



British American Tobacco p.l.c.
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PRESENTATION

Nicandro Durante - British American Tobacco plc – Chief Executive

Good morning everyone and welcome to British American Tobacco's 2016 full year results presentation. I'm Nicandro Durante, Chief Executive of British American Tobacco, and with me this morning is Ben Stevens, Finance Director. And, as always, a warm welcome to those of you who may be listening on the conference call or watching via our website, bat.com.

After taking you through the results presentation there will be an opportunity for those of you in the audience here and also this time for those of you dialled into the conference call to ask questions.

Before I start the presentation I will take it as read that you have all seen and read the disclaimer on slides three and four.

I am pleased to announce that the Group delivered exceptionally good results in 2016, with strong growth across all our key business metrics, despite the continuing difficult economic environment.

EPS for the full year was up nearly 19% at current rates and over 10% at constant rates, exceeding our high single figure earnings growth target. This is an excellent performance given the fact that we have absorbed a 6% transactional FX impact on operating profit. Excluding this, currency neutral EPS would have been up around 16%.

In addition, I am very pleased about the progress we continue to make from our significant investments in the NGP category. We are now present in the five largest vapour markets in Europe and we are already the leading international vapour business.

Our recent launch of our tobacco heating product, Glo, in Japan is going well and early results are very promising. I will provide more detail on this later.

I am also excited about our recent announcement regarding the proposed acquisition of Reynolds American. Strategically, this is a great deal that will create one stronger, truly global tobacco and Next Generation Products business, with a world class portfolio of products and brands that can be leveraged on a global scale. The Board believes this is an attractive transaction for both Reynolds and BAT shareholders.

In recognition of the underlying strength of the business and demonstrating our commitment to growing shareholder returns, we have increased the dividend by 10%, in line with constant currency EPS growth.

I will now hand over to Ben who will take you through the detail of our 2016 results.

Ben Stevens - British American Tobacco plc - Finance Director

Thank you Nicandro, and good morning everyone.

As Nicandro mentioned, 2016 was an outstanding year, driven by strong volume, revenue and share growth. The relative weakness of Sterling resulted in a translational FX tailwind; however, as previously highlighted, transactional FX remained a challenge, impacting operating profit by approximately 6%.

This slide shows some of our key business metrics. Reported cigarette volume grew 0.2% and organic volume was down only 0.8%, outperforming the industry, which we estimate to be down around 3%. This reflects our continued strong share growth of 50 basis points.

The GDBs delivered another excellent performance, with overall share growth of 100 basis points and volume up 7.5%.

Price mix was 6.7%, driven by good pricing across our markets. Reported revenue was up 12.6% and at constant currency was up 6.9%, with organic revenue growth of 5.3%.

Operating profit grew 9.8% at current rates of exchange and 4.1% on a constant basis, despite the absorption of a 6% transactional currency headwind, excluding this organic operating profit would have risen by around 10%.

Operating margin was down 90 basis points due to the impact of transactional FX, excluding this and with organic adjustments; underlying operating margin was up around 160 basis points. I'll give more detail on this later.

Constant currency EPS was up 10.4% to 230 pence, benefitting from our investment in the enlarged Reynolds American business and the buyout of the Souza Cruz minority. With translational FX turning in our favour in the second half, reported EPS increased strongly to 247.5p, up 18.8%.

Currencies remained a key feature of 2016. With the devaluation of sterling following the Brexit vote, the 4% translational headwind on operating profit in the first half of the year turned into a 15% tailwind in the second half, and a 6% tailwind for the full year.

However, transactional FX remained a challenge and was a 6% impact on operating profit for the full year. This was due to the timing of hedges rolling off and the scale of FX movements relative to the US dollar in a number of countries, including Russia, Japan and Ukraine.

Based on current spot rates and the timing of hedges, we would expect a transactional headwind of around 2% on operating profit for 2017. However, translational FX should remain a tailwind of 9% on operating profit and 10% on EPS at current exchange rates.

Turning now to margins. We continued to make good progress on the margin during 2016 with an underlying improvement of around 160 basis points. This was driven by pricing, together with significant product cost savings and the benefits of TaO efficiencies. However, this was more than offset by the transactional currency impact of around 210 basis points.

Organic margin was down just 50 basis points, and the effect of acquisitions in the prior year, left reported margin down 90 basis points.

