



British American Tobacco p.l.c. Preliminary Results 2017

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PRESENTATION

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

Good morning, everyone, and welcome to British American Tobacco 2017 preliminary results presentation. I'm Nicandro Durante, Chief Executive of British American Tobacco, and with me this morning is Ben Stevens, Finance Director. As always, a warm welcome to those of you who are listening on the conference call, or watching via our website, bat.com. As usual, after taking you through the results presentation, then there would be an opportunity for you to ask questions. Before I start the presentation, I will take it that you have all seen and read the disclaimer.

2017 was a transformational year for BAT. Not only did it deliver on the financials but we also completed our acquisition with Reynolds America, the largest tobacco deal in history. It's a transformational deal providing BAT access to one of the most profitable markets in the world, a unique portfolio of brands and products, and further reinforces the long-term sustainability of our commitment to high single figure EPS growth.

I am proud to say that once again we have delivered on this commitment. At current rates, adjusted EPS grew 15% and was up 10% on a constant currency basis. This was driven by the continued good performance of our combustible business, with the GDBs, the newly acquired US brands and the Group overall growing share.

Reported EPS was up over 600%, mainly due to the accounting treatment of the Reynolds acquisition. Ben will talk more about this later.

2017 was also a transformational year for us in NGP. Our expanded vapour business reached an annualised revenue of nearly £300 million and the strong growth of glo in Japan drove THP revenue from zero to over £200 million. In total the combined NGP business delivered £500 million to Group revenue on an annualised basis in 2017, meeting the target we set at our Investor Day in October. We are aiming to grow this to over £1 billion this year, and to £5 billion by 2022. I am confident of substantially increasing, exceeding these targets. Our confidence in the future of the business reflected in the 15% increase in the dividend, which announced this morning.

2017 was also an eventful year for the industry. Although we saw higher price in most markets, we also have seen significant exciting increases in the GCC, Russia, Pakistan and Malaysia over recent years. This, together with a more aggressive pricing environment in a number of markets, led to down-trading, continued growth in illicit and industry volume decline. Against this challenging backdrop, BAT once again outperformed the industry. Organic cigarette volume including THP was down 2.6% against an industry down around 3.5%.

In July, the FDA announced a consultation for new tobacco regulation proposals. We remain very encouraged by the FDA's recognition of the continuum risk for tobacco products, and of tobacco harm reduction as a policy. We have advocated these principles for 20 years and the supportive regulatory is key to the transformation of the tobacco industry. However, this is a new, complicated area, and it will take time to get through the process. We await the publication of the Advanced Notice of Proposed Rule Making, and look forward to participating in the consultation process.

In Quebec, a judgement for the Court of Appeal continues to be expected any time with the class action cases against our Canadian subsidiary. As I've said before, a wide range of outcomes is possible, including a request for leave to appeal to the Supreme Court of Canada, and the use of Canadian regulation such as CCAA.

Finally, at the end of the year, the US corporate tax reform plans were approved. As announced earlier this year, this provides a benefit to 2018 EPS of 6%, all things being equal. We would expect around half of this to be reinvested in the rollout of NGPs.

The highlight of the year was of course our acquisition Reynolds and I'm delighted to say that the benefits of the deal are already beginning to flow through. With only five months' contribution for Reynolds in our numbers, and no comparison base available, we are unable to give any financial performance commentary on the business. However, what I can say is that Reynolds is performing very well with strong share growth in the second half of the year. And the integration is progressing smoothly.

Detailed plans have been drawn up for delivery of the synergies. As we said on the day of the deal we expect cost synergies of at least \$400 million, and I'm happy to report that savings are flowing through a little earlier than anticipated and we have already delivered more than \$70 million in 2017.

This has been driven by the benefits of procurement, the implementation of BAT systems and process into the Reynolds production facilities, together with the integration of the coverage functions. We remain well on track to deliver the target of at least \$400 million in cost synergies by the end of 2020.

In addition, we are combining the capabilities of both organisations to fully strengthen our global R&D. We are the only company with a predicate tobacco heating product in the US market. I'm pleased to say that the Substantial Equivalence application for our carbon tipped product has been accepted by the FDA and moved to scientific review. We await the final decision around mid-year.

We are also making good progress on the development of our SE application for glo in the US, and we are on track for a submission to be made this month, to be followed by MRTP application in due course. Finally, we look forward to the FDA response on our MRTP applications for Camel Snus and are awaiting the scheduling of a TPSAC meeting to review the application later this year.

The addition of Reynolds to the business gives us an industry leading portfolio of brands and products giving these and the growing importance of NGP to the business we have expanded our focus from just the GDP's to include the US drive brands, our NGP business and our oral products business in the US and the Nordics. Oral tobacco products, like snus and US moist stuff have existing epidemiology demonstrating their potential as reduced risk products. Together with our NGP we referred to them as Potentially Reduced Risk Products.

From 2018, our strategic metrics will focus on revenue growth for this expanded drive portfolio, as this is a key measure of success that has come across all four product categories. This more closely aligns with our strategy and vision.

