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Interim Results Presentation

Jack Bowles, Chief Executive
Good morning and welcome to BAT's 2020 Interim results presentation. I am Jack Bowles, Chief Executive, and with me today is Tadeu Marroco, Finance Director.

I hope everyone listening this morning and your family and friends are well.

Before I start the presentation, I need to draw your attention to the disclaimer on slide 2 and slide 3, which I will take as read.

I am very proud to report in the first half of 2020 our multi category strategy has continued to deliver growth, in what have been exceptionally challenging circumstances.

These results demonstrate that our strategy is delivering growth in all key metrics, revenue, operating profit, EPS, and cash; driven by growing volume share in THP, value share in Vapour and revenue in Modern Oral, alongside Combustibles and strong pricing.

Our increased agility brought about through Quantum and our diverse geographic footprint has enabled us to adapt and navigate the challenges caused by COVID.

We remain committed to delivering a strong operational performance and our dividend policy.

We are building A Better Tomorrow, with our defining corporate purpose and an ESG strategy that is front and centre of everything we do; we have made strong progress in 2020.

Non-combustibles now make up 10% of Group revenue. We have continued to invest more in the business, attracting an additional 2.7 million consumers in our non-combustible products compared to last year, having added 1.1 million new consumers during the first half, through the peak of the pandemic.

And, we have also set ambitious environmental targets. We are clearly powering forward.

With our focus on our three clear commercial priorities, we are delivering today and investing in the future.

We continue driving a step change in New Category performance, with market share gains and 12.7% adjusted revenue growth at constant currency

Our continued focus on Combustible value growth drove strong cigarette price mix and adjusted revenue up 2.4% at constant currency

The benefits of project Quantum, delivering a stronger, simpler and faster organisation, have enabled us to navigate COVID with increased agility, whilst delivering £240m cost savings year to date.

We have a commitment to deliver. And I would like to take this opportunity to thank you people who have gone above and beyond to deliver these results, despite very challenging circumstances.

Turning now to the numbers. Reported results benefit from the impact of the Quebec class action on the prior year comparator, and reflect a foreign exchange headwind of about 1%.

To better understand the key drivers of our performance, we will now focus on constant currency adjusted results, unless otherwise stated.

We are taking share almost everywhere - in all four of our regions in Combustibles. With growth across all key metrics, we grew revenue, profit, and EPS, despite a 4% revenue headwind from COVID in the first half.

Cigarette and THP volume was down 6.3%, or 5.3% excluding Global Travel Retail this was against an industry down around 6%, excluding GTR. We continue to expect full year global industry volume to be down around 7%, excluding GTR.

Strong cigarette price mix and New Category performance drove total Group revenue up 2.4%.

Adjusted operating profit was up 3.3%, ahead of revenue growth, reflecting tight cost control and the early benefits of project Quantum.

This was a strong performance delivered in challenging circumstances. The 4% revenue headwind from COVID in the first half reflected the impact of reduced international travel on GTR, and contrasting experiences in Developed and Emerging markets.

In Developed markets, which are around 75% of our revenues, consumption trends have generally been resilient or even slightly improved, with good pricing, and to date we have seen little evidence of accelerated down trading.

In Emerging markets, which account for around 25% of revenue, the picture has been more mixed. In some markets we have seen government mandated factory closures and deeper lockdown measures that have significantly impacted consumers' ability to access our products.

Uniquely in South Africa, there has been a ban on cigarette sales since late March, which remains in place.

By contrast, in other markets, such as Brazil, we have seen border closures benefit industry volumes through a reduction in illicit trade.

Despite the pressures from COVID, we have grown volume share across both Developed and Emerging markets.

While New Category growth initially slowed, it is now recovering. In New Categories we responded rapidly to the new environment, leveraging our digital capacity, investing in consumer acquisitions and growing our volume share in THP, value share in Vapour and revenue in Modern Oral. We are making good progress across our three strategic brand platforms.

With 2.7 million growth in consumer numbers, we have increased revenue nearly 13%, despite the challenging environment. We invested an additional £250m in New Categories in the first half.

With our clear focus on consumer acquisition and digital, we are now the leader in device sales in Vapour. We have doubled our e-commerce sales, and we have halved the time we take to go from prototype to launch. This is a strong base for the future.

During the pandemic, we successfully pivoted our consumer activations into digital, achieving best in class consumer engagement readings across all three category brand platforms.

Turning to each category. In Vapour, with consumer numbers now over 6 million, we delivered an excellent performance. The key Vapour markets are growing strongly in the first half, and Vuse Vype is growing value share in every key market.

Adding over 2 million consumers compared to the same period last year, we delivered 39% revenue growth in Vapour. This was driven by an excellent performance from our strategic brand platform Vuse Vype, which tripled total value share across our T5 markets against the same period last year.

The T5 markets represent 80% of total Vapour industry revenue.

In the US, Vuse Alto tripled its value share year on year, driving revenue up 70%. This performance must be seen against the context of industry dynamics over the last 12 months which have not been easy.

In the second half of last year, concerns in the US, specifically around youth vaping trends and the EVALI crisis, resulted in broad based vapour industry decline across our Top 5 markets.

We see stronger recovery, with the majority of markets now back to those pre-crisis levels. Industry growth rates in the last three months have been very encouraging and Vuse Vype has grown value share strongly in every key market.

The brand is now the leader in device sales in all key markets. It is clear that getting devices into the hands of consumers is vital to conversion, and we see this as a lead indicator of our future growth in the category.

Last year, to further strengthen our portfolio we decided to migrate to three global New Category brands. Brand migrations in Vapour have continued during the period, with 70% of Vapour revenue now under the Vuse brand, and Canada is an excellent example.

In Canada, share gains accelerated through the migration of Vype to Vuse. The migration plan was driven through digital channels, generating record levels of consumer awareness, and drew on our many years of successful experience in Combustible brand migrations.

Online sales were up over 50% sequentially in Q2 and our share of device sales reached 70%. Retention rates were 100% over the migration and Vuse reached over 44% share in June.

We are particularly pleased with these results given that the activity was completed under lockdown restrictions in Canada.

Turning now to our performance in THP. In line with our strong innovation plans for THP, and building on the launch of glo pro last year, we have started to rollout Hyper, strengthening our glo portfolio.

We have achieved our highest volume share positions for glo across key markets. This has been driven by the early success of glo Hyper in launch markets and the improved consumer satisfaction it offers.

Launch and activation plans for Hyper were switched to digital, and we are extremely encouraged by early results.

In Q2, Hyper is driving share growth in both Japan and ENA. In Moscow, glo segment share has doubled to 16% and total nicotine share has accelerated to 2.8%. We have started the rollouts in Italy and other markets in ENA.

This has driven good growth in consumable volumes, which were up 9.1%. THP revenue in the period was down 12% due to the excise harmonisation in Japan and the underperformance of glo Sens, our hybrid platform.

glo Hyper's improved product performance comes from several advances that have materially improved consumer satisfaction.

These include, powerful new induction. This provides a fast ramp up time and a boost function, delivering additional satisfaction and impact. And new consumables with 30% more tobacco and a familiar premium king stick format, delivering more taste and flavour.

This has delivered strong consumer acceptance scores, with research showing 80% overall likability in terms of taste satisfaction, flavours and taste intensity.

In Japan, supported by the success of glo Hyper, total glo volume share is now 5.4% in June and reached a June exit volume share of 5.9%, its highest ever level.

37% of Hyper consumers are new to the franchise, and conversion rates, from trial to regular usage, are at 50%, double the previous levels. Both are good indicators for the future growth outlook.

After 12 weeks, Hyper has achieved a June monthly volume share of 0.7%, and reached a weekly exit volume share of 1.3% at the end of June.

In Modern Oral, we are growing revenue in a rapidly growing category, with an exciting future opportunity.

We have strengthened our leadership position in Scandinavia and remain leaders outside the US.

Also, in Emerging markets we are establishing a supply chain and manufacturing for pilot launches in APME and AMSSA, with encouraging initial results, despite COVID.

In the US, it is a nascent but promising category with around 1% Total Nicotine value share, compared to traditional oral at more than 10% Total Nicotine value share.

Year to date, we have grown share in the US, with a limited product range. This is hampering growth in the short term, in what is a highly competitive category.

We are working hard to address the portfolio gaps. This will require us navigating the FDA regulatory framework, which will take some time.

Globally, Modern Oral is an exciting category with high growth, high margins, a rapid payback, and significant potential.

We have a winning portfolio in Scandinavia, and continue to build on our strong market share positions.

While consumer activation for more recent launches has been impacted by COVID, we have a programme of roll outs planned for the second half, building on encouraging pilots in APME and AMSSA.

It is clearly still early days for this exciting category.