As you know, on average over the years, we aim to grow our operating margin between 50 and 100 basis points per year and I remain confident in our ability to achieve this.

Turning now to the regions. Asia Pacific delivered its fourth consecutive year of strong share growth, up 30 basis points. This was driven by the continued momentum of the Global Drive Brands across the region, with strong performances from Dunhill in Indonesia, Kent in Japan, Lucky Strike in Indonesia and Rothmans in Australia and South Korea.

Volume in the region was down only 0.9%, despite significant excise-driven industry declines in Malaysia and Pakistan.

Regional revenue was flat at constant rates and profit was up 1%. This was mainly due to the impact of the excise increases and associated down trading in Malaysia and Australia. This masks strong revenue and profit growth at constant rates in a number of countries including Bangladesh, Pakistan, Vietnam and Sri Lanka. Excluding the impact of transactional FX regional profit would have increased around 6%.

In Australia, despite the down trading environment market share increased, driven by another strong performance from Rothmans.

In Malaysia, corporate share declined as Dunhill in the premium segment was impacted by the excise increase and growth in illicit trade. However, Peter Stuyvesant, the fastest growing brand in aspirational premium, performed well, partly offsetting the decline.

In Japan, BAT grew share, driven by Kent, in an industry down around 5%, due to strong growth in Next Generation Products. Including Next Generation Products, the industry declined around 2%.

Overall, reported revenue and operating profit in the region grew strongly as a result of the translational FX tailwind.

In the Americas, reported revenue grew 5% and profit was flat, driven by good performances from Canada, Chile and the Caribbean.

Volume was down 8.8%, largely due to industry decline in Brazil and Venezuela. However, volume increased in Mexico and Colombia.

At constant rates, regional revenue grew 11%. Profit grew 3% and would have increased by around 6%, excluding the impact of transactional FX.

In Brazil, continued excise and VAT driven price increases, together with a weak macro-economic environment, led to a significant industry volume decline, down trading and growth in illicit trade. Although overall share was down, Minister

grew share strongly, capturing its fair share of down trading, and Dunhill increased its share of the premium segment by 50 basis points.

Canada delivered its fourth year of strong profit growth, driven by Pall Mall and a stable performance from DuMaurier.

Profit in Mexico was flat due to delayed pricing, but volume and share grew. Strong pricing offset currency devaluation and inflation in Venezuela, driving a decline in industry volume.

The Global Drive Brands performed well across the region with volume up 7.7% and share up 150 basis points. This was driven by good performances from Lucky Strike in Brazil and Chile, Pall Mall in Mexico and Canada, as well as successful migrations, including Consul to Pall Mall in Venezuela.

Western Europe delivered a strong set of results, as the economic recovery in the region continued. Revenue grew strongly and was up 21% at current rates, 8% at constant rates, and 3.6% on an organic basis. This was largely driven by pricing in Germany and Romania and a good volume performance across the region.

Volume was up 6.7%, or 2.4% on an organic basis, strongly outperforming the industry, which we estimate to be down around 1.5%.

Share continued to recover and grew 10 basis points, driven by good performances in Romania, Poland and France.

Profit growth in Romania, Germany and Italy helped increase regional profit by 8% at constant rates and 21% at current rates. On a constant organic basis, profit was up 6.9% and, excluding transactional FX, would have increased around 9%.

In Romania, corporate share was up 130 basis points reaching 54.4%, reflecting record shares for Dunhill and Pall Mall.

In Germany, good profit growth was driven by pricing and a strong performance from Lucky Strike.

In Italy, Global Drive Brand share grew, driven by Rothmans and Lucky Strike. Profit was up following good pricing.

The integration of the TDR business is substantially complete, resulting in strong share growth of 120 basis points in Croatia.

EEMEA delivered another strong underlying performance, despite continuing economic and political challenges in the region.

Share growth of 140 basis points drove organic volume growth of 2.1%. This reflects an excellent performance from the Global Drive Brands, in particular Rothmans in Russia and Ukraine. Together with strong pricing, this led to constant currency organic revenue growth of 8.6% and profit growth of 4.3%.

Currency devaluations in Russia, Ukraine and Nigeria, again resulted in a large transactional FX impact. Excluding this, organic operating profit would have grown around 19%.

Corporate share in Russia was up 140 basis points, largely driven by the success of Rothmans, as well as growth in Yava and a stable performance from Kent. Profit was up significantly, despite the impact of transactional FX, as a result of strong pricing and volume growth.