This expanded portfolio gives BAT an industry leading range of brands and products spanning the risk continuum that's second to none.

Even with the growing importance of NGPs a significant proportion of the portfolio remains in the combustible cigarette business, which I'm pleased to say has continued to perform very well. Overall corporate share grew strongly and was up 40 basis points in 2017 on top of the 50 basis points achieved last year. This was driven by another excellent performance for the GDBs which grew shares by 110 basis points across our key markets outside the US. This is now our seventh consecutive year of share growth, with corporate share up a total of 210 basis points over the period and GDB is up 630 basis points over the same period.

The US Drive Brands outperformed the US industry, growing share by 40 basis points. Combined together Newport and NAS are the fastest growing brands in premium. Dunhill held up well in the premium segment,

but was impacted by downgrading and significant excise increases in many of its key markets including Malaysia, Brazil and Indonesia. However, share was down only 10 basis points.

Kent, Lucky Strike, Pall Mall, Rothmans all grew share, demonstrating the strength of our differentiated brand portfolio and diverse geographic footprint.

Our expanded drive brand portfolio includes an exciting portfolio of potentially reduced-risk products. Our Tobacco Heating Products cover electronic, carbon tip and hybrid products. In vapour, we have a wide range of open and closed systems and under both Vype and Fuse. Finally, the recent acquisition of Reynolds and Winnington extend the portfolio even further into the growing oral tobacco segment, with both tobacco, and non-tobacco oral products.

BAT now has the widest range of potentially reduced-risk products of any tobacco company in the world with the capability of addressing the widest range of consumer needs. We are therefore the best-placed tobacco company to lead the transformation of the industry and transition the largest number of smokers from traditional cigarettes to potentially reduced risk products.

glo is already demonstrating this in Japan. Just four months after the national rollout, glo already has 4.1% market share in January despite continuing capacity constraints, limiting devices to one per store per week. Together with our suppliers we are building device manufacturing capacity rapidly and anticipate having an annualised capacity of 25 million units by the end of the year. We expect device capacity to become unconstrained during Q2. Our annualised consumer capacity is already at 15bn sticks and we are able to increase this to 52 billion by the end of the year. In December, we launched four NeoStik variants which have quickly grown to represent 40% of glo's sales. glo now has the widest range of products in the market with a strong pipeline of innovations, including capsule variants and glo mini following later in this year.

During 2017, glo was also launched in South Korea, Canada, Russia, Switzerland and most recently Romania. In South Korea following its launch in Seoul in August, glo was rolled out nationally. glo continues to grow national share and now reached 0.4%. Share in Seoul has slowed, impacted by a combination of supply constraints and a new competitor entry into the market. We are currently expanding distribution and adapting our marketing model to reinforce our market presence. With a strong pipeline of innovations we are confident in glo's potential in South Korea.

In our trial markets of Canada and Switzerland, we are continuing to refine our marketing model in order to address the challenges of extremely restricted communication environments and consumer preferences for stronger cigarettes. Our recent city launches in Russia and in Romania are showing very encouraging early results.

During 2018, we have plans to launch glo in an additional 14 markets. Having only entered the THP market in December 2016 we have made excellent progress during '17 and expect to build on this in 2018.

We also continued to make good progress in the development of our vapour business in 2017. Excluding the US, vapour revenue was up 30% mainly driven by acquisition, gross margin improved by 10 percentage points, and we are now on track for our vapour business to breakeven by the end of '18. We continue to consolidate our leadership position in our key markets. In the UK, our vapour business maintains a record share in retail of 40%. In Germany, Vype became the number one brand in retail with a record 37% share in the channel and estimated 10% of the total vapour markets. In France, offtake volume was up a third, and in Italy, we expanded on distribution to national coverage, driving a significant increase in sales. In the US, Vuse grew by 16% and revenue by 29% following increased distribution for Vype and the launch of Ciro. Commercial

performance will be boosted further by the recent launch of Vuse e-commerce platform. Importantly, products performance continues to be highly valued by consumers when tested against direct competitors' products.

Our acquisitions in Poland and the UK have performed well. In Poland, Chic volumes was up over 20% and in the UK Ten Motives has grown market share and revenue month on month. The integration of the VIP vape store chain in the UK is progressing well and at least 25% expansion of the footprint is planned for 2018.

Finally, the priority for 2018 is our second generation of vapour products, ePen3 and Raptor, both of which are due for launch towards the year end. During 2017 consumer incidence in vapour across our key markets is estimated to have grown around 40% with sharp rises in category penetration in a number of emerging markets. Our strong pipeline of second generation vapour products and a growing understanding of vapour consumers puts us in a strong position to capitalise on this growth.

Alongside our growing NGP business, our large and successful oral tobacco business in the Nordics and in the larger US market provides a further opportunity for its smokers to switch to lower risk products. In 2017, total revenue from oral tobacco grew 16% to nearly £900 million, driven by strong performance in the US, Sweden and Norway. In US, Grizzly remains the leader in the growing wintergreen and pouch segments. The brand gained a full point of market share to reach 31.8% in 2017 driven by Grizzly Dark Styles, limited edition packaging and powerful equity building campaigns.