In the key Nordic markets, we are consolidating our leadership position with our superior products, reaching 14.7% of the Norwegian, and 4.5% of the Swedish total Oral market in June.

In summary, in New Categories, we are driving growth through consumer acquisition. We continue to invest, with an additional £250m in New Category marketing in the first half.

We have attracted an additional 2.7 million new consumers to our non-combustible products year on year and continued to add to our consumer base throughout the pandemic.

We have adapted to the challenges of COVID, switching to digital activation and generated results, with share gains in Vapour and THP in all regions, and strong revenue growth in Modern Oral.

Moving to Combustibles, we delivered an excellent performance. We are growing volume and value share globally, with share gains in every region.

In the US, we continue to drive revenue growth, delivering strong results.

Global volume share was up 50 basis points, one of our strongest performances ever, and value share was up 20 basis points.

This was driven by a 40 basis points value share gain in strategic brands, which represent two-thirds of Group volume. These share gains and strong price mix of 8.5%, combined to drive Combustible revenue up 2.2%, despite the industry volume decline.

We have a well balanced portfolio of brands across a broad geographic footprint. This has delivered consistent growth across all price segments in the first half.

In some markets, down trading has been a feature in recent years, and this continues. However we have seen acceleration of down trading in the period, and our portfolio is well positioned across all price points.

Our strong differentiated brand portfolio continues to drive share growth across all the key consumer segments, in freshness and stimulation, slimmer formats and in non-full flavours.

Our focus on value growth in Developed markets and volume growth in Emerging markets is also delivering results, with value share up 30 basis points in Developed markets, and volume share up 70 basis points in Emerging.

In the US we have driven revenue, taking pricing ahead of peers, while continuing to grow combustible value and volume share, driven by the strength of our brand portfolio. As a result, adjusted revenue and profit were both up 10%.

Value share was up 30 basis points and volume share grew 10 basis points. Reynolds achieved a corporate volume share of 35%, with Newport at 15% and a continued strong performance from Natural American Spirit, driving premium volume share up by 50 basis points.

The US industry cigarette volume was up 0.8% during the period, driven by stronger consumption trends, a less negative impact of vaping on cigarette consumption, higher inventories at all levels of the supply chain and an extra selling day.
We now expect US industry volume to be down around 2.5% for the full year, driven by the continued resilience of consumer demand and higher trade stock levels being maintained as a result of COVID.

New Category revenue grew 76%, driven by US Vapour value share gains of 10 percentage points. The Vapour category is recovering in the US, growing 20% in the last three months.

Our multi category strategy is delivering strong share growth in Total Nicotine in the US. Total Nicotine value share grew 70 basis points and volume share was up 60 basis points.

Looking ahead to H2, we continue to see robust consumer fundamentals and lockdown restrictions are easing. These results demonstrate our ability to successfully navigate the pandemic, but the environment remains uncertain.

Our Global Travel Retail business remains substantially impacted and we do not anticipate a recovery until late in the year.

In South Africa, cigarettes and reinstated alcohol sales bans are in place. We are challenging the ban and the court hearing, after some delay, is now scheduled for August. We believe we have a strong case.

While COVID related uncertainty is remaining, we are planning for the sequential recovery to continue through the second half.

South Africa remains a unique situation. We had a very strong first quarter, with volume up 10%, driven by a reduction in illicit trade. Since the imposition of the sales ban in March the whole market has shifted into illicit.

In addition, illicit prices have tripled compared to prices prior to lockdown, and created product availability issues around the country. As a result, the government has lost £340m in excise and VAT and we are experiencing an on-going profit impact of £25m per month.

We look forward to the court hearing next month and we are planning for a positive outcome.

So, in summary, our strategy is delivering growth in very difficult times. We remain committed to delivering strong operational results and to our dividend growth policy.

We remain focused on our commercial priorities. We are delivering today and investing in the future, creating a stronger BAT.

Our people have gone above and beyond to deliver these results and I am proud of what we have achieved. I will now hand over to Tadeu, who will take you through the financials.

Tadeu Marroco, Finance Director
Thank you Jack, and good morning everyone.

As Jack highlighted we are proud of our first half performance. We have delivered growth in what have been challenging circumstances.

Our relentless focus on cost has released funds to support our growth agenda and drive good margin expansion.

We are realising the benefits of Quantum, with Phase 1 savings accelerated into the first half.

We are highly cash generative and remain committed to deleveraging, to dividend growth and a 65% payout ratio.

Our strong performance in Combustibles drove revenue growth of 2.4%, despite a 4% COVID headwind in the first half. Combustible volume decline was more than offset by value share gains and good pricing, powered by our global brands.

First half price mix was strong at 8.5%. This reflected the achievement of over 80% of full year planned pricing, and the rollover benefit from good pricing in 2019. This means we will be lapping a strong pricing comparator in the second half.

Industry elasticity and affordability dynamics remain robust, and we have seen little evidence of accelerated down trading to date.

In addition, the rollout of our revenue growth management initiatives enable us to take more targeted pricing, and to manage discounting more effectively, on a data driven basis.

Turning to our regional performance. We have grown value share and volume share in all four regions.

Financial results across the regions reflect their differing exposures to Developed and Emerging markets, with stronger revenue growth in the US and ENA. The results in APME and AMSSA demonstrate the impact of COVID in Emerging markets.

In the US, as Jack has already covered, revenue and profit grew close to 10% driven by value share growth, strong pricing, and better than expected industry volume.

In ENA, total cigarette volume share was up 50 basis points, with value share up 10 basis points, driven by strong performances in Russia, Turkey, Italy and Romania. Volume in Russia has benefitted from trade stock movements in 2019 and 2020, related to the preparation of track and trace implementation.

The EU menthol ban was introduced in mid-May, although its full implementation has been delayed in some markets due to COVID. While it is very early days, results to date have been encouraging.

In key markets our consumer retention rates are currently in excess of 100%. We are growing our share of consumers in the Total Nicotine market. This is driven by cross-category consumer activation, our differentiated Combustibles products and the strength of our new category menthol portfolio.

In APME we continue to gain volume and value share despite the challenging backdrop of COVID, the delayed implementation of minimum pricing laws and tax rises in Indonesia, and increased illicit trade in Pakistan.

In AMSSA, volume share gains and strong pricing resulted in revenues down only 1%. This was an excellent performance given the South African sales ban, and government mandated factory closures and lockdowns in countries including Mexico and Argentina.

This slide highlights the contrasting industry volume performances in Developed and Emerging markets.

In Germany, for example, domestic purchases stepped up as border closures restricted cross-border volume and cut outward tourism, leading to industry volume growth.

In Emerging markets, the picture is more mixed. Deeper lockdown measures have impacted volume in countries like Mexico and Vietnam. In contrast, border closures have reduced illicit trade and increased duty paid volume, in markets like Brazil. While in Russia, consumption has remained relatively resilient.

Moving onto operating margin, we are releasing the funds to support the growth agenda. We delivered margin growth and further increased investment in New Categories, carrying over the step up in New Category support from the second half of last year.

The 80 basis points increase in the first half builds on a strong performance in the prior period, and is despite a 50 basis points impact from transactional FX. This was driven by another excellent performance from the business, which more than offset the incremental costs related to COVID.

Strong pricing, continued cost control and the acceleration of Quantum drove a 400 basis points improvement.

We are realising the benefits of Phase 1 of Quantum. Alongside greater organisational speed and agility, Quantum is delivering significant cost savings. We have accelerated Phase 1 savings, realising £240m in the first half.

Phase 2 will build on this success, with the organisation expected to be ready for project rollouts from the beginning of 2021.

EPS grew strongly and was up 6.6% in constant currency, driven by our good operational performance. Earnings growth also benefitted from a lower underlying tax rate and a strong contribution from associates. Our share of income from associates, mainly ITC, is expected to reflect the impact of COVID in the second half.

We expect a full year underlying tax rate of slightly lower than the previous guidance of 25.5%, as the impact of several one off items in the first half are diluted over the full year.

Extrapolating current spot rates we expect a currency translation headwind of around 2.5% on adjusted EPS growth for the full year.

Cash conversion in the period was strong at 80% or 73% adjusting for the benefits of deferred US tax payments and the impact of COVID related stock builds. This is still materially above the prior year period.

In the first half we further strengthened our liquidity position through bond issuances, the establishment of bilaterals and the renegotiation of our RCF.

Our maturity profile remains very manageable, with an average maturity approaching nine years and close currency matching.

Having repaid £2.3bn in July, we have just £1bn remaining in 2020. In the 2021 financial year we expect to be able to pre-pay a proportion of our 2022 maturities, as we have done in the past.

We remain focused on maximising cash generation and deleveraging the balance sheet.

We expect to deliver at least 90% operating cash conversion, and are on track to end 2021 with adjusted net debt to adjusted EBITDA around 3 times.