Volume declined in South Africa, where trading remains difficult due to a weak macro-economic environment, currency devaluation and political instability.

In Turkey, share grew for the third consecutive year, driven by Kent and Rothmans. Volume growth, together with good pricing, led to significant profit growth.

Adjusted EPS of 247.5p at current rates was up nearly 19%, driven by growth in operating profit, together with excellent results from our associates, in particular the enlarged Reynolds American business, and an 8% translational currency tailwind.

Net Finance costs increased, mainly due to M&A funding.

The effective tax rate was lower at 29.8% due to a change in mix of profits.

Non-controlling interests were lower as a result of the buyout of the Souza Cruz minority.

Now, on to cash flow. Overall, free cash flow was £3,389 million, which is £92m lower than last year. However, excluding the non-recurring receipt in 2015 of £963m in the UK related to the Franked Investment Income Group Litigation Order, free cash flow was £871m or 35% higher. This was mainly due to higher operating cash flow conversion, up 1.7 percentage points to 93.5%, lower dividends paid to non-controlling interests and higher dividends received from associates.

Depreciation is the main component of non-cash items. Working capital outflows were slightly below last year at £254m, and were mainly due to stock builds linked to the timing of excise driven price increases.

Gross capex of £652m was £61m higher than 2015, largely due to investments in Next Generation Products. This was partly offset by asset sales, giving a net capex of £559m. Based on current rates, we expect gross capex in 2017 to be around £700m due to additional investments in Next Generation Products.

Net interest paid was slightly higher at £537m due to the full year impact of additional financing costs arising from prior year M&A activity.

Tax outflows were marginally below 2015 due mainly to the mix in taxable profits and payment timing. Dividends paid to non-controlling interests of £147m were £88m lower due to the full year benefit of the acquisition of the Souza Cruz non-controlling interests.

Restructuring and settlement outflows were £231m higher primarily as a result of deposit payments linked to the Quebec Class Action lawsuit.

Dividends from associates were up £392m versus 2015 reflecting the full year benefit from the prior year investment in the enlarged Reynolds business, as well as participating in Reynolds' share buyback programme.

This delivers free cash flow of £3,389m.

I'd like to finish off by touching on financing and shareholder returns. Net debt increased by £2bn to £16.8bn. The increase is primarily driven by a £1.7bn FX impact due to the devaluation of sterling against the US dollar and the euro. This leaves net debt to EBITDA at 2.9 times.

Following the announcement of our recommended offer for the remaining 58% of Reynolds American, S&P and Moody's confirmed the Group's credit ratings at BBB+/Baa2 stable. Given the highly cash generative nature of the business, we would expect to recover to BBB+/Baa1, in the medium term.

We have increased our full-year dividend in 2016 by 10%, whilst at the same time reducing our payout ratio to 68%. This is consistent with our stated intention to gradually return to our long term payout policy of 65%, once currencies turned in our favour. We remain committed to rewarding shareholders with an increasing dividend and continue to see 65% as a sustainable long term payout ratio, given the investment opportunities in the business.

Thank you and I'll hand you back to Nicandro.

Nicandro Durante - British American Tobacco plc – Chief Executive

BAT has a very successful track record of developing strong brands and growing market share, through a consistent growth on superior consumer understanding, product quality and innovation.

I am pleased to say that this continued during 2016, with a record year of corporate share growth of 50 basis points, as measured by independent third party retail audit data.

This performance continues to be powered by the GDBs, which grew share by an impressive 100 basis points and volume by 7.5% in 2016.

This is on top of the 120 basis points of share growth and 8.5% volume growth the brands achieved in 2015.

Since 2010, our GDBs have added 520 basis points of share globally, with all five brands contributing to this strong performance. The GDBs now represent nearly 49% of our portfolio.

Dunhill performed well in a number of key markets. The brand held share overall and grew slightly within the Premium segment. This was a strong performance, given the impact of industry volume decline and down trading in Malaysia and Brazil, as a result of excise-driven price increases.

In Indonesia, Dunhill continued to grow both volume and share, and it is now the largest international kretek brand in the market with a 4.9% share, up 0.5%.

In Romania, Dunhill also achieved strong volume and share growth to reach a record market share of 6.5%.