In Sweden, we are the fastest growing company, adding 170 basis points over the year to reach a share of 10.3% in December. In Norway, share was up 340 basis points to a record 6.4% in December, driven by the success of Epok, our innovative white snus brand.

Across the Nordics, we are now the leader in white snus, the fastest growing segment across the market with an 85% share of segment. We expect to launch a non-tobacco variant in the second half and have plans to expand outside the Nordics with this innovative and profitable product.

So, in summary, in 2017 we completed the Reynolds acquisition, and we made excellent progress in NGPs, and the wider potentially reduced risk products portfolio. Our combustible business continued to perform strongly and we are investing a substantial amount of money in the long-term sustainability of the Group. This was all done whilst delivering on our commitment to high single figure earnings growth. This was a truly transformational year.

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

Ben Stevens - British American Tobacco p.l.c. - Finance Director

Thank you, Nicandro. As Nicandro said in his opening, this year's numbers have been significantly impacted by the accounting treatment of the Reynolds acquisition. Revenue was up 38% and profit from operations increased by 39%. This reflects the additional volume of 36 billion sticks, revenue of £4.2 billion and profit from operations of £1.3 billion from the inclusion of Reynolds from the date of acquisition.

Diluted EPS was up over 600%. You can see from the slide that this was mainly due to a gain of £23.3 billion on the deemed disposal of the associate holding in Reynolds, and a deferred tax credit created by the revaluation of the deferred tax liability, relating to the acquisition, at a reduced tax rate following the US tax reforms. More detail on the adjustments is available in the announcement published this morning, and there's a reconciliation of IFRS to the adjusted numbers in the supplementary slides to this presentation, which are

available on our website. I do not propose to go any deeper into the technical accounting details of this presentation, but for those of you who want to go into the detail in more depth, please contact our IR after the meeting closes.

So, for clarity, I'll now focus on the adjusted organic results which excludes the results of Reynolds and our other acquisitions. Organic volume is down 2.6%. This was mainly due to industry volume decline in particular in Ukraine, Brazil, South Africa and Russia, driven by excise increases and illicit trade growth. This includes THP volume of 2.2 billion sticks. Adjusted organic revenue was up 6.5% or 2.9% on a constant basis, benefitting from higher pricing across the majority of our markets, offset by negative geographic and portfolio mix of around 1.4%. Adjusted organic profits was up 7.8% benefiting from a 4% currency tailwind. This was a 6% tailwind including the contribution from Reynolds. On a constant basis, profit grew 3.7%. This reflects the stronger second half profit growth of 4.1% against the first half growth of 3.2% as was anticipated at the Interims. Adjusted diluted EPS on a constant basis grew nearly 10% and was up almost 15% of current rates, exceeding our high single figure EPS growth objective.

Turning now to the regions. In EMEA, adjusted revenue on a constant basis was up 0.6% as prices in a number of markets including the Ukraine, Turkey and Iran more than offset volume declines in the region and down-trading in Russia and the GCC. Volume was down 3.4% to 228 billion sticks. Growth in Nigeria, Turkey, the GCC and Algeria was more than offset by reductions in Ukraine, South Africa, Russia and Iran. Share grew 30 basis points with good performances from Russia and Turkey in particular. This is now the fourth consecutive year of share growth in the region. Despite good performances from Ukraine, Iran and Nigeria, constant currency adjusted profit was down 1.9%. This was mainly due to a significant excise increase in the GCC, difficult trading conditions in Russia and the continuing negative impact of transactional foreign exchange on costs. In Russia, trading remains challenging with increased price competition. This has led to some absorption of excise and down-trading. Share grew 10 basis points, driven by another strong performance from Rothman's, which now has over 10% market share. In South Africa, the weak macroeconomic environment continues to impact trading. However, share was stable and Dunhill reached a record share of over 15%. Turkey delivered an excellent performance with growth in revenue, profit and share. Overall the GDBs had another outstanding year across the region. GDB volume was up 9.9% driven by good performances from Pall Mall in the GCC, Rothmans in Russia and Kent in Turkey.

The ASPAC region hosted a good performance, delivering revenue, profit and share growth in a challenging trading environment. Regional volume was down 1.3% as the impact of industry volume declined in Malaysia, Pakistan and South Korea more than offset growth from glo and excellent volume and share growth in Bangladesh. Adjusted revenue on a constant currency basis increased by 1.3% to £4.3 billion, higher pricing and incremental revenues from glo was offset by negative mix effects. This was mainly as a result of strong growth in lower price markets including Bangladesh and significant industry volume decline and down-trading in Malaysia and Pakistan.