We continue to expect gross capex for the year to be around £650m, broadly in line with adjusted depreciation.

Our priorities remain unchanged, to de-lever the balance sheet while maintaining our commitment to dividend growth and our 65% payout ratio.

These results demonstrate our continued resilience. We continue to expect around a 3% COVID headwind on 2020 revenue.

Whilst uncertainties remain for the second half, we are on track to deliver our 2020 guidance of 1 to 3% constant currency revenue and mid-single digit EPS growth.

Overall we are performing well in challenging circumstances. The changes we are making in the business and our continued investment in our brands will enable us to exit this crisis stronger.

And with that I will now hand back to Jack for his closing remarks.

Jack Bowles, Chief Executive
Thank you Tadeu.

Our people have gone above and beyond to deliver these results. Our multi category strategy is delivering revenue, profit and earnings growth in exceptional circumstances.

The strength of our brands across New Categories and Combustibles is driving volume and value share growth across all regions. And we are navigating the environment with agility supported by the diversity of our geographic footprint.

Our three clear commercial priorities have enabled us to make good progress in 2020 and we are building a stronger, simpler, faster organisation.

The strength and resilience of our multi category business is enabling us to deliver today, as shown by these strong results, and invest for the future.

There is strong energy in the business. We are building A Better Tomorrow with a clearly defined purpose to reduce the health impact of our business.

In 2020 we have made good progress against our clearly defined ambitions and we remain committed to our medium term guidance post-COVID.

While we cannot know what the future will hold, I am confident that we will exit this crisis stronger than we entered it.

Thank you. There will be a conference call Q&A held at 8.30 am UK time, where there will be an opportunity to ask questions.

Thank you very much for listening and stay well.

Queston and Answer Conference Call

Operator
Hello and welcome to the BAT 2020 interim results Q&A conference call. All participants will be in a listen only mode during the Q&A session.

If you would like to ask a question please press *1 on your telephone keypads, and please ensure that your lines remain unmuted. I will now hand you over to Jack Bowles, Chief Executive. Thank you.

Jack Bowles, Chief Executive
Good morning everyone, and welcome to BAT's 2020 interim results Q&A session. I'm Jack Bowles, Chief Executive and joining me on the phone is Tadeu Marroco, Finance Director.

As you will have seen from our announcement this morning our multi category strategy continues to deliver revenue, profit and EPS growth in the first half in exceptionally challenging circumstances.

We have continued to invest in our portfolio, the strength of our brands across New Categories and Combustible is growing volume and value share growth in all regions, enabling strong pricing.

In the last 12 months we have attracted 2.7 million additional consumers to our non-combustible portfolio, which now makes up 10% of our Group revenue.

With our diverse geographic footprint and the increased agility brought about through Quantum, we've adapted rapidly and are successful navigating the challenges of COVID.

There is strong energy in the business; we are building A Better Tomorrow, with a clearly defined purpose to reduce the health impact of our business. Together with our three clear commercial priorities this has enabled us to deliver a strong performance in the first half of 2020.

I will now hand over the call for your questions. Operator please may I take the first question.

Operator
The first question in the queue comes from the line of Rey Wium from SBG Securities. Rey, you're now unmuted.

Jack Bowles, Chief Executive
Good morning.

Rey Wium, Analyst, SBG Securities
Hi Jack and Tadeu, thank you for the opportunity to as questions. I just have a question basically around South Africa. I just want to know how does it impact your market share position subsequent to let's say things get sorted out? Because I'm sure obviously it must be destroying brand equity.

And also related to that, these players that are now operating in the market, are they basically - can I call it non-duty paid cigarettes, or are they like probably in Brazil where it's like half or underpaid on duties. So that would be quite interesting just to hear your views on how this is actually impacting your business, because clearly it's not a decent situation?

Jack Bowles, Chief Executive
It's a very complex situation. Yet at the end of the day the governments take their actions related to COVID. What I can tell you because as you know there is a legal case at the moment and I cannot elaborate too much on that but the reality in the market is the following, there is a ban on cigarettes. And there is a renewed ban on alcohol so that's a lot of lost revenue for the government.

At the same time the market has become completely 100% illicit, and the prices have tripled in the market. So you have a situation where the consumers do not access legal products, and even for illegal products the availability of products is a bit patchy.

In that environment as I said we have a legal case and we're preparing, of course, the mother of all returns when the market reopens.

Clearly our brands are extremely strong, as you could see in the Q1 of the year with an extremely strong performance in South Africa. In 2019 also we saw growth in revenue and we saw growth in terms of volume and market share. So our brands I assure you are very strong in South Africa and we'll do the mother of all comebacks as soon as it reopens.

Tadeu do you want to add something?

Rey Wium, Analyst, SBG Securities
Sorry, I also just want to know, I mean just in terms of excise tax, a little bit more in our medium term. Clearly when governments are under pressure, you know, excise tax is normally the first lever that gets pulled. I don't know if you have any indications of where there may be some excise problems down the line? And maybe if you can tell us anything

that you've learned from after the global financial crisis, in terms of what tends to happen with excise taxes?

Jack Bowles, Chief Executive

Thank you very much. I think that in general as we saw in the first quarter, we're extremely good at navigating these kinds of circumstances. As I said the prices at the moment are three times higher than the prices post the lockdown. So there is a lot of space to operate. And as I said we're going to have the mother of all comebacks in South Africa. Our brands are extremely strong and there will be some skirmishes but we'll take care of that.

We have a very strong position in South Africa, we didn't reduce any personnel in the whole company and the whole salesforce is up and running and we'll make sure that we take back our position in South Africa. And I think that it's going to be a very vibrant situation as soon as it reopens.

Tadeu Marroco, Finance Director

Can I just complement this point around the excise? Cigarette taxes are a percentage of government revenue in general it's not as big as people think. But at the end it ranges between 1%, 2%, and in extreme cases it can go up to about 5%. And when you compare the tobacco excise contribution with the government debt as a percentage of the GDP it's quite - not really material.

So I don't think it is an assumption that necessarily we're going to see a lot of excise hikes if supported. But this has side effects like the illicit trade that we all know.

In the case of South Africa in particular they have just passed on the new budget, where they kept all the excise rates for another year. So I just want to put it in perspective.

Telephone Operator

Thank you Rey for your question. The next question is coming from the line of Gaurav Jain, from Barclays. You're now unmuted, please go ahead.

Gaurav Jain, Analyst, Barclays

Good morning Jack, good morning Tadeu, thanks a lot for the opportunity. My first set of questions centres on Japan. So your volumes in THP are down 6, while you know your key competitor their volumes are up 9% and is 20. So I just want to understand whether you are gaining volume share? And also if you could explain why revenues are down, that would be very helpful?

Jack Bowles, Analyst, Chief Executive

Sorry I didn't hear the second part of the question?

Gaurav Jain, Analyst, Barclays

Why are revenues down in Japan on the THP side of things? That would be very helpful.

Jack Bowles, Chief Executive
Yes in Japan as you know it's a bigger market in terms of THP worldwide. And we have glo that is there and has been doing extremely well. Of course glo Sens was not as successful as we expected, but glo Pro was very successful. And on the back of that we've launched glo Hyper which gives us the latest - THP share of glo at 5.9% in Japan and Hyper at 1.3%. So it's a very, very strong performance.

So stock movements yes, but yet the acquisition of consumers is doing extremely well. And we have a very high share in terms of devices so we're in a good situation.

Tadeu do you want to add something?

Tadeu Marroco, Finance Director
Yes I want to remember that in October 2019 we had another step of these THP excise harmonisation that is happening in Japan, when we were having a 10% (?) due to the increased of Japan's consumption tax, that's equivalent to VAT. That moved from 8 to 10%, so for competitive reasons we had to absorb that excise harmonisation. As you know we always keep an eye in terms of relative price in the markets and so on. So that's the major reason why we have these reductions in terms of revenue in Japan.

In the volumes that you are referring to, in November and December of 2019 the volumes were driven by normal end of year load difference and stronger shipments to support their Pro national expansion. If you go back at that time we were launching our induction technology, which is what we call Pro and the device as well as glo Nano. And we had in parallel a much improved consumables that were also being launched.

So basically a new device penetration activities were complimented by higher IMS of consumables at that point in time.

So that's the reason why we see a dip in sales in January this year. Just to give you a flavour, if you compare February to June 2020 with February 2019 our volumes would be up 5.2%, which shows how impressive were our sales in January 2020 because of the dynamics that I just explained.

Gaurav Jain, Analyst, Barclays
That's very, very helpful. My second question is on the E-cigarette PMTA process which is now just a month away and I think you had mentioned once that it can open up almost a 2bn retail sales opportunity for you if I remember correctly. So what is your expectation now with what you have seen in the market in the last few months?