Kent grew volume 1% and share 10 basis points as the result of good performances in Japan, Russia and Turkey, as well as the migration from Belmont to Kent in Chile.

In Russia, Kent grew premium segment share, driven by Nano, maintaining premium leadership.

In Turkey, Kent Spark Demi Slims and Kent Switch are driving share and volume growth.

Kent Spark and slimmer variants helped Kent reach a record brand share of over 8% in Japan.

Lucky Strike had another excellent year with volume up 13.5% and share up 10 basis points.

This was driven by strong performances in Germany, France, Chile and Italy, with the Black Series continuing to drive growth.

The brand was launched in Indonesia in May and had already achieved a share of nearly 0.5% by August. Following the migration of Club Mild in the second half, Lucky Strike has grown significantly, reaching a market share of 1.4% in December.

Pall Mall continued its good performance, with share up 10 basis points, driven by Pakistan, Romania, South Africa, Poland and Canada.

In Romania, Pall Mall remains the fastest growing brand in the market, driven by Extra Cut, and reached a record share of over 17%.

In Poland, following the successful launch of Tubes, the brand also reached a record share of 9% in December.

Finally, Rothmans delivered another outstanding performance, growing volume nearly 37% and share 70 basis points. Rothmans is our second largest GDB based on volume and maintaining these growth rates as the brand gets larger will clearly be more challenging.

Rothmans Demi Slims continued to drive the growth of the brand and launches such as Demi Click in Russia and Ukraine have become a major driver of Rothmans' success in 2016.

In Turkey, Rothmans became the fastest growing brand in the market and, in December, reached a 4% share after only two years.

In Ukraine, it is also the number one brand in the market and in Russia; Rothmans is the fastest growing brand for the third consecutive year.

Turning now to NGPs. We have always said that our strategy is to invest in a range of products across the risk continuum that satisfy different consumer moments. That is why we are investing in both vapour and tobacco heating products.

BAT is already the largest international company in the vaping category, with a portfolio of products and an estimated combined share of 8.2% in the five largest vapour markets in Europe. Vype is now available across ten markets worldwide, with leadership positions in the UK and Poland.

In December last year, we launched Vype Pebble online in Italy, UK, Germany, France and Poland. Pebble starter kits sales are already two to three times higher than ePen sales were in these markets over the same time period.

In the UK, Vype is one of the fastest growing brands in UK retail, growing significantly to 9.5% at the end of the year and our retail share of the UK vapour market is now nearly 40%.

Vype distribution has expanded rapidly in the other European launch markets. It is now available in 5,300 outlets in Germany and 7,800 outlets in France. In Italy, Vype is now available nationwide, reaching 2.7% category share of retail in the first month of national presence.

Vype also continues to grow in Poland, with share in retail increasing from 4.7% in Q1 to 6.6% in Q4, largely driven by growth in liquid sales.

In addition, we are already working on the next platforms of the ePen and Pebble.

In the tobacco heating products area, we have also made excellent progress. As most of you will know, in December 2016 we launched Glo in Sendai, Japan, and results to date have been very encouraging. At the end of the first 10 weeks, Glo already has a 5.4% share in a leading convenience chain in Sendai and a 4.9% share in a second chain after six weeks. The two chains represent approximately 40% of total tobacco category sales in Sendai.

Consumer feedback is that they appreciate the simple and intuitive design, the back-to-back uses between charges and the easy to clean feature. The sensorial experience of both the tobacco and menthol variants also resonates with consumers. With prevailing excise rates, NeoStik margins are around 2.5 times higher than Kent combustibles in Japan.

We are very pleased with these early results and will be rolling out Glo nationally in Japan, in the second half. This will already be version 1.2 of Glo, which incorporates a number of product upgrades.

In Romania, iFuse, launched last year continues to perform well, with awareness, trial and sales growing. The product is now available in 800 outlets across Bucharest. We will launch an upgraded version in the coming months.

We have always said that we see a significant opportunity in NGPs and we are making great progress. We continue to believe that we should offer consumers a range of products in both the vapour and tobacco heating, as we believe that both categories have significant long term growth potential.

Our investment in NGPs continues to increase, and we plan to double our footprint in 2017 and we aim to double it again in 2018. With our strong portfolio of products, we believe we are well on track to capture a significant share of this growing market.

So, in summary, 2016 has been a very strong year for BAT. Excluding translational and transactional currency effects, revenue, profit and EPS, were up 7%, 10% and 16% respectively.