Although there was significantly increased investment behind glo in Japan and South Korea, adjusted profit on a constant basis was up 2.7% or 1.7 billion, driven by revenue growth and cost saving. At current rates, adjusted revenue was up by 5.7% and profit was 7.7% higher, benefiting from foreign exchange tailwinds, notably the relative movements in US dollar and the Euro against the Japanese Yen. Australia delivered a good performance, growing profit and share. In Indonesia, volume was lower, in line with the overall market decline. However, with strong volume growth of 13%, Dunhill and Lucky Strike now represent 97% of our portfolio volume. Profitability increased driven by cost savings and business efficiencies. Bangladesh had an outstanding performance with strong volume, profit and share growth. Market share across the region was up 60 basis points, with a good performance in the Global Drive Brands which grew volume by 1.5%.

The Americas faced a challenging macroeconomic environment in 2017 impacting consumption across the region, and leading to significant down-trading and growth in illicit trade. Despite this at constant rates, adjusted revenue in the region grew 11% and adjusted profit grew 10% driven by Canada, Mexico, Chile, Venezuela and Columbia, more than offsetting decline in Brazil. Volume was down by 5% largely due to down-trading and industry contraction in Brazil and Argentina and the growth of illicit trade in Chile. In Brazil, volume decline rates moderated compared to previous years as our low-price brand Minister captured a fair share of the down-trading. Canada delivered its fifth consecutive year of profit growth driven by successful pricing and good cost control. Regional market share was flat with growth in Mexico, Argentina, Columbia and Chile offset by lower share in Brazil. The GDBs performed well across the region, with volume up by 10.9%. This was driven by the good performance of Pall Mall in Mexico, Lucky Strike in Columbia as well as successful migrations including Free to Kent in Brazil and Viceroy to Rothmans in Argentina.

Western Europe delivered an excellent set of results as economic sentiment in the Eurozone improved to reach the highest level since January 2001. Strong performances in Germany, Spain, Poland and Romania were offset by excise absorption in France and Italy. As a result, revenue grew 0.9% on a constant organic basis and was up 7.6% of current rate, mainly due to the relative weakness of Sterling to the Euro. Volume in the region was up 1.7%, benefiting from M&A. Organic volume was down only 0.8% as growth in Spain, Romania, Portugal, Poland and Hungary was offset by lower volume in Italy and Greece. This significantly outperformed the industry, which we estimate was down more than 2%. Regional share was up 30 basis points driven by the GDBs, which were up 8.9%. This was driven by good performances by Rothmans in Poland, Lucky Strike in Spain as well as successful migrations in Germany and Poland.

Turning now to operating margin. Whilst margin clearly benefitted from the inclusion of Reynolds, I am pleased to say that after two years of reported decline, we've once again returned to operating margin growth. Underlying margin improved by 110 basis points. This was offset by an increase in NGP investment of 70 basis points, leaving adjusted organic operating margin up by 40 basis points, only just outside our target of 50 to 100 basis points per annum. This was driven by ongoing cost savings and efficiencies from the implementation of TaO and OneSAP. It was also after the absorption of a continuing transactional foreign exchange headwind estimated at around 1% of operating profit and after the significant additional investment behind NGP. M&A in Western Europe is diluted from reduced margin by 20 basis points. Finally, the inclusion of five months of Reynolds added 250 basis points to margin, leaving our full year adjusted operating margin at 39.9%.

Although we continue to invest behind the rollout of NGPs and expect 2018 to be a heavy investment year, we remain confident of delivering 50 to 100 basis points of margin improvement on average over the years.

As I said earlier, reported EPS benefited significantly from the accounting treatment of the Reynolds American acquisition. A reconciliation from 2017 reported EPS to both 2016 reported EPS and 2017 adjusted diluted EPS is available in the supplementary slides. As you can see here, adjusted diluted EPS of 284.4p, at current rates was up 15% driven by growth in operating profit, the contribution from Reynolds, good results from ITC and the 5% translational currency tailwind.

Net finance costs were up significantly as a result of financing the Reynolds transaction, however the average cost of debt was marginally lower. We expect net finance cost in 2018 to be around £1.5 billion. Despite good results from ITC, the contribution from associate's decreased due to the inclusion of only seven months of Reynolds. Our expected tax rate was slightly lower in 2016, with 29.7%. Non-controlling interests were marginally higher, as profit growth in Algeria and Vietnam was offset by decline in Malaysia.

I usually give some guidance around the expected full year tax rate. With the full 12 months' inclusion of Reynolds and the reduction in US tax rate, I would expect a tax rate for the group of around 27% in 2018.

On currencies, if rates were to stay where they are today, the translational FX impact including a full year of Reynolds would be a headwind of around 9% on operating profit and a headwind of around 7% on EPS. We will also continue to have a small headwind on transactional FX.

We've always said that we don't believe it is appropriate to strip out transactional FX from constant currency performance, and only adjust the translational FX in our numbers. However, in recent years, the scale and speed of devaluations has generated such a significant headwind, the comparisons of other companies treating transactional FX differently, risked being misleading. As a result, we were forced to quote an estimated impact from transactional currency movements included in our constant currency figures. Now that transactional headwinds has abated to more normal levels, we will no longer be separating it out in our constant currency analysis.