Jack Bowles, Chief Executive
The PMTA in the US is a lengthy process. As you know the date has been moved already in the past and what we said is 1.5bn of contestable space available by the end of 2021. I

mean what we'll have to see is at what speed the FDA will take their decision after the submissions are over.

However, we think we're very well placed with all our submissions and it will take a bit of time. But nonetheless what you see in the US is that the clothed systems are getting traction, and at the same time that the cost of going through a full PMTA for products is quite expensive. So that's why we said that there is a potential contestable space of 1.5bn moving forward.

As you know with our SKUs in the US, and Alto as you saw the performance, we're doing extremely well. Alto has tripled the share in the US year on year. So we're doing extremely well. And we'll continue to bring consumers to these platforms.

Tadeu do you want to add?

Tadeu Marroco, Finance Director
Yes I think they just moved their goalposts now to September so like Jack said we are very well prepared to make also the submissions. We have already submitted 29 SKUs in Vapour and it's a question now to wait for the enforcement to materialise in the market.

Jack Bowles, Chief Executive
So we've tripled our share with Alto in the US so we're doing extremely well. The PMTA takes a little bit more time and that will create a lot of contestable space, and we're growing in that environment.

Gaurav Jain, Analyst, Barclays
That's very helpful, and my last question is on the political environment in the US and these flavour ban bills, especially Bill 793 in California, clearly half of your cigarette portfolio is menthol. So how do you expect - if a flavour ban were to happen in California how would that impact?

Jack Bowles, Chief Executive
It's a very good question, thank you for asking that. I would just like to remind everybody a bit of geography. The US is a lot of states, 50 states and they're all different in terms of price, in terms of excise, in terms of regulations. So I think that we have to separate what happens in one specific location in the US to the total US market.

I think we have a lot already; we have a lot of different situations in terms of pricing, in terms of access to consumers in different states. I must say that these are skirmishes that are not that important and we'll take care of them as we go along.

The most important bit is that we have very strong brands and that we're able to navigate the situations in the different states already, and that we'll continue to do so. So there will be some skirmishes but the overall market in the US is very favourable. There is a lot of progression in terms of our market share, our value share across the different portfolios. And we're in a very strong position.

Tadeu do you want to add?

Tadeu Marroco, Finance Director
I think that you know that we have - Reynolds has filled a litigation challenge on the local flavour bans. While we cannot comment on the specifics of ongoing litigation we believe that some flavour products are important and this helps adult smokers we migrate away from cigarettes. And the flavours we market provide consumers acceptable choice for adult smokers who are really looking for potential less harmful alternative to cigarettes. So I think that should be …… law, and I think that's like Jack said, there are very different dynamics across the states.

Gaurav Jain, Analyst, Barclays
Brilliant, thanks a lot.

Jack Bowles, Chief Executive
Thank you very much.

Operator
Thank you Gaurav. And the next question is coming from the line of Owen Bennett from Jefferies. Owen you're unmuted and may now go ahead.

Jack Bowles, Chief Executive
Hi Owen how are you, I read your notes always with a lot of interest.

Owen Bennett, Analyst, Jefferies
Thank you, some one is at least. Good morning. I just had a quick question on, coming back to PMTAs and Modern Oral. I was just wondering what your plans are around a PMTA for potentially higher nicotine strengths and additional flavours? Given that the gap in your portfolio there and is that something you're looking to address sooner rather than later? Thank you.

Jack Bowles, Chief Executive
Yes I mean in terms of the PMTAs for oral tobacco - so everybody - everything will be submitted at the right time. As you rightly point out as we said in our different communications, we are doing well in 4mg and below and we have a gap in terms of flavour. Just remember that the Modern Oral in the US is 1% of Total Nicotine consumption, compared to 10% nicotine consumption in traditional oral. So it's a small segment at the moment and we're doing well in 4mg and below.

All the PMTAs are lined up and we want to expand our portfolio in higher nicotine levels. And we will communicate with you when we put in place those solutions. It will take a little bit of time but I'm not too concerned about that, we're working hard on the subject and we have a lot of other priorities to take care of in the US. This is a mid-term thing and I promise you that we'll take care of it.

Owen Bennett, Analyst, Jefferies
Okay thanks very much, appreciate it.

Operator
Thank you Owen. And the next question is coming from the line of Nik Oliver from UBS. You are now unmuted and may now go ahead.

Nik Oliver, Analyst, UBS
Hey good morning guys.

Jack Bowles, Chief Executive
Hey, good morning how are you?

Nik Oliver, Analyst, UBS
Good thank you. Just a couple from me. Firstly on the investments in New Categories. Last year I think if I'm right, you invested £500m in H2. And how should we see the £250m investment in H1 in that context? Should we expect a further step up in the second half?

Jack Bowles, Chief Executive
Yes first I mean as you saw through the numbers, I mean we have navigated very well the first half of the year, and we're coming stronger out of the first half of the year.

The second thing is we said last year that with Quantum we have at least £300m available that we want to reinvest in the business. Which we are doing as you saw £250m in the first half of the year in a very challenging environment. But I'm convinced that we have to do the right thing for the business for the mid to long term. And to make sure that we invest with platforms that are working extremely well.

We've seen the traction that we get in the three different platforms, in Modern Oral, in THP, and in E-cigarettes. So we'll continue to invest. The comparators will be different between H1 and H2. But I think that we have to grab the opportunities as they present themselves and to invest where it is important for the business in the mid to long term. Tadeu do you want to add something?

Tadeu Marroco, Finance Director
Yeah I just want to remind them that £500m last year a lot of that we did in the second half of 2019. And so we've been lapping a very strong investment measure now in 2020.

We continue to invest in the first half of 2020 that momentum that we started to have at the end of the last year where we started investing in THP to move into ENA, in places like Russia. Now we are more recently rolling out Hyper in Japan and also in ENA. Within

Vapour we have up scaled our investments in the US and ENA, in order to support our menthol ban strategy. And in Modern Oral we are moving launches to Emerging markets like Pakistan for example.

We are also investing in capabilities in social media listening to the commentary insights and design, data analytics and so on. But you have to have in mind that will be lapping a half year now that was full of investments. So we are not providing any guidance in terms of full year, but that's the only thing you have to have in mind.

Jack Bowles, Analyst, Chief Executive
What's important for me on that one, also to add, thank you Tadeu, to add is the 2.7 million of non-combustible product consumers is more than we've added versus the same period last year, which represents about 30% of our consumers, and that's absolutely massive. So it means that we have a formula that is working in terms of first to consumers, secondly it means that with our MAPS system that we have in place we have extremely good insights on the consumers and working on SWOT.

So it's about the rollout, as Tadeu said, we've done a lot of improvements in terms of digital during the COVID, and we see the results. I mean Vuse is now 26% share holds for T5 markets, which are representing 80% of our local Vapour industry, Alto has tripled share in the US and glo is doing its best market share at 5.9 at the end of June.

glo in Moscow is now at 2.8% of Total Nicotine in June. So we're getting some traction. And we are - we want to make sure that we invest so we do resource allocation every month.

Tadeu and myself are extremely busy on the weekly basis to do the heaviest resource allocation in order to make sure that we continue to grow our New Category business. As I said, we've added 2.7 million of non-combustible product insurance, it's massive.

At the same time, we never let go of Combustibles. We are growing value share, we are growing market share at record levels in the last few years and it is very important for us to get the cash, to get the resources in order to continue to invest.

So we are investing at the right level for Combustible. We're getting the traction, and the pricing environment is good.

Nik Oliver, Analyst, UBS
Okay, great. And then just one final one, also for New Categories.

Jack Bowles, Chief Executive
Sure.

Nik Oliver, Analyst, UBS

I think in the past you said you're making positive operating profits in Vapour in Canada, Modern Oral in Scandinavia and THP in Japan. Are there any changes to that or any other markets you can call out that are kind of positive from a profits perspective?

Jack Bowles, Chief Executive
I think we are in the phase of acquisition of consumers because a few years ago we were a bit on the back foot, and we've accelerated dramatically with much better traction in terms of development of new products. Before we needed 24 months to go from working prototype to launch, now we're at 12 months working prototype to launch and this is going to continue to improve.

I think with the quality of the insights that we have on all four categories, which we were the only ones to advocate, we were the only ones to operate worldwide all these categories at the same time. It is more complex, but we have a lot of insight that allows us to push forward. Tadeu, did you want to add something?

Tadeu Marroco, Finance Director
Yeah, well the only thing I would like to add Nik is, in summarising, is the payback that we had in Modern Oral is quite fast, like I have already said in the past. And all those markets where we have been launched we have been extremely successful in Modern Oral so that we increased our revenue by 7% in the first half of the year. So these are basically always positive territories in a very short period of time.