This is a very strong performance which was underpinned by record corporate share growth, driven by an outstanding performance from the GDBs.

We have increased the dividend by 10%, in line with constant currency EPS growth, recognising the underlying strength of the business and demonstrating our commitment to growing shareholder returns.

Although it is only early in the year, the trading environment continues to be tough, with challenging conditions in markets including Brazil, South Africa and Malaysia. But much like last year, we expect profit growth to be skewed to the second half. This is mainly due to the phasing of volume shipments in a number of key markets, including Pakistan as well as the timing of marketing spend and NGP investments.

Nevertheless, at this stage, I am confident of another good year of constant currency earnings growth.

Thank you, we will now open it for questions. First we'll take questions in the room and after that we'll go for those who dial in. So who would like to shot the first question?

QUESTION AND ANSWER

Fulvio Cazzol – Goldmans - Analyst

A couple of questions, could you give us a bit of an idea of how much product mix and geographic mix impacted 2016 revenues please?

And then the second one is on NGPs, could you give us also an indication of how much these contributed to 2016 net revenues for the Group?

And my final question is on the outlook on excise duties across your key markets, should there be anything in particular that you wanted to highlight for 2017 that could impact the volatility? Thank you.

Nicandro Durante - British American Tobacco plc – Chief Executive

In terms of portfolio and geographic mix it was a headwind in both, geographically because we grew substantially in places like South Asia, which is great for the business, the potential is fantastic and some of the high margin markets declined a little bit faster. So I think that the impact in our numbers for geo plus portfolio mix this year was around - the headwind of around 3.5%, both together, more on the geographic mix than the portfolio mix of course, much more.

And the second question about excise duties, well excise duties, we always have some - you know some headwinds at the beginning of the year, we have some this year. So you have an excise increase in Colombia in January 2017, that's going to be a headwind.

We have potentially one in the GCC, Saudi Arabia, that has not been confirmed yet, but there is a possibility that around March and April the government has released already their tax plans and they are talking about a substantial excise increase there.

The third one is in Russia, it's going to have a higher excise increase this year than last year, the pass on excise last year in terms of pricing was already around ten roubles, this year it is going to around 13 to 14 to cope with the excise increase, or a little bit higher. I am not that sure that in terms of consumer price there's going to be that difference, but we'd expect that Russia will decline a little bit faster next year, around 6.5; this year was 5.5 because of that.

So those are the main headwinds that we have. In places like Brazil we'll have a better excise environment. So we think that the industry is going to perform better in 2017 in terms of industry decline than it performed last year, that was around 9% decline, we expect for 2017 the industry to decline 2% because prices, excise price driven increases are going to be much lower.

The third question is about NGPs, I think the impact of NGPs in our numbers was extremely small in '16. 2017 will depend a lot on our performance in the market. But '16 was very small, really small. Adam?

Adam Spielman – Citi – Analyst

First of all a question on margins, you're reiterating the 50 to 100 basis points, can you just talk about that in the light of the fact of where we are with TaO and the savings from TaO? And also I guess what the means with the 2% transaction headwinds in 2017?

And then a separate question, you said on the footprint for NGPs you're going to double this and double this again, can you just explain what you mean by footprint, can you just be a bit more specific about it?

Nicandro Durante - British American Tobacco plc – Chief Executive

I'll go for the second question if you don't mind, we are adding around 11 markets in December 2016, we think that we can be in another 10 to 11 markets in 2017, and you can be in another 20 markets in 2018. So it's doubling '17, doubling '18, the number of the markets that we'll be present.

Adam Spielman – Citi – Analyst

And that will all be new vaping markets?

Nicandro Durante - British American Tobacco plc – Chief Executive

It will be vaping, plus tobacco heating products. For tobacco heating products we expect by the year end of '17 we will be able to launch in around five markets, with further expansion next year. We are learning with the launch in Japan, I have questions, I had some before coming here today about why we don't rollout in Japan faster, why don't we rollout to the other markets faster, but you have to understand that to launch this in December there will be a lot of learnings that you are taking, not only about the product, but also about the market mix. That's why we are going to rollout nationally in Japan in the second half, more the beginning of the second half than the end of the second half, and then we will launch in other markets at the end of the year.

We will come with an improved version of the Glo because we learn a lot, despite being an outstanding performance in the market, but we think that can do even better. So that's the plan.