Now on to cash flow. Overall adjusted cash generated from operations was £3,282 million which is 167 million higher than last year. This is mainly due to higher operating profits driven by the contribution from Reynolds, offset by an early MSA payment of \$1.8 billion, £1.4 billion, made by Reynolds in December 2017 as it is deductible at the 35% tax rate.

As a result, operating cash flow conversion was lower than last year at 78.6%. However, excluding this early MSA payment, operating cash flow conversion would have been approximately 96%. Depreciation is the main component of non-cash items excluding the MSA payment, working capital outflows of £93 million was significantly lower than in 2016, which was an outflow of £254 million. Net capital expenditure was £208 million higher than in 2016, largely due to investment in NGP. We expect gross capex in 2018 to be around £1.1 billion.

Net interest paid was higher at £1,004 million, due to the upfront cost relating to financing arrangement at the acquisition of Reynolds. Tax outflows of £1,675 million including approximately £550 million of tax flows relating to the US, together with slightly lower payments in the rest of BAT due to the timing of payments. Higher dividend payments to minorities are attributable to higher profit in Malaysia in 2016. This delivers adjusted cash generated from operations of £3,282 million.

Turning now to financing and shareholder returns. We ended the year with net debt-to-EBITDA at four times on an annualised basis 12 months of Reynolds, as anticipated at the time of the deal. This was 5.3 times on an accounting basis. We continue to target reducing this to around three times by 2019, returning to the upper end of the 1.5x to 2.5x net debt to EBITDA corridor in the medium term. Our target credit rating remains BB+/Baa1 with S&P and Moody's, with the rating currently standing at BBB+/Baa2. The rating is driven by our net debt-to-EBITDA ratio, and we are focused on managing this down.

We continue to target a dividend pay-out ratio of 65%. As part of the transition to quarterly dividends we have kept the pay-out ratio higher than our targets at 69% to equalise cash payments but intend to gradually return to 65% over time. This remains a floor, not a ceiling. In the face of currency translation headwinds we will increase the pay-out ratio through our sterling shareholders receive an increased dividend based on good, constant currency performance as we have done historically.

So, in summary, the business performed very well in 2017. There were a number of one off items relating to the Reynolds acquisition which benefited reported results. Excluding these, constant organic adjusted revenue grew 3%, profits 4% and adjusted diluted EPS 10% exceeding our high single figure earnings growth target. We

continue to outperform the market and have once again grown share, powered by the continued strength of our brand portfolio.

With a 15% increase in the dividend, backed by EPS growth, we have demonstrated our continued commitment to growing shareholder returns over the longer term. Looking into 2018, the pricing environment remains competitive. Volume shipment phasing in certain markets including the GCC and the timing of NGP investments means we expect adjusted profit growth to be skewed to the second half as in previous years. However, we are confident of another good year of constant currency adjusted earnings growth with the benefit of the US tax reform, providing additional support to shareholder returns and helping to fund significantly increased investment in NGP.

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

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

Thank you, Ben. 2017 was a year which changed the shape of the group. We invested heavily into NGPs, with excellent results and our combustible business has continued to perform strongly. And this is expected to continue in 2018. It is an exciting time for BAT and we remain confident in our abilities to continue to deliver high single figure earnings growth in the years to come.

Thank you. I now open up for questions for those of you in the room. Who'd like to start?

We'll need a microphone because the sound system is not working that well. So, if you guys can wait for the microphone to get to you.

QUESTION AND ANSWER

Alberto Lopez – JP Morgan Cazenove - Analyst

thanks, Alberto Lopez from JP Morgan. Couple of questions from my side. First, how should we think about the investments as you're doing this year, beyond 2018? Is that some investment goal off the base as we go into 19, 20? Also, if you can give a bit of details on what exactly are you spending in terms of device discount, is it infrastructure, store rollout, etc. And then also, I was keen to get your views on Japan since you know, THP is doing very well. What would be your views on how big can THP be in the total Japan market this year? And what would you aspire to capture from that share of the segment?

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

That's a question. [inaudible]. So, in terms of investment, beyond for 2018, as we just mentioned, we are going to use part of the US tax reform for additional investment in BAT. So, I expect that in all you have an additional of just in THP space and THP and vaping, mainly THP, another £500 million for 2018. So, it's a huge investment to allow us to rollout to at least 14 markets for THP and several others for vaping in 2018 because we are capacity-constrained as you just mentioned. The breakdown of investment in terms of stores and so on and so forth, I don't have this here, but I can supply this later for you. No problem at all. We don't usually disclose the investment in this kind of detail, but I'm sure that you'll find a way of percentage base to tell you whatever you asked.

