



British American Tobacco Half-yearly Results 2012  
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## PRESENTATION

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

I'm Nicandro Durante, Chief Executive of British American Tobacco, and with me this morning is Finance Director, Ben Stevens.

This morning, we'll be taking you through the half yearly results. Due to the Olympics and certain disruptions to travel, we are changing the format to the previous years. We'll be doing our Q&A via conference call following the presentation, when there will be the opportunity for you to ask questions.

And now the headlines. I'm glad to report that we have delivered a good set of numbers against a difficult backdrop of global economic uncertainties, contracting markets, a tough comparison, given the one-off benefit seen from Japan last year, and significant currency headwinds.

On a reported level, volumes, profit, and margin were all up, with the exception of revenue, which was flat. However, the real story is in the constant organic numbers, which show the underlying performance of the business. Organic volumes were down 0.6%, and if we strip out the Japan benefit, they would have grown slightly, up 0.1%.

Constant organic revenue was up 4%, and profit up 6%. GDBs continued to perform well, up 4%, with growth in all four brands. Again, excluding the Japan benefit they would have grown nearly 6%.

The decline in industry volumes continues to moderate and, on an underlying basis, volumes were down between 1% and 1.5%. Excluding the impact of Japan, the Group's cigarette market share in its top 40 markets is essentially flat, compared to the full year 2011, and is showing a growing trend in 2012. We continue to grow our share in premium.

Adjusted EPS rose 7% to 102.4p but, in constant terms, would have grown 10%. And the Board declared an interim dividend per share of 42.2p, up 11%. As is usual, the interim dividend has been set at one-third of last year's total dividend.

Let's now look at the brands. As I said, all four GDBs contributed to a good overall volume growth, up 4.4% at 112 billion at the half-year. This growth was driven by the successful geographic rollout of our main innovation platforms, in particular, the capsule market, where we have global leadership with a 52% share. In total, innovations were up an impressive 26%, and GDBs now represents one-third of Group's volume.

Also, we have a number of other international brands which, together with the GDBs, account for 53% of Group volumes. In total, international brands were up 3% in the half-year.

Looking at the brands individually; Dunhill volumes were up 3%, despite the share loss following the price increase last year in South Korea. Excluding South Korea, Dunhill was up 11% with gains in Malaysia, Indonesia, Romania, South Africa, Nigeria and the GCC as the brand continue to benefit from the rollout of innovations.

Kent volumes were 2% ahead as volume growth in Russia, Ukraine and Switzerland more than offset declines in Chile and Uzbekistan and the tough comparator from Japan. Excluding the one-off in Japan, the brand was up 7%.

Lucky Strike produced another excellent performance, up 19%, driven by France, Germany, Spain and Argentina. Lucky Strike is now the fastest growing brand in Western Europe. Capsules are driving the share and volume gains.

Pall Mall was up 3% with strong growth in Pakistan, Russia and Romania, and gains in Germany and Canada. These more than offset the decline in Spain, Italy and Chile.

Looking at the volume and constant revenue on an organic basis in more detail, volumes were down 0.6% and revenue was up more than 4%, implying continued good pricing mix of around 5%. Higher volumes were recorded in a number of top 40 markets, including Pakistan, Vietnam, Canada, Chile, France, Switzerland, Ukraine, South Africa and the Middle East. Volumes and revenue in Asia Pacific were flat against the strong prior year comparator, but were up nearly 3% and 5% excluding the Japan one-off.

In the Americas, organic volumes were down 2%, principally due to the marked volume declines in Brazil and Mexico, partially offset by growth in Canada and Chile. Organic revenue was up 2%. Western Europe volumes were down 4%, mainly due to market contractions in Italy and Spain. However, the strong pricing in the region led to a 3% improvement in organic revenue.

EEMEA volumes were 2% ahead, with increases in the Middle East, South Africa and Ukraine. These, together with strong pricing and product mix, resulted in an impressive 13% increase in revenue. At constant rate, each of the regions contributed to the Group's 6% growth in organic operating profit.