Ben Stevens - British American Tobacco plc - Finance Director

Yes, on operating margins I mean obviously we're delighted by growing underlying margin by 160 basis points this year, that's a tremendous achievement I think. The TaO programme we finished the rollout in Indonesia and in the Balkans in January this year, so even the acquisitions like TDR are already now on the TaO programme and we've got better and better at deploying TaO as we've got more and more experienced on it.

But of course that's just deploying the IT system; the actual cost savings come from how well you use that. So for example we're driving out now HR shared services, which is in addition to the TaO platform. That will have margin implications for us. We're getting better and better at sales operations planning as a result of the TaO programme, that means we carry less stock, we make less mistakes in terms of write-offs, things like that.

There are other services we can transfer into the shared service centres, things like tax compliance for example could be done out of shared services. I mean anything that's rule based activity should really sit in a shared service centre and everything that's judgement based activity should sit either in the centre or in the end markets. And we've got a long way to go to do that still, so I'm confident that we can continue to grow our operating margin over the years to come.

Now in terms of reported margin obviously we had a £300m hit on transactional FX this year, that goes down to £100m next year, but it's still a hit, so we've still got to overcome that. And of course the rollout of Next Generation Products will be lots of turnover but we'll be investing in that next year, so that won't come through to margin until 2018. But despite all of those things I remain confident that we can grow operating margin.

Owen Bennett - Jefferies - Analyst

A couple of questions please. Firstly, pricing and volume outlook in Brazil in this year please?

And then secondly just coming back to NGP investment, so PM said they're at a point now where they're going to reallocate resources from combustibles to NGPs in certain markets, will you be adopting a similar strategy or will investment be incremental to the combustible business?

Nicandro Durante - British American Tobacco plc - Chief Executive

Okay the first question is about volume outlook in Brazil, I think that I mentioned before Brazil this year we had industry decline of around 9%, we expect next year to be around 1.5 to 2% only, because you have much lower excise increases in Brazil and much lower price increases in Brazil.

We had one in December and I think that pricing in Brazil are going to be much more manageable and so the impact in the market is going to be much more manageable. So that's the answer for Brazil.

Regarding resource allocation, well we do resource allocation on a daily basis in BAT and we used to do it between regions, among markets, now we do markets, region and categories. But it's not about taking money from combustible, it's about allocating resources in the right markets, in the right brands, in the right segments and when I say segments I'm talking about different categories. So I don't think that's going to be about - I'm launching this for example in Japan and I'll take money from the combustible business in Japan and I'll put it back in the NGP, it doesn't work like that.

So we will try to be smarter and smarter in the way that we allocate investments in a way that you can keep growing and why we keep launching the products.

Jonathan Leinster - Berenberg - Analyst

I have a more general question, one of your competitors has noted that there seems to be very aggressive pricing actions in Russia recently and when France introduced a sort of turnover tax then some of the major players, including yourselves, didn't pass through that in terms of prices to consumers. In general do you think that price mix or pricing is becoming more aggressive within the industry as people search for market share?

Nicandro Durante - British American Tobacco plc – Chief Executive

Jon, of course I'm not going to talk about specific markets in terms of pricing going forward, we don't talk about that. But what I can say is we have a solid price environment nowadays, we had a good price environment in 2016. We are moving to 2017 - by today we have already 50% of the pricing of the year that you're expecting. So it seems to be a good price environment overall. But I'm not going to be discussing here market by market. But it's a good price environment, not that dissimilar than the one that had last year.

I think that now I think that we take some questions from the ones that have dialled if there is any?

Telephone Operator

Thank you. Our first question comes from the line of Rey Wium from SBG Securities. Please go ahead your line is open.

Rey Wium - Standard Bank Group Securities - Analyst

Good morning guys, also just a question on the NGPs, I just want to get a feel of - you know if I look at numbers from Reynolds, it's had a bit of a drag on operating profit, now I just want to get some clarity at what sort of level do you need to be in terms of volumes or markets penetration for the Next Generation Products to be sort of at breakeven?

And then I also have a quick question on the overall cost of debt, I'm not sure if I missed it, but Ben maybe if you can just give an indication if it was in the order of about 3.6, 3.7% this year?