In terms of Japan, you know, your question was about Japan, how big the segment is. Well, as you know, the segment is quite substantial in Japan. It's very difficult to predict how it's going to be in one year time. But do I see this growing for 30% of the segment – of the market? Yeah, I see the growing 30% of the market. I cannot

be precise on how long it's going to take. Talking a little about our performance in Japan. You know that you are capacity-constrained. I think that the numbers are showing that despite the capacity-constrained, since the national launch in October, we are supplying one device per store per week, the national base in Japan. And even though we are market share is growing substantially in December it was 3.3. The last reading that you had for the end of January was 4.1. So, it's growing extremely well. And your question is how high is high; because nowadays we have around 20% of the segment, despite the huge constraints that you have in terms of supply and despite the competitions has not been constrained, they are not constrained. I feel like you can make a [inaudible] of Sendai. If you look at Sendai nowadays our market share in Sendai we are one third of the market and we are constrained there as well. In the first six months of our launch in Sendai first half of last year, which we all provided three device per store per week, we got from 0% to 8% in six months. But because of the national launch, the launch in the four prefectures in July, the national launch, we had to scale it back in Sendai. So, we moved from three devices per store per week to one device per store per week. And, of course, our market share growth is low, from 8% to 10% nowadays, still one third of the market. So, I think that gives you an idea how strongly the proposition is. Another factor that I'd like to mention is that as I mentioned early on, I think the expertise and innovation that you have for combustible can be applied for the consumables. We launched four new flavours in December. Two months later the four new flavours, they are 40% of our volume. And the widest range of flavours in the market nowadays is with BAT. But with the constraints that you have in device, it's very difficult to grow even faster than you have grown. But I think that just shows their strength. The other important piece of information, if you take after the national launch in October, 60% of the growth of segment is coming from us despite the device constraints. And net inflow of consumers is higher to our product than the competition's product, inside the THP category. So, it gives you some signals that we are in a very strong position in terms of product, and in terms of device. And I think it is the pipeline that you have it coming this year, you have growth of 2.2 coming in July, when you're being constrained, and probably it's the one we're going to use for the rollout. And we have the mini coming at the end of the year, and we have new flavours coming the second half as well. I think that you'll be in a very strong position to grow this category beyond the numbers that has been estimated. That's why I said despite in October, giving you the target of £1 billion for 2018, I think that it is going to be substantially higher this year. Long answer, but still a long question anyway.

Yes?

Alicia Forrey – Investec – Analyst

Hi, it's Alicia Forrey from Investec. My question is on the EMEA region which was perhaps one of the weaker areas this year. Do you expect the down-trading in Russia, the impact of the excise in GCC foreign exchange headwinds on the COGS in that region to persist again in 2018, i.e. should we see another year of EBIT being under pressure in this region? And then secondly, I was interested to hear a little bit more about the THP launch in Russia, you mentioned it briefly in the presentation. But any additional colour would be appreciated. Thank you.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

Let me start in the EMEA in general. It was a difficult year for 2017 for a lot of different reasons. One of those was for example we saw in Russia excise absorption, a very competitive price environment there. It seems that things are getting better for this year. So, at least for the price environment in Russia, you'll see a much better environment. The second one was a substantial excise increase in the GCC that is very important market for us, not only for BAT, for other players as well, which is, the excise increase in [inaudible] double price and one of the reasons that you have hit [inaudible] last year, because turnover went down dramatically in the second half of last year in the GCC. And I think that probably those are the two main reasons for EMEA being under pressure, and I think that I have to mention as well, the transaction headwinds that we had in Russia last year, that affects the COGS as you mentioned. We don't see transaction headwinds for 2018, the same level of 17.

So, it's going to ease on that side. For BAT as a whole, we think transactions headwinds is going to be 1% only for 2018. Much better position than it was in '17 and even better than '16. And if it's going to be at that range we are not going to report back numbers with and without transaction because BAT doesn't believe that's the right way to report anyway. So, that's the COGS element. But I think that things should be a better environment for '18, for the year but too early to call. So, have to wait a little bit. But it seems the conditions are improving. But don't forget that in the GCC, you are comparing 12 months with the substantial excise increase against six months of the prior year. It's going to affect '18 anyway. Not only for us but for other companies. But I think the environment is better.

Ben Stevens – British American Tobacco p.l.c. – Finance Director

Remember selling prices have to double in the GCC after the excise increase so it's been very disruptive to the market.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

Yeah, the declining revenue in net revenue there was 26%. I think the second half because of the huge excise, the down- trading the market. But, you know, you should never lose focus of a good crisis, our market share is I think that's on 80 to 10 basis points, 80 to 100 basis points higher. We had one of the most important segments GCC is the value for money out of [inaudible] we did extremely well with Pall Mall there. And I think that our market share has increased substantially there. Substantially. So, when the market picks up again, I think that we'll be in a very good position there. So, that's the GCC. Regarding the launch in Russia, it's six weeks. So, it's too early to call. And we are capacity-constrained as well. We have launched at the end of last year in addition of four markets. And all of them, like Romania is three weeks after launch. Russia, six weeks after launch. So, it's too early to call. But the initial reading of the market is that the market is consuming everything that you have in store. One device per week per store, and we are selling everything. So, it's going very well, with extremely limited distribution, because our focus for 2017 has been in Japan. So, we are giving all the supplies that we have for Japan because it's a more developed market. So, the other markets like Korea, like Russia, like Romania, we have very limited supply. That's going to be lifted in the second half of this year. I was discussing this earlier on with some of you. It's going to be in full supply around March and April, but we have to build capacity in order to be able to respond to the market needs. So, around May and June we'll be fully unconstrained. And I think, and that's the reason that we are scheduling all the launches in market at the beginning of the second half of the year, probably third quarter of the year. And then you'll see unconstrained supply in places like Russia, Romania, South Korea, and so on, so forth. Then you have a better reading about the performance of the brand. But if you look at Japan as a proxy, with the numbers that I gave early on, it gives the rationale for the confidence. And that's why I said that we should substantially exceed because it's beyond our expectations and results in Japan. Adam?