When it comes Vape and THP it takes longer. When you see our numbers, you just saw our consolidation of all the categories in all the geographies. So I said before that I expected moving forward to the years to come, a lower operating margin drag from the base that we had in 2019. And from 2021 given the encouraging performance that we have seen across all categories and the plans that we have to improve - further improve gross margin, we expect the impact in the P&L to soften and be more actuated year after year.

Nik Oliver, Analyst, UBS
Okay, that's very clear guys. Thanks a lot for your answers.

Jack Bowles, Chief Executive
Thank you very much.

Operator
Thank you, Nik. And the next question is coming from the line of Adam Spielman from Citi. Adam, you're unmuted and may now go ahead.

Jack Bowles, Chief Executive
Hi, Adam. How are you?

Adam Spielman, Analyst, Citi

I'm fine, thank you very much. So thank you for taking the question.

My first question is around up trading or down trading in the US, and I guess more globally.

So there's been a lot of comment that actually we're seeing down trading in the US and yet at the same time your premium brands are doing quite well, which in the US is actually up trading. So I was just wondering whether you can think there's sort of – you think there's a market where there's up trading or down trading?

And then I've got a sort of more general question afterwards about globally.

Jack Bowles, Chief Executive
Yeah sorry, Adam. You know, I'm French so let's start with the French - with the first question. My brain is small. So let's focus first on that one.

The, if I may, the you know, I mean there is a limited number of brands in the US that you have to look at to understand. First you have to always refer to the point that the pricing elasticity in the US is very good, .3, .4.

The second thing is absolute prices in the US are quite low compared to disposable income. And in absolute terms when you have a pack of cigarettes at €10 in Europe, you have a pack of cigarettes of $5 to $6 in the US, $5 to $6.

So I think that there is a strong space for pricing as you've seen in the last two years. And on the back of that some say that there is down trading.

I don't see that down trading in the US. When you compare the big three and the non-big three, you see that the non-big three trend of growth has not changed. They're taking pricing alongside the big three, so the price gaps are not significantly increasing.

And then the second thing is that there has been some de-positioning of SKUs for some competitors that moved 10% of their volume on one brand to a lower price point, whereas at the end of the day with above - up or our premium share going up as you saw in the presentation and our brands being very strong, it demonstrates again what is the definition of marketing. It builds strong brands and makes sure that they have the equity to support a fair price position.

So I think that we're doing extremely well in that environment and I do not see in the US any important size - or signs or accelerated down trading.

In terms of the rest of the world, what you see is for mature markets very little signs - we're going to down trading. It is more if you take Germany for instance, because as I said before, the market - the legal market in Germany because of the closing of the borders to

Eastern Europe, the size of the market that's increased, it was a negative in 2019. It's positive now in 2020 in Germany.

And of course the consumers are looking for alternatives. The consumers that were buying these illicit products they are now buying more, you know, make your own and roll your own at low price points. So it's not down trading, it's just the flux of distribution. And the premium in Developed markets is doing extremely well and the above RRP, so above average price in the market is doing extremely well. Then, so no sign of accelerated down trading. None.

Then you go to Emerging markets. And in Emerging markets it's more a question of availability of products and the lockdowns.

So these are situations where when the markets open, we don't see any acceleration related to that. And then the numbers that you could see here and there are more related to lockdowns or different pieces of distribution.

In some countries CVSs are closed, in some others General Distribution are open. So it all makes sense to me, and that will normalise. So I insist, no down trading.

Remember always in any other FMCG category the price gaps top to bottom are normally two-fold, 400% and more.

In cigarettes you are more around 25% top to bottom. And the consumers do not buy like their toothpaste every month, but they buy cigarettes every day.

So, you don't have - there's a much more resilient environment and as I said the price elasticities are good.

Did I answer your question, Adam?

Adam Spielman, Analyst, Citi
Yes, thank you. And you went a little bit beyond it. But there's one ...

Jack Bowles, Chief Executive
I'm always trying with you to go beyond the question.

Adam Spielman, Analyst, Citi
On Slide 29 of the presentation pack, I'm quite intrigued because there it says, in EM your volume share was up 70% but your value share was flat. I don't really understand that.

Jack Bowles, Chief Executive
Yes. Tadeu, do you want to take that one? It's more related to the availability of some products and the lockdown of some markets. But Tadeu, so maybe you can take that one.

Tadeu Marroco, Finance Director
Yes, you are referring to our different share positions in Developed and Emerging markets? Adam?

Adam Spielman, Analyst, Citi
Yes, I can hear you.

Tadeu Marroco, Finance Director
Yes, yes. Hi, Adam. You are referring to the - some different positions in terms of our share in Developed and Emerging markets, no?

Adam Spielman, Analyst, Citi
Yes. But particularly in Emerging markets, your volume share is up, and your value share isn't. That implies ...

Tadeu Marroco, Finance Director
Yeah. But that's the dynamic that Jack was referring to. A lot of those Developed markets where you have people for example in a daily you know, salary basis and you have lockdowns and the level of switch that normally happens to be around 10% in those markets went to 20%. And they change brands either for economic reasons, but also because they don't - they can't find their brands and they eventually will buy brands that is more lower end of the market.

It's not a consistent down trading movement, but it's just because of the circumstances that they are living in. And we have been tracking things on a monthly basis, and if we can see this value changing substantially when you move away from lockdowns and when we get into lockdowns. I think that's why you've seen - this chart is a reflection of some of these movements. That's what it's contributed to.

Adam Spielman, Analyst, Citi
Okay, thank you very much. And then can I ask a question about the rollout of glo Hyper?

Clearly the reviews are good. You say that you're going to full distribution in many markets. And I - the question is what difference will that make? Do you see a sort of discontinuity, a positive - a stepped change in volume for glo Hyper? And can you give us any sense of your capacity for it in you know, the second half of this year and looking into 2021 and beyond?

Jack Bowles, Chief Executive
Yeah. I mean, Adam, you know me, I go step by step. You know, we've made the make the proof of the concept in Japan. We're having now 1.3 share points after a limited number of weeks, less than two months.

Normally as you know in Japan, you have three weeks of excitement at the beginning and then it dips like it does. And a very encouraging sign in Japan is that we continue to grow.

Very clearly on one of the charts of the presentation we say why? Because the product is having overall a satisfaction that has grown. The format is better. There's 30% more tobacco in there and we're actually good in terms of everything related to the flavours. So we have success there. We'll have to see how it continues and how it starts.

It's a very competitive market in Japan. It's the most competitive market. This market - it represents more than half of the total volume of THP. And we see that when we do either market research or pilots or limited launches like in Russia for instance, in Moscow we have 2.8% in June, and it is a great majority on Hyper.

So we will do the rollout and we will do it step by step in order to make sure that we have the traction that we do have product in terms of - sorry do we have issues in terms of manufacturing? The answer is no.

But I want to go step by step in order to take the learnings as we go along to increase the efficiency of our market in retail.

I want to make sure that we learn as we go along. I think that we have a very good product, induction heating plus a boost button, a better format in terms of - which was one of the problems that we had. A better format in terms of the dimension of the consumable and we'll continue to push through.

We have very good insight. It's extremely promising and we'll take it step by step.

Adam Spielman, Analyst, Citi
Is there any, you know, if you were an analyst what sort of volume numbers would you be putting in for 2021 in your model?

Jack Bowles, Chief Executive
Well I mean the sad news is I'm not an analyst.

[Laughter]

You guys, you know, remember I'm a limited French farmer so my brain doesn't work that well. So we have to make sure that we understand that, what are the different parts of the puzzle. As I said in terms of manufacturing, no issue. In terms of insights, very positive. In terms of overall acceptance, competitiveness and conversion rates, very high and very competitive, let's put it this way. And we have something that works very well. Now we have to do the rollout. We have to build the brands; we have to look at the specificities.

Remember always that MAPS chart that I shared with all of you at the Investor Day recently. It's very important to know and to look at the consumer satisfaction index also that was in Paul Lageweg's presentation during the Investor Day, yeah? Markets where THP can be more successful than others.

If you look at the US for instance, very clearly there is no traction on THP as we speak. And there is a lot of traction in terms of E-cigarettes and Oral and Modern Oral. So I think it will depend on geographies.

Well we know when we want to launch and we have just to be cognisant of the fact that in some markets the category, THP, is having some breaks in terms of taxation level that are maybe potentially not so significant on the mid to long term. So then having products that are sold far below the price of cigarettes in some - mostly some countries of Europe you know, you really have to have satisfaction of the consumer base, very strong.

So we will navigate all this and make sure that we have the right understanding. We have a winning product. I will launch it fast but there is a difference between rush and speed. I will go for speed rather than rush, but we'll do it.

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

Jack Bowles, Chief Executive
Thank you, Adam. Stay safe.

Operator
Thank you, Adam, for your question. And the next question is coming from the line of Michael Lavery from Piper Sandler. Michael, you're unmuted and may now go ahead.

