in our targets because are seeing some of that being offset by the performance in developed markets. So I think that's more or less the story that we came up with in terms of this revised guidance.

Alan Erskine, Analyst, Credit Suisse
Super, thank you.

Operator
Thank you the next question comes from the line of Alicia Forry, from Investec. You are unmuted. Please go ahead.

Alicia Forry, Analyst, Investec
Good morning Tadeu. I'm just wondering, I appreciate it's maybe difficult for you to quantify, but I'm just curious how much of your business globally you think might be exposed to social environments like the HoReCa channel, I'm just curious how that might impact your business during this time - how meaningful it is?

And then my second question is on the margin headwinds during this disruptive period. I understand that the headwinds that you expect are primarily due to your decision to continue investing in the New Categories business through the slowdown. But there has clearly been an increase in cost in tobacco side of the business as well, I was wondering if you could comment on those costs that you're seeing in the tobacco business associated with the lockdowns and how quickly might those fall away as lockdowns ease? Those are my questions. Thank you.

Tadeu Marroco, Finance Director
Okay look on the margin side, for us to be able to - from 1 to 3 NTO, deliver the mid EPS target we would need to get a good operating margin growth. And we are expecting a good operating margin growth, because we have been working in terms of making the company more agile, faster, empowered and this was all down on the back of Quantum that we started last year. And Quantum as I mentioned at the beginning of the year is bringing good savings this year, it's £300m.

We also have Quantum 2 for 2021/2022 and we are trying to bring forward some of those savings as well as much as we can. And this will help us to continue investing whilst being able to cope with some of those extra costs that I was referring to. And clearly the extra costs, not just in terms of working capital, but in terms of logistics costs, because when you have for example to activate a factory in Chile that's supposed to supply the Argentina markets, or in Mexico that we have our factory supplying Canada and you have to all of a sudden supply from our factories in Brazil and Chile, this brings costs, this brings extra costs.

And so we will be able to, with this exercise that we were very fortunate to start last year, to cope with that and still be in a position to continuing investing behind the New Categories and deliver this revised guidance and that are now making public in the market.

In terms of the HoReCa, the HoReCa all the emerging markets' consumption is a very social event. And I was quoting that. And these are the places where we suffered most. What we are seeing is that little by little these spaces are opening up. You saw for example in Europe, in France for example you saw already cafes in place and Italy is the same, it's happening now. So I think that is not a major concern at this point in time, if things move in that direction.

For sure nobody knows if there is another spike coming or not, but some of these emerging markets are very subject to the HoReCa channels. And in other markets, like the US for example, it's pretty much convenience stores where 7% of the cigarettes are sold. So it's less of a problem in that particular space.

And again that's why you see a lot of differentiation between the patterns we have been seeing so far in terms of volumes in developed, mature and emerging markets; this is part of the explanation.

Operator
Thank you, we'll move on to the next question from Nico von Stackelberg from Liberum. You are unmuted. Please go ahead.

Nico Von Stackelberg, Liberum
Hi, good morning, just a quick question on the guidance for the top line. So I remember the guidance was at the lower end of the 3 to 5% range, so let's call that 3.5 and then you say there's around a 3% headwind on the top line due to COVID. So that suggests you end up flat to maybe plus 1%, am I right in picking that, so why is the target 1 to 3?

Tadeu Marroco, Finance Director
Well Nico, the target is 1 to 3 basically for us to have space to face eventually some unknowns given the circumstances that we are living, I cannot be precise in terms of turnover at this point in time, because at the end there's still a lot of uncertainties out there in terms of the pace of recovery in some of those markets that were badly hit. And South Africa is a good example; I think the more extreme example where we are not being able to sell one stick of cigarettes since the beginning of April. But that's the only reason why we are saying that.

And the reason why we decided to revise it downwards - this guidance that we released at the end of April, it's pretty much because of the extension of some of those lockdowns. In South Africa I explained the situation there. But it also happened in places like Argentina and Mexico where we are still seeing the factories closed at this point in time. And some of the broader group covering emerging markets in terms of consumption patterns related to, again the disruption in lockdown.

That's the reason why because of global travel retail we already knew by April, we knew that some of the emerging markets were suffering disruptions that we had at that time revised the volume, guided to minus 5%. But the reality is that this impact in the emerging markets was even bigger than we first thought.

Nico Von Stackelberg, Analyst, Liberum
Okay. Can I ask two other questions? Could you - I know there is a lot of uncertainty in the US on pricing, can you give me any feelers for what you expect in the second half and what you're specifically looking out for and how you think it plays out?

And then secondly, can I ask about the £5bn target for NGP revenue, do you think that's really incentivising the right behaviour to be pushing for revenues? And I appreciate if you focus only on profits it's not going to give a chance for this category to mature and to blossom, but at the same time - well it would seem that putting a profitability target maybe five years out might help encourage investment in the categories that should reasonably deliver the returns on capital over time and not just pushing for sales at the end of the day. Do you have any view on that?