Adam Spielman – Citi - Analyst

Hi. Can I ask three questions? First of all, you talk about device-constraints. Just within your tobacco heating sales, what percentage roughly is coming from devices versus the renewables? And related to that, for each sort of consumer you have, how many devices does he or she need to be a glo consumer? So, that would be one question. And there are a couple of follow ups.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

I think the relationship between device and consumers is one to three. In terms of revenue. The percentage of device in our sales – to be honest, can I go back to you at the end of this session and I'll give you the --a more appropriate number? If not, I will give a very wrong number. I will get back to you.

Adam Spielman – Citi – Analyst

Thank you. Moving on to the US. As you look forward, is your priority really operating profit growth or is it market share progression? In other words, would you be happy in 2018 to have flat share but nice growth of profit, or would you, if you have a choice, or would you prefer share growth but no profit growth? If you had to choose between those two?

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

We are in the business of making money, Adam. We are not in the business of making market share or volume. Market share and volume should make money. So, I don't see that you have this choice. It's either go for market share or go for money. We try to have the right brands in the market with the right consumer propositions that you drive our market share, that you drive volume, that you drive money. So, I don't see that you stop and think okay, let's have less market share here to have a little bit more money. That's not a discussion you have inside the company. So, that's not really top of my mind. But I think that what BAT has shown in the last years, and if you look at the combustible business, the business model that we have is to have world new innovations in the markets, and I think that we have done extremely well with our portfolio through that. We have been declining in the last years, much less than the industry, and this year was not different. Driven by the GDBs. The GDBs have grown 600 basis points in six years. It's a fantastic performance. And this has helped us to over-deliver the financial results. So, that's the strategy for the world, that's the strategy for the US. So – I'm very happy with the results of Reynolds last year. They had flat share in the first half, the second half they grew, they have a very good growth in terms of market share. But, you know, you'll be competitive in pricing.

Adam Spielman – Citi – Analyst

And then the final question, if I think about the rest of the world and around, so not the US, not Tobacco Heating Products, in 2015-2016 you had over 5% organic sales growth. This year it was two point something. Which would imply that it's slowed down. And I'm just wandering, do you think that slowdown is temporary, or do you think it's permanent? And if we think out the next few years, we're getting back to the 5%. Again, excluding Tobacco Heating, excluding the US.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

I don't think that you can exclude US yet because you have to make comparisons. I cannot – I don't think that you can exclude THP. THP and combustible, they are categories in which the migration is 100%. So, when you leave the combustible category you go to THP, I don't think that you can exclude that. Then you start saying let's exclude Japan. Or let's exclude Russia, you cannot do that. So, I have to look at both things together, if not their management becomes very, very difficult. Because the migration from one category is 100% to the other category. And at the end of the day, it's tobacco. So, if you look at both categories, because it's how I like to read it, and I think that's the right way to read it is to look at the price mix that the most important thing that we should be discussing here. The price mix of last year was 5.5%. And if you look at the price mix of the last three years on average was 5.6%. Our net was 46 was in the high end of the matter. So, I think the price-mix in 2017 despite everything that I said was solid, was quite good. Of course, there are some concerns, and I heard some concerns, because in 2016 the price mix was a little bit higher than usual with 6.5%, 6.7% and there was a decline for 2017. But then a good rationale for that. As I said before, we had some excise absorption because of competitive environment in places like Italy, France, Russia. We had a substantial excise increase that was not passed surprising 2016 in places like Brazil, Malaysia. And you had the issue that I mentioned all over in places like the GCC. But despite all that, the price mix of 5.5% was at the high end of our metrics, was quite solid. And it was on par with the average of the last three years. And if you take five years, you'll see that was even a little bit higher. So, it's not bad. It's very good.

Adam Spielman – Citi - Analyst

OK. Thank you.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

I have a question down there and then I'll go back to you okay, because he raised before.

Owen Bennett – Jefferies - Analyst

Morning, gents. Owen Bennett, Jefferies. And just a few questions on the SC applications in the US, please. Firstly, are you confident at approval, I think you shared around midyear, issued here? Secondly, can we get any details on commercialisation plans in place? And then thirdly, could you give us any details on capacity you have in place for the carbon tip should it prove popular in the US. Thank you.