Jack Bowles, Chief Executive
Hi Michael, how are you?

Michael Lavery, Analyst, Piper Jaffray
Thanks. Good morning. Yeah, thanks. How are you?

Jack Bowles, Chief Executive
Very good.

Michael Lavery, Analyst, Piper Jaffray
I'm sorry if I missed this before but I just wanted to see if you could give us some updates on the disputes with Florida, Texas and Minnesota on the KOOL, Winston and Salem and Maverick brands. And I just - I guess the two or three questions would be, I know Florida's appeals court has found you liable for about 100 million and ongoing payments related to that.

So first would just be is there an appeal process still to go there? Is that final? What are any next steps? And then next would just be what's the read through for any of the other States that are in similar discussions?

Jack Bowles, Chief Executive
Mike, I mean ...

Tadeu Marroco, Finance Director
Jack, sorry. Maybe I'll start with this one if you don't mind?

Yeah. No, this is the recent case that came up yesterday. And as you can imagine, Mike, we cannot comment on that.

The only - for litigation that is going on, the only thing that we can say that we are not expecting any type of short-term resolution. This will probably come through 2021. But other than that we cannot mention or make comments about that.

Michael Lavery, Analyst, Piper Jaffray
Can you at least confirm that you then of course have some more appeal steps to take it sounds like?

Tadeu Marroco, Finance Director
Well like I said, I think that this will carry on until 2021.

Michael Lavery, Analyst, Piper Jaffray
And would that apply for Texas and Minnesota as well?

Tadeu Marroco, Finance Director
Well yes. The whole three, yeah.

Michael Lavery, Analyst, Piper Jaffray
Okay. All right, thank you very much.

Jack Bowles, Chief Executive
Thank you very much. We - I mean we take all these legal cases seriously. I guess at the end the day they are limited, and we have to make sure that we take the right time and the right approach.

It will take time as Tadeu has said. It will take time.

Michael Lavery, Analyst, Piper Jaffray
Okay, understood. Thank you very much.

Operator

Thank you, Michael. The next question is coming from the line of Jon Leinster from Societe Generale. Jon, you're unmuted and may now go ahead.

Jon Leinster, Analyst, Societe Generale
Right, good morning. Thank you.

Jack Bowles, Chief Executive
Good morning.

Jon Leinster, Analyst, Societe Generale
Yeah, morning. A couple of things please. I think in the recorded presentation you mentioned that the early signs in Europe in terms of the switchover from menthol were going quite well.

I was just wondering if you could flesh that out? Because I mean obviously there's been some delays in some of the implementations, in particular whether Poland has ...

Jack Bowles, Chief Executive
Are you referring to the menthol ban?

Jon Leinster, Societe Generale
That's right.

Jack Bowles, Chief Executive
Okay, yes.

Jon Leinster, Analyst, Societe Generale
And there's obviously been some delays in implementation. I was wondering, in particular in Poland, has it actually been implemented? And can you flesh-out the comments as I think you were making some comments about cross-category switching and so on and so forth as to what we've seen in Europe with that please?

Jack Bowles, Chief Executive
Yes. Yes, as we know, I mean a menthol ban, I mean it's not the first time that it happens. You have some examples in Canada and in other places.

What happens normally is that you have a very good retention in terms of our consumers. Why? Because - on Combustibles. Why? Because the consumers are smoker first, then they are smoking a brand, then they are smoking menthol and in that order. So normally the retention is very good.

The only signs, as you said, it has been delayed in terms of implementation, in terms of controls. And I think what is important to see is that for the first elements that we get out of this, we will have a better read towards the end of the year in order to you know, the dust to have settled a bit is that the retention rate is very high.

And then also in Europe very clearly E-cigarette is the number one in terms of number of consumers in Europe, far beyond any of the other categories. And there is good switching when consumers want to continue with menthol.

And it goes to E-cigarettes and we're very strong in E-cigarettes. We're the leaders in Europe in E-cigarettes. And so we're having a positive level in terms of our consumer retention.

So early signs are extremely good. Every country, Poland and others. But we'll have to see and wait a little bit for a few months to go through.

I think that between Combustibles, as I said, smokers are smokers first then it's about the brand and then it is about nicotine and flavour.

So I think that what is important is to see that there is no revolution. It was the same in Canada; it was the same in the other places of course. And I think that this is something that we're able to navigate very well.

Jon Leinster, Analyst, Societe Generale
Okay, thank you. Secondly I think again, you on - there was some possibility of legislating in Russia; obviously the Modern Oral segment was effectively banned for a time. Is that correct? Is there a likelihood that Russia will illegalise it?

Jack Bowles, Chief Executive
Yeah. But you know, we're a very responsible Company, and it starts there. And we have the experience of some players in the US on E-cigarettes that were going too far in terms of consumer activation, that were going too young in terms of consumer reach and that were, you know, doing too much in terms of digital. That has created a lot of problems.

My approach is always the same, if I may, and very consequent and consistent with the past, which is we want to have a level playing field in terms of our commercial activities. And we want to have regulations that put the protection of the consumer first.

When we saw at the end of last year in Russia that there were some small players that were putting levels of nicotine in their pouches that were more than ten times more anything that you can think of. We went ourselves to the government and said that there is a need for a new regulatory framework in Russia we needed to model on. And if it could not be done on the short-term that ban of sales should be the right way to go, which has happened.

Now it takes a bit of time to have a regulatory framework that is put in place because I want that category not to be built on sand, I want that category to be built on a framework and a foundation that allows us to play to our muscles, which is quality of the brands, products stewardship and quality of the products in an environment that is sustainable.

And I think that was the right approach that we took there. And when the new regulatory framework will be defined then we'll go full blast because we know from the first months where we were in the market before it was banned, and then we are doing extremely well, like all the other countries where we went to with Modern Oral.

I think that Modern Oral has a lot of traction, because remember the consumer movements are always set-up and before for cigarettes you had around 20 consumer moments, now around 5 for Combustibles, so there are 15 to be recaptured by other forms of products for the consumers, and I think that there is a lot of opportunities.

But I prefer to play it step by step and to have a long-term sustainability of the business rather than a crisis with more players that are putting some product definitions that are not in the purpose of our company, which is to reduce the health impact of our portfolio moving forwards.

Did I answer your question?

Jon Leinster, Analyst, Societe Generale
Well yeah, I guess really, I guess in Russia therefore you're saying that you don't the ban to continue indefinitely, you do expect it to become - to be removed at some point?

Jack Bowles, Chief Executive
Yeah, yeah, absolutely.

Jon Leinster, Analyst, Societe Generale
Okay.

Jack Bowles, Chief Executive
It is about finding the time and the development of the new regulation in Russia, and then we'll go on from that.

We know that the products work over there. We've been successful as I've said in the months when we launched. There is appetite for this category in Russia.

Jon Leinster, Analyst, Societe Generale
Okay and lastly if I may, a more general question?

Jack Bowles, Chief Executive
Sure.

Jon Leinster, Analyst, Societe Generale
The price mix comparative of, I think you've said yourself, becomes quite difficult, more difficult in the second half. And I know that there's been some industry comment about prices being delayed, perhaps unsurprisingly given the COVID situation. Should we

therefore see quite a big drop-off in the sort of price mix that we've seen in the very strong sort of first half?

Jack Bowles, Chief Executive
You know, I mean all our competitors are different in terms of geographies and things like that.

What I can tell you is that in the US we start with, you've seen a very, very strong pricing environment and you've seen that also in 2019. And you've seen that the market size in the US is fairing not too badly in the first half of the year.

So the pricing elasticity in a lot of places is at the .3, .4 in the mature markets, which represent 75% of our revenue worldwide. I think there is still some space for pricing. And I think that to comments were maybe related more to specific countries and specific geographies, we don't see major pricing.

We have had a lot of pricing in H2 last year, so the comparator will be high, but yet the pricing environment is strong.

There are some things in Indonesia where the minimum price is delayed. But Indonesia you know, when you know Indonesia what you know is when there is an excise increase at the beginning of the year the price is passed on through the year, and you're going to a neutral point by the half year, and then on top of that. So it's very progressive in Indonesia.

And then after that there are minimum prices and things like that. It's very impactful in Indonesia, so the market has gone down dramatically. But that's more in one place. In all the other places we are seeing the pricing environment is strong.

Tadeu, do you want to add something?

Tadeu Marroco, Finance Director
Yeah, well the reason why we highlighted the second half is just to put in perspective. We have our guidance out there for this year to grow revenue between 1 to 3. This takes this into consideration, like Jack said; the pricing environment is still very strong. There are some outliers for the disruption like you said, but it's nowhere near the majority.

We - and more important we had 84% of our price that we expect for the year undertaken. So I think that everything is already in our assumptions.