Tadeu Marroco, Finance Director
Look I think we cannot associate the £5bn push for one year with any financial decision. The reason why we are bringing down the target for mid is exactly to create the space for us to continue investment. So we are not compromising investment behind the New Categories.

But we had to realise that those categories are very new to the world, some of them completely unregulated. So what we saw in the US for example at the back of last year with this whole issue around the youth epidemic and all that is just a consequence of an unregulated product. And this has implications that are difficult to foresee.

There is the same happening in the modern oral when the local player goes then and commercialising in a very irresponsible way a product that should never have been in the market in the first place.

So they are unregulated categories and as a consequence volatile, difficult to predict. This has nothing to do with our decision to invest more or less, we are continuing investing, we are continuing working hard in our pipeline, the whole organisation is mobilised, to make a step up in New Categories, it's one of the priorities that Jack stepped up since the beginning. And as I said, our underlying performance is very strong.

Now we have previously move this to 2025 as a consequence that we actually are facing a very difficult year that's low in growth. But we will have - it's a mathematic thing, there's lower growth in one year, given the fact that it was very close already will have an implication. But it has nothing to do with the mobilisation of the Group and it has nothing to do with the decisions around investment. We continually have been doing all possible to first improve the quality of our pipeline and I think that we are demonstrating this by the performance in the market.

Second, we are working hard to get all the insights we need in terms of consumer to even promote a better efficiency in terms of market investment. And we are getting better and better on that. So where we allocate our investments behind New Categories we are making big inroads on that.

And third, we are doing all the support necessary to create the global brands. And you are seeing some migrations already happening in the Modern Oral space towards Velo and we are seeing some migration happening now in Canada we are just moving to Vuse. So things are happening as we said and we continue doing that. So I don't think we need to link the £5bn 2025 to any financial space or decision related to that. Be assured that the whole Group, the whole organisation is mobilised to make it happen as fast as we can.

On the pricing it's difficult for me to make an assumption on what's happened. Last year we had three price; it was a bit abnormal compared with the previous years, that was basically a two price pattern. And we really have to see what happens in the second half, we probably have another price happening there. But the fact is that the market is really strong as well. So we'll have to see how this pans out.

Nico Von Stackelberg, Analyst, Liberum
Okay, alright, thank you.

Operator
And now for our last question in the queue from the line of Patrick Folan, from Redburn. You are unmuted. Please go ahead.

Patrick Folan, Analyst, Redburn
Good morning guys, just two questions from me please. Looking at the overall full year cigarette volume, value share grew less than volume share, so is that down-trading, is it geo mix, or is it discounting?

And then secondly you talked about the impact in emerging markets and considering the situation in Brazil, are you seeing any change in Brazil, is there a more pronounced illicit impact? Just those two thanks.

Tadeu Marroco, Finance Director
Okay, let's start with Brazil, yes we are seeing year to date an increase in sales around 6% in the market, 6 or 7%. And as I said this has also to do with the fact that - in Brazil although the COVID situation is really, I would say, hitting the country badly, we haven't seen these levels of disruption since the lockdowns that we saw in many other markets that we spoke about.

And in Brazil we have this external supply of illicit coming mainly from Paraguay, when we had the border closure you just create a disruption in that flow. And this translates into more legal consumption in the market. So we are seeing an increase in volumes there.

But it would be also helpful for the government to reconfirm how important it is to take measures against illicit trade, because this is the immediate reaction that they face in terms of the tax collection increase, which is a very positive size.

And the volumes - and the price is just a consequence of the volumes being more focused on here. Yeah, we have seen more of the market share growth happening in emerging markets. One thing that is - we have seen every time there is a lockdown and the market comes back, we are able to gain a lot of traction, because we have been planning ahead of that. And in some of those markets we have direct distribution that's very helpful as well.

So we have a very strong plan to recover as much ground as possible, this is paying off and you see most of this market share growth coming from emerging markets. And that has nothing to do with down-trading it's just the way that it's happened.

Patrick Folan, Analyst, Redburn
Thanks.

Operator
Thank you. There are no further questions so I'll now hand the call back to Tadeu Marroco to close the call. Thank you.

Tadeu Marroco, Finance Director
Before I give my final remarks to you, the only comment I would like you to take with you. I think we are living in a kind of Darwin moment, where just the strongest will probably thrive in the future. And BAT will be adapting, so what we are trying to do now being adaptive to that and we will continue investing and we will continue growth in this new normal.

And for us the priority is to continue growing our business and keep investing and doing the right things for the business.

So I would like to thank you all for your time today. Just a few words for you in summary.

We are a strong business. The environment is very unpredictable, as you all know, but we are performing well against that backdrop.

We are building a Better Tomorrow. We continuing to invest in the business, in both combustibles and New Categories

We are delivering on our three key priorities. We are delivering value from combustibles, we are driving a step change in new categories, and we are transforming the business

Despite the challenges we all face with COVID-19, I am very excited by the future opportunities for BAT. Our confidence is reflected in our continued commitment to our 65% dividend pay-out policy

So I thank you again for joining us today, we look forward to speaking to you over the next couple of days and, of course, in July at our Interims. So stay well, stay safe and bye-bye.

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