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

Well, the carbon tip application, the submission was July 2017. We expect the decision to be half one 2018. Unfortunately, we don't manage this process. FDA manages the process. Our expectation is that half one of this year, you have FDA making the call, I cannot guarantee that. But our expectations is going to be first half one 2018. If at the half one 2018 it is confirmed and we are able to launch this product in the market, it's going to happen in the second half. We have plans for that in the United States, and you don't have capacity problem. So, that's what I can disclose. I cannot disclose the states and things like that, because these are plans that are quite confidential. But we'll be launching before the end of the year in the United States, and we'll be, you won't be capacity-constrained in the case of carbon tip. But as I said, it's all dependent on FDA. It's very difficult for me to tell you what I think is going to happen. And my expectations half one, we'll have this going ahead. I have a question here.

Jon Leinster– Berenberg - Analyst

Hi, Jon Leinster, Berenberg. Actually a few I'm afraid. First of all, I think you mentioned in passing intense competition in South Korea in terms of the heated tobacco market. Was that a reference to Phillip Morris or was that a reference to the new products from KT&G?

Nicandro Durante - British American Tobacco p.l.c. – Chief Executive

The reference for the products from KT&G because the size of the company in that market, they have a lot of trading power in order to put forward propositions. So, I think that's more on the South Korean side than anything else. But the main reason for having 0.7% share in South Korea is initial supply as well. As soon as you have a constrained supply, we think that you have the same success in South Korea that you have in Japan. But I was mentioning a second player – a third player in the category in my comment.

Jon Leinster– Berenberg – Analyst

But the product is a product from KT&G seems credible then.

Nicandro Durante – British American Tobacco p.l.c. - Chief Executive

That I cannot say. I think that you have to ask KT&G. I think that glo has the best product in the market and has the widest range of flavours in the market. I'm extremely happy with the brand, as I said the net inflow of consumers in Japan is positive for glo. So, I'm extremely excited about what we have in the market, and now a new launch is in terms of consumables and device. That's what I can tell you.

Jon Leinster– Berenberg - Analyst

Second, when you launch Raptor and some of the other products in the vaping market, do you expect that to cause a step change in the growth of the vaping market in the way that perhaps JUUL does in the US market?

Nicandro Durante - British American Tobacco p.l.c. - Chief Executive

That's a very good question. The answer is yes. And as I said before, and in October at the Investor Day in October, I think that it is a ground-breaking development. I think that ePen3 and Raptor will be best in class. The initial results of the test market that we are going through in the UK, it's a very small test market, are extremely positive. We think that you don't see this in our numbers because we are playing safe here and still having the product available for launch. But I think that could get very important step in terms of the growth of the category and the growth of our business. So, I'm very optimistic about both products. But one of those, you come at the end of the year, as we said at the Investor Day, we'll do our city launch maybe beginning of second half of next year. That's Raptor but it's not coming to the market before the year end. And ePen3 we are testing now, probably in the beginning of the second half you'll see a launch, maybe an expansion for one of the countries. So, we're taking a little bit more time. It's going according to what we said in October. But the timing that it takes to guarantee that you come to the market with the right products and the right proposition with consumers mind to meet consumer needs. And also, there is an element here of margins. These are going to be products that usually demand higher margins. And I think that from the financial point of view, from the market point of view, I am extremely excited about those developments. And they are going to go through FDA. It's in our plans as soon as we have the final products, they are going to follow the FDA path. So, everything is being mapped.

Jon Leinster– Berenberg - Analyst

And lastly, do you think the health claims or medical claims, do you think that's absolutely key to getting this – to getting heated tobacco – to grow in Europe or indeed in the US or do you think that's a key competitor tool or do you think that's not particularly –

Nicandro Durante - British American Tobacco p.l.c. - Chief Executive

Well we don't have a medical claim in Japan and Korea. I think the markets are growing for a lot of different reasons. As we discussed this several times before, why it grow so fast when you see in other markets in the world not growing as fast, as you know as well, as I know, it was launched in Italy, at the same time that was launched in Japan. Just look at the performance of both markets. There are a lot of reasons why it's growing so fast in Japan and Korea. And I'm not going to go back on that, because we discussed this so many times before. And I think that it's – in some markets can be more important than others, but if you ask me the question, do I think if I had the chance to use this tool, it would be very important. But it's difficult to tell you in a world-wide base. I think in some of the markets it's going to be more important than others.

Can I have one more question before we close the session? If there is one? Yes, one there.

Mirco Badocco – RBC Capital Markets – Analyst

Hi. Mirco Badocco, RBC. So, you mentioned a total community investment in NGPs of \$2.5 billion since 2012. I wanted to know if you can share more, if you can give more colour on how much that was behind heat-not-burn, how much behind vaping and the state of capex in P&L?

Nicandro Durante - British American Tobacco p.l.c. - Chief Executive

We don't disclose this kind of data to give you a breakdown of \$2.5 billion. And I have to say that some of the research that we do works for both categories. In terms of personal, works for both categories. So, it's difficult for you, for us to start splitting this. And so, the laboratory work works for both categories. So, we don't disclose this kind of data.

So, guys, thank you for coming. We look forward to speaking to you in July at our interim results when we will be reporting under our new regional structure. So, thank you very much for coming.

---Conference call ends---