Jon Leinster, Analyst, Societe Generale
Okay, great. Thank you very much.

Jack Bowles, Chief Executive
Thank you very much.

Operator
Thank you Jon. And the next question is coming from the line of Nico Von Stackelberg from Liberum. You're unmuted and may now go ahead.

Nico Von Stackelberg, Analyst, Liberum
Hi, morning guys, I hope you're all well.

Jack Bowles, Chief Executive
Good morning.

Nico Von Stackelberg, Analyst, Liberum
I just want to ask a quick question on the cash performance, it was a good one, but there was some deferral of excise and corporate tax payments in the US. Do you know roughly when that's expected to reverse?

And I guess related to that the cash flow conversion was strong and you're continuing to expect that cash conversion above 90%, what gives you that confidence for the full year?

Jack Bowles, Chief Executive
Tadeu is very confident on that.

Tadeu Marroco, Finance Director
Yes, Hi Nick. Look, yes we had this boost from the deferral of tax. If you take our conversion on the excise that was deferred in the US, around 800m, we also had to cope with very high levels of inventory due to security stock inventories as a consequence of COVID, adding up 400m pressure in our working capital. If you strip this out the conversion would be around 71, which is still ahead of last year, which is just a demonstration and the discipline we are taking in terms of the cash flow.

So we expect to reverse 95% of this cash in Q3, so we'll be all done in the second half of 2020. But given the focus that we have seen in managing cash for some time now I'm quite confident that we can deliver the 90 plus conversion.

Nico Von Stackelberg, Analyst, Liberum
All right, great. And a quick question on South Africa really, it's a bit of a, I'm sure, a known unknown, but what are you factoring into the guidance and maybe just the fact that is a known unknown kind of explains the range at the end of the day? Is that fair, I'm sure curious what's factored in there.

Jack Bowles, Chief Executive
Yeah it's a known unknown yes; it's a known unknown so we have the legal case that is in there. As I said we have prepared the mother of all comebacks in South Africa. The prices are three times higher before COVID, so there is a lot of space to operate and we'll make sure that we take all the benefits.

Now I don't want to give too many, you know, inputs on that one because we have a legal case. It took us some time to get the court hearing, now we have it and we'll take it from there. Also as booze, or alcohol sorry …

Nico Von Stackelberg, Analyst, Liberum
Okay, yeah that's right. And going back to Adam's question -

[All talking together]

Jack Bowles, Chief Executive
Sorry?

Nico Von Stackelberg, Analyst, Liberum
Can I go back to Adam's question; his question I think was a bit more on global, but can we zero in on the US a little bit just so I understand better. I think that figure - industry volumes were up 80bps. Your volumes were down …

Jack Bowles, Chief Executive
Sorry, I was just finishing on the previous question I didn't hear, you jumped the gun a bit there, I didn't hear your question, can you repeat your question**?**

Nico Von Stackelberg, Analyst, Liberum
Yeah, sure, sorry about that I didn't mean to interrupt.

The question is on cigarette industry volumes in the US, the industry volumes were up 80 bps, your volumes were down 20 bps, and yet you say you gained volume share of 10 bps, is this just an issue of coverage?

Jack Bowles, Chief Executive
Tadeu.

Tadeu Marroco, Finance Director
Yeah there is movement in inventories here, there always are in the US, you cannot take this literally. The important thing is that the market is performing better than we first thought, that's why we moved from 4 to 2.5, there are still some uncertainties out there for the second half of the year. You know the in the first half we had additional stock build by retailers and consumers, which is pretty much a one off, independent of reversing or not in the second half we don't believe that will, but it's a one off that will not repeat in the second half.

We had the dilution of the extra trading days we had in the half one throughout the year as well. And still there are some uncertainties out there in terms of consumer reaction to the recent second price increase, given the economic background, the consumer purchasing power dynamics in terms of levels of unemployment, vis-à-vis the consummation of fiscal stimulus.

The COVID dynamic itself in terms of easing of lockdowns, so there is still some uncertainties, that is why we are expecting a second half worse than what the first half was. But this direct correlation between our volumes and the market volumes, again it's always tricky because of some inventory movement at the end of the periods.

Nico Von Stackelberg, Analyst, Liberum
Okay, one final quick question. You know the alcohol industry has been pretty clever in terms of setting up industry regulators to govern advertising policy, you know the experience in the US with ICOUS (?) and certainly this experience in Russia with Modern Oral, I'm just curious, why hasn't the tobacco industry decided to establish regulatory bodies that effectively monitor and help control responsible advertising, because it's been quite a net benefit to the alcohol industry and it seems like the tobacco industry could benefit as well?

Jack Bowles, Chief Executive
Yeah, I mean it's a question that is more related to the fact of having marketing codes and we have very strong marketing codes in BAT. Now some others do or don't have. The way that we do our business with the marketing code that we have, that we review on a regular basis, is to be on the right side of the fence, always, and to make sure that we have the possibility to have a sustainable, short term, medium term and long term business.

Other industries might do it differently, but the reality is you know you have a lot of small players in the industry; you have a lot of small players. We always forget that in the US you might have maybe 200 different tobacco companies in the US. And we are always speaking about the big three and they're not big three, but the reality is there are more than 200 companies. And I do not feel that there is a possibility to bring all these people together. It's extremely fragmented. So we have as a leading company in the business, we have a very strong and a very robust market code and that has allowed us to be responsible in the way we do our business moving forward.

Nico Von Stackelberg, Analyst, Liberum
Okay, thank you guys I appreciate it and I think I might have mis-spoken actually, I meant Juul in the US (?) [All talking together] - thank you ….

Telephone Operator
Thank you Nico for your question. and the next question is coming from the line of Sanath Sudarsan, from Morgan Stanley. You are unmuted and may now go ahead.

Jack Bowles, Chief Executive
Hi how are you?

Sanath Sudarsan, Analyst, Morgan Stanley

I'm good, how are you? How's Tadeu? I hope all are well. I have two questions on the US if I may please. The first one - I'd just like to kind of peel the onion maybe on the US volume growth number which has been very strong. Of course at the start of the year had Tobacco 21 any thoughts about how that might impact the overall volumes. And the COVID struck, you probably have more income - or discretionary income now with consumers.

But if you kind of think about overall smoking prevalence rates or per user rates, or maybe consumers migrating away from vaping back into cigarettes, how do you see all these moving variables and the impact of Tobacco 21 along with that? Just so that we get a frame of reference for how to think about it for 2021 maybe?

Jack Bowles, Chief Executive
Yeah, yeah, so as I said in terms of the situation in the US - you have Modern Oral, that is around 1%; you have Traditional Oral, that is around 10%; you have E-cigarettes, that is very close to that now, that 10%; and the rest is Combustible.

What we've seen is there was a slowdown in New Categories, well THP - sorry I forgot THP, but it's so small that it's after six or nine months - there is more time to wait, these categories take a very long time to establish themselves, it's normal.

So in terms of the movements that we see, we see that there was a crisis in Q3, Q4 related to E-cigarettes which is the bigger one and that has recovered quite nicely. So it has grown by 20%, so that's good - so it's coming back to the right levels. We are taking stronger positions in this category.

What I think is important is that there is also a more - I would say big company approach related to that, why because consumers are going into closed systems, which is extremely interesting for products that were cheap once and also for efficiencies in terms of the business.

So as we've said, Alto has tripled its share in the US year on year. I think that overall trends will continue in terms of E-cigarettes recovering in the next periods. And you will have the same situation that you have at the moment in terms of that slowdown that has happened in terms of transfer from combustibles to New Categories and it will take some time for the trend to re-emerge strongly again.

So I think that the Combustibles in the last six months, Tadeu was referring to that earlier, has benefitted from less intake from E-cigarettes, the E-cigarettes have started to grow again. So all this will go in the right direction.

But I think that on the mid-term to long term you will have the continuous of migration from Combustible to the other categories. But I would say at a reasonable pace. And all this will bring some stronger foundations and also the PMTAs will help to great contestable space in New Categories because we still have a lot of space to conquer in terms of New Categories in the US and there is a lot of potential that is already there. So we're not speaking about things that might become - or people that might become users of these categories, they are already there.

There is a lot of space and that's why we say that for companies like us, for us especially with the strength that we have in our portfolio in the US in non-combustibles there is 1.5bn contestable space for the next two years, so that's just massive. But we needed to build these strong foundations, which we did in the last 18 months.

Okay and the regulatory framework is getting more you know predictable because you know Mr Gottlieb has been very active in Tweeting, but in reality in the two years that he was there nothing has changed. It's something that is extremely important to consider that you know there have been some flavours and things that have happened, but in fairness it has been more benign and better than what was expected by most.

Tadeu, do you want to add something?