Nicandro Durante - British American Tobacco plc – Chief Executive

Okay, let me take your first questions about profitability and NGPs in terms of returns for the company. It is very difficult to answer your question on a global base; you have to look at this on a market by market. So if you look at for example Japan, I just gave you some numbers, our margins in Japan as compared to the consumable margins of tobacco heating products as compared to Kent combustible margins, 2.5, 2.6 times higher. That's very clear that is going to have a fantastic return for us in a short period of time. Probably not in '17 because you'll be launching nationally in the second half of the year, but I expect it to be accretive in terms of profit for next year.

In terms of vaping, and that is easier to talk market by market because if I decide next year to launch in another 100 markets of course we are going to start losing money because the amount of money that I'm going to be investing is going to be substantial. But as I said we expect to launch in another 11 countries this year, another 20 to 25 next year. So it's a very forward kind of expansion for the markets that give us the best returns.

But for example for vaping we launched in Germany last year and we got very good results in terms of market share in Germany, around 7 to 8% after a couple of months. We think that this year we'll start making money in Russia in vaping. So it depends market by market, it depends on the launch costs and things like that. So we expect that THP we will in the second year start making money, in vaping probably 12 to 24 months later we'll start making money as well.

But the margins in vaping as well are much higher than in combustible, which helps.

Rey Wium - Standard Bank Group Securities - Analyst

Okay thanks.

Ben Stevens - British American Tobacco plc – Finance Director

Rey, our average cost of debt is 3.1%.

Rey Wium - Standard Bank Group Securities - Analyst

Okay, thank you

Telephone Operator

Thank you. Our last question comes from the line of David Hayes of Merrill Lynch. Please go ahead your line is open.

David Hayes - Bank of America Merrill Lynch - Analyst

Morning everyone, thank you. I'm going to go for three if I can. Just firstly on the Global Drive Brands you made the point that the success of Rothmans and the fact that the scale of that now means the growth may slow, I just wonder whether there's scope or plans for another Global Drive Brand to slot in and if that was the case what kind of brand positioning that would have moving forward?

And then the other two, just on the Glo 1.2 the variations that you're making to the product I wonder if you can I guess simplistically explain maybe some of the things that you've learned and therefore what the new product will have that's an adaptation of the original?

And then finally I think I probably know the answer to this one but I'll ask it anyway, just in terms of the Reynolds synergies that you've talked about up till now, I just wonder whether you've done any more work on that and any more access at all following the Board approvals that means you can elaborate on some of the synergy outlooks? Thanks very much.

Ben Stevens – British American Tobacco plc – Finance Director

I think the answer is no, no, no isn't it?

Nicandro Durante – British American Tobacco plc - Chief Executive

Ben just said the answer is no, no, no but I will try to elaborate on that. In the case of Rothmans the answer is no, we don't expect to have another Global Drive Brands. We think that we have a fantastic portfolio now to meet consumer needs in different price and consumer segments. There is no plans to have another one.

In the case of Glo 1.2 it's the one that's going to be rolled out in Japan. Basically there are - I'm just simplifying with two basic features there are some improvements but the two basic features is the extended section length in terms of smoking and the second is a better retention of the consumable on the clean device. Those are the two main changes that you are going to go through.

Glo has been extremely well evaluated but we are always looking for new improvements and in this area the kind of innovations that you need to go through the product is a little bit different than combustibles because you have to keep improving this every six months. So we have already we are working heavily on a Glo 2.0 that should be available at the beginning of next year with some other improvements. So these will come as natural for BAT and as I said before, last year when I was squeezed here about why you haven't launched and I said it that you are going to launch when you have the right products to go to the market. And then we have already the 1.2, 2.0 in the bag.

And the third question no. We haven't done any more work on synergies. We can't do any more work on the synergies with Reynolds unless shareholders approve the deal.

David Hayes - Bank of America Merrill Lynch - Analyst

I guessed that would be all. Thank you very much, cheers.

Telephone Operator

Thank you. I'll now hand the call back to Nicandro.

Nicandro Durante – British American Tobacco plc - Chief Executive

Can I have one last question? Adam you have one more question or you have two more questions? So Adam?

Adam Spielman – Citi - Analyst

So can I ask a question about innovation excluding Next Generation Products? This year or 2016 volume increased by 12%. I guess would you hope to achieve or is it likely you'll achieve the same sort of volume growth on innovations in the conventional business?

And I guess also in your mind if you weigh up the relative importance of innovation on conventional business versus NGPs are they roughly equal importance or is one of those two buckets more important in your mind?

Nicandro Durante - British American Tobacco plc - Chief Executive

Okay let me start at the beginning by saying that we think we can grow another 12% easily because we have good plans in place. Not only rolling out the innovations that we have already in the market to other markets, to other brands, but also some new stuff coming through the pipe.

Secondly when you talk about importance everything is important. At the end of the day 100% of the profit of the industry nowadays more or less is in combustible. And you look at five years down the road it's going to be still by a country mile the biggest part of profitability. So innovation in combustible is very important because it's what going to deliver the funds for us to invest in other categories. So we want to keep innovating in combustible, and we keep offering consumers options to trade up and to come into our brands. This strategy is working by the way. If you look at in terms of operating profit this has been, and I don't think that we have seen this before, measured by the independent panel Nielsen, the sixth year in which BAT is growing market share, corporate market share, with strong growth with the GDPs. I see no reason for slowing this down so we will keep investing in combustible.

And at the same time we are investing in Next Generation and here it is not about vaping or tobacco heating products, I think that both categories are going to be important. In some of the markets probably vaping is going to grow a little bit faster. As you saw in tobacco heating products, different markets they have different profiles and you know we had products available in different markets at the same time and one grew very fast, the other not. So you see markets will develop in a different way because consumers are different. So we keep investing in the three categories, vaping, tobacco heating products and combustible, and this is a model that has worked for us extremely well so far, no reason to change it.

Chas Manso - Société Générale – Analyst

I think the first question sort of follows on from that. Maybe you could highlight a few of the combustible launches that are already out there that you think will feature in 2017?

And then a couple on Next Generation. On the Sendai trial could you say whether your growth has been incremental to the category or whether it's sort of taking share?

And more generally I think traditionally you've regarded the opportunity to be greater in vaping than in heat not burning, especially outside of Japan, and now you're talking about launching into five markets outside Japan. Have your views changed on the potential between the different Next Generation formats?

Nicandro Durante - British American Tobacco plc - Chief Executive

So the first question you talk about Glo share. It's not been totally incremental to the category but it has helped the category to grow in Sendai. That's the answer. But we are in the market for ten weeks; you need to wait a little bit more to have a better reading. We have our reading already after ten weeks but I think that's too premature to have started drawing a percentage, but it's very clear that it has been incremental to the category but we haven't taken everything from - you know it has not been 100% incremental so the category is growing.

The second question about vaping being bigger or tobacco heating products being bigger what we always said is that those two categories have different qualities and they are going to grow in a different pace, it depends on the market. So we always said that in some markets probably vaping is going to do extremely well. Some others like Japan, tobacco heating products are going to do extremely well. Vaping nowadays is the biggest category but I think there is space for both. But you know at the end of the day it's the consumer that's going to decide which category is going to grow faster in each of the markets. Our role here is to offer the best products that we can offer with the best marketing mix in order to win in the category when the consumer decides to jump to one of those. That's my role here, our role here so we are ready for that.

Your first question, can you repeat your first question?

Chas Manso - Société Générale – Analyst

Combustible launches in 2017.

Nicandro Durante - British American Tobacco plc - Chief Executive

We have a lot of room to grow innovation but just rolling out what we have there. So we have a lot of innovation in the capsule with different capsules, flavours and double capsules and so on and so forth. We have the tube and we have some other innovations as well. So we have a lot to gain. But we will be launching some new stuff in the next year, but for obvious reasons, for competitive reasons, I cannot tell you which markets and which innovations we are going to launch. But watch this space.

Can I have one more question?

Fulvio Cazzol – Goldmans - Analyst

Taking another follow up, you highlighted £700m of capex guidance for '17. Can you give us any indication at all on what capacity you hope to have for the Glo refillables by the end of the year? Is that a number you can disclose?

Ben Stevens - British American Tobacco plc – Finance Director

Well we're not going to disclose the rollout plans for Glo but obviously we'll be national in Japan by the end of the year and we'll have plans well underway for launches in the other markets and the capacity planning supports that.

Nicandro Durante - British American Tobacco plc - Chief Executive

Okay guys thank you for joining us for this conference call and being here present. If you have any more follow up questions you can contact our IR department. Thank you very much for coming.

Ben Stevens – British American Tobacco plc – Finance Director

Thanks guys.

---Conference call ends--

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