Tadeu Marroco, Finance Director
I think that more important is looking to the Total Nicotine size in the US moving forwards. As you said there is a defined - predefined reduction in FMC that will happen due to the reasons that you just highlighted. But there will be movements throughout the other categories and you have to see the US market - holistically in terms of size of nicotine. And this one we expect to grow over time.

Sanath Sudarsan, Analyst, Morgan Stanley
And on that if I may, I'd just like to extend on that question. You've shared nicely with the slide with the split of the US nicotine market, how much do you expect this to kind of evolve and how do you expect this to evolve let's say in that ten year time frame you have posted for recruiting 50 million new consumers, or 50 million NCB consumers, how do you expect the US market to evolve with Modern Oral, Vaping and Combustibles and how many of the new consumers do you expect you'll probably get from the US?

Jack Bowles, Chief Executive
Of course we are doing planning, but this is to be recalibrated as we go along. What we know is that the closed systems in E-cigarette which is the biggest category, the closed systems in E-cigarettes are growing quite strongly in the market. But to put some numbers ten years down the road would be totally premature. I think that we're doing well in the current environment, we have grown substantial share recently and we'll continue to do so step by step.

Sanath Sudarsan, Analyst, Morgan Stanley
Thank you very much.

Operator

Thank you Sanath for your question. and the next question is coming from the line of Alicia Forry from Investment. Alicia you're unmuted and may now go ahead.

Jack Bowles, Chief Executive
Hello Alicia. Hello.

Sorry, if there was a question I didn't hear the question.

Alicia Forry, Analyst, Investec
Okay, can you hear me now?

Jack Bowles, Chief Executive
Yes, better.

Alicia Forry, Analyst, Investec
Okay, so Modern Oral in the US clearly outperforming Heated Tobacco and they are both fairly new categories to that market. What do you think is behind that outperformance in Modern Oral, especially considering that Heated Tobacco is a closer approximation of the smoking experience, what can you tell us about why consumers are moving to Modern Oral more quickly then they are to Heated Tobacco?

And then my second question is on …

Jack Bowles, Chief Executive
Maybe we should stop there and then you ask your second question after.

Alicia Forry, Analyst, Investec
Sure, no problem.

Jack Bowles, Chief Executive
On THP, you know we look at all the different categories and we look at the facts. And in the US it has not been a tremendous success up to now. It's a long term play, for sure, and as we have said many times in terms of the satisfaction index you always have to refer to the situation whereby a cigarette in Japan is around 3mg and a cigarette in the US is around 15, 16mg. So it's very difficult when you heat tobacco to have the same satisfaction as when we burn tobacco, okay. So there is a gap there.

Also you have Modern Oral, that is also on the back of a tradition that is already existing in the US, so Traditional Oral that represents 10% of the market, so there is a bit more traction related to Modern Oral. But we'll have to see in time what happens really, because at the moment it is a category that is interesting of course for the long term, don't get me wrong. But at the moment it is most acquisition of distribution from the different players. It is a rollout and it is a small category that is 1% of Total Nicotine usage. So you have to take a bit of time.

It makes sense in terms of having the possibility, referring to the consumer moments that I was speaking about before, that if you bring for instance the kids to school in the morning you're not going to smoke, you're not going to vape, or you're not going to use THP in the car, so Modern Oral is a solution for these kinds of moments.

But let's take it step by step, for the time being the strong acceleration is related to the expansion of distribution and availability through the market. Then we'll have to take it from there. You have difference in different markets, or between states, that are just absolutely massive. So the whole dust will have to settle a bit, the portfolios will have to go through PMTAs in order to be validated and then we'll take it from there.

As a category, worldwide, I think that Modern Oral has traction, especially in Emerging markets, because in those markets very seldom the consumers can afford a device, like a THP device, or like an E-cigarette device, they are very expensive for them. So it's a very good alternative of a more acceptable product in terms of the consumers.

So we'll have to see but you know we are doing some pilot tests in different markets, in Emerging markets and the first results are quite encouraging. So we'll take it step by step, okay. Tadeu, do you want to add something on that one?

Tadeu Marroco, Finance Director
No I think that's right - I think that the THP is based with satisfaction the issue like Jack was explaining and the Modern Oral, the source of business, 40% comes from moist, it's loose, so it's not a surprise you're seeing when you have a Traditional Oral market already established, which is exactly the case that we saw in Sweden, in Nordics, that you're going to have, you know a 10% ish of the segment coming from Modern Oral because it's a more modern way of using the product. And there is another future percentage coming from other categories, FMC, vapes and others. So it's a different dynamic from THP.

Alicia Forry, Analyst, Investec
Thank you. My second question is on the Emerging markets, you've previously noted that many of them are under pressure from COVID which has impacted logistics and how consumers can move about in some of those markets.

My question is how have you seen trends evolve perhaps in some of your larger Emerging markets that were under pressure since these various countries have emerged from lockdown. Has there been a big rush of pent up demand, or has the recovery been more gradual?

Jack Bowles, Chief Executive
I think it's a very broad question, but let me try to have a go at it. I mean if you take Brazil because you are speaking about important markets for us. I mean Brazil was in a situation of illicit beyond 50%, with the reduction of illicit volume by 6, 7% on a yearly basis and sometimes even more.

We have a very strong portfolio in Brazil, but because of the lockdown you have the borders that are locked. Because the borders are locked then the illicit that is coming mostly from Paraguay has been reduced quite considerably, you have army on one side of the border and army on the other side of the border.

So what we've done is we've activated on Rothmans some additional SKUs in order to capture these consumers that were not having the possibility to buy illicit cigarettes. Because when we bring them back to the portfolio then we start to bring them back to the family if I may say so.

So what we've seen is that market - the legal market in Brazil has grown by 7% since the beginning of the year, that's absolutely massive. And our market share has gone up. We have the best portfolio by far in Brazil with a presence in all the different price points. And we're benefitting from all this.

So I think that what you have to consider in a market like that that has benefited. Then Mexico is another one that is very important and you might have seen that we've grown share very, very strongly in Mexico. Why? Because we were able to have the right products in the right places available to the consumers better than the competition.

So we moved around a lot of products. And as I said upfront, I mean we spent more than 90m on the first half of the year in terms of logistics and moving products around in order to make sure that we delivered the products to the distribution and that we deliver the products to the consumers.

But in some situations you know there's just lockdown, if you take Pakistan for instance, there is more problems in terms of availability. Tadeu, do you want to add on that?

Tadeu Marroco, Finance Director
Yeah it's more on the availability side, if you go to Vietnam it's very social the consumption of cigarettes, when you have lockdowns in places, like HoReCa for example, it just reduced substantially, or when you are in curfews and you are not able to go out and buy it and find your products. That's the dynamic; it's very different from other places like Jack was referring to where you have illicit reducing as a consequence of border closures.

So we have a mixed picture there, overall it's negative, that's why it's a drag. But we expect that as the lockdowns start easing the situation comes back in a favourable way.

Jack Bowles, Chief Executive
Okay, hello?

Alicia Forry, Analyst, Investec
Thank you.

Jack Bowles, Chief Executive
Ah, sorry I thought that the line went dead. That's the beauty of this connectivity, but also the problem. So sorry, did I miss one of your questions?

Alicia Forry, Analyst, Investec
No I think that was it, maybe if we have time for just one last one? You talk about distribution changing a bit in New Categories, clearly - in mature markets, clearly some of the Vape shops haven't been open and also their products in the US they haven't been able to sell all of them, while the flavours have been banned. So do you think that these channel shifts are likely to persist post the crisis, has the marketplace in mature markets changed?

Jack Bowles, Chief Executive
It's a good question; you know I mean there has already been the trend in the last periods that consumers go now more to general trade shops in order to buy their products. And the Vape shops have seen the impact of general trade having more sales now and also closed systems are having more sales now, so this specialised side of these shops is a different situation than it was even a year ago.

I think that it's good that it goes to general trade because then we can flex our muscles in terms of distribution because we have already very strong positions with these different channels. So that helps the evolution of the market.

Operator
Thank you. That was the last question in the queue and I will now hand it back over to Jack Bowles to close today's call.

Jack Bowles, Chief Executive
Well thank you very much. A lot of questions - thank you very much for your interest.

In conclusion, these are strong results delivered in challenging circumstances. Our people have gone above and beyond to deliver them and I'm proud of what we have achieved. In the first half of 2020 we have made good progress, our priorities are clear. We remain committed on our dividend policy and medium term guidance post-COVID.

Whilst the global pandemic creates uncertainty in the near term, we continue to adapt and invest in our business. I am therefore confident that we will exit this crisis stronger than we entered it. We are building a stronger, simpler, faster BAT and thank you very much for listening and stay well. Thank you very much.

Operator
Thank you for joining today's call, you may now disconnect your handsets. Host, please stay connected.

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