Adjusted for Japan one-off sales, AsPac profit at constant rates would have been up 10%. The strong performance in Japan, Malaysia, Pakistan and Vietnam, together with cost savings initiatives across the regions, contributed to the profit improvement. Profit in Americas was up 3%, mainly due to the growth in Brazil and Chile, partially offset by a lower contribution from Mexico. This was more than offset by adverse currency movements resulting in a 2% drop in profit at current rates.

In Western Europe, despite the volume contraction caused by the economic turmoil, profit increased 2%. This was driven by good performance in Germany, Switzerland, Denmark, UK, France and Romania, partially offset by Italy and Greece. Despite an instability in some EEMEA markets, the region delivered an excellent 15% growth in profit at constant rates, mainly due to strong performances in Russia, Turkey, the GCC and South Africa.

Turning now to the regions in more detail, starting with Asia Pacific. Japan volumes were down, following the significant one-off sales benefit last year. Share remains above 12%; that's more than 1 percentage point over December 2010 exit share. Excluding the one-off effect, profit grew strongly during the period. In Australia, profit was up as a result of favorable exchange rates, while the impact of lower volumes partially offset by cost savings and higher pricing.

In Indonesia, following the change in excise structure and consequent price increases, we delisted a number of our tail brands. These, coupled with higher costs, [has] resulted in lower volumes and profit. In Malaysia we grew share, profit and volumes, and strengthened our leadership position, mainly through the continued strong performance on Dunhill.

In South Korea, profit was in line with last year as a major competitor failed to increase prices. And in Vietnam, volume and share grew, driven by Kent and State Express 555. Higher pricing and volumes resulted in good profit growth.

Now to the Americas. In Brazil, the market contracted following the recent excise-led price increase. However, GDP performance improved market share. Higher prices, and an improved product mix, resulted in good profit growth. In Canada, industry volumes increased as a result of more moderate price and excise increases, and stable illicit trades. Market share was flat with good performances from du Maurier and Pall Mall. We remain leaders in both the premium and below premium segments.

Despite higher volume and lower costs, profits were down due to the continued down trading. In Mexico, following the sharp excise-led price increase in 2011, illicit trade has more than doubled over the last year and is now 15% of the market. Industry volumes declined substantially, but the market share was essentially flat against the full year. In Colombia, an increase in organic volumes, and savings for an integration of Protobaco improved profits.

In Western Europe, despite a tough economic environment, overall market share was up, with growth in the majority of the markets. This was mainly driven by the good performance of GDBs, which were flat in a declining market.

Lucky Strike is doing particularly well. Fine Cut volumes grew strongly, up 7%, and share rose significantly versus the same period last year. Pall Mall is, by far, the largest Fine Cut brand in Europe.

In Germany, volumes were stable and share grew in a declining market. Profit increased strongly as a result of higher margins and lower costs. In France, a rising market share led to higher volumes. Coupled with improved margins, this resulted in good profit growth.

In Italy, the market contract and our volumes declined as a result of the economic downturn. Market share was lower compared to last year, following declines in the tail brands. Dunhill and Lucky Strike performed well. Despite an improved mix, price increase and cost savings, profit was lower.

In Spain, profit was up, driven by stabilization of the price environment and the continued growth of Lucky Strike. In Romania, Dunhill and Pall Mall contributed to an increase in profit, volumes and market share.

And finally, EEMEA. Volumes in Russia were in line with last year and, compared to the full year, market share improved. Kent volumes were up 5%, driving increase in our premium share to 50%, further strengthening our leadership position in the segment. Price increases, coupled with an improved product mix, resulted in a strong profit growth.

In Ukraine, higher market share led to volume growth. The improvement in the product mix was offset by competitive pricing activities in the lower end of the markets. This together with increased market investments, resulted in a lower profit.

Constant profit was higher in South Africa, this following favorable pricing and increased volumes. Despite an increase in illicit trade, Dunhill and Peter Stuyvesant both posted strong performance.

In the GCC markets, good performance by Dunhill and Rothmans led to an increase in volumes and share. Higher volumes, improved margins, and cost savings resulted in strong profit growth.

In Turkey, profit was up, helped by cost savings and higher margins, and the excise-driven price increase taken last year. Volumes and market share declined mainly as a result of competitor price activities and volume losses on tail brands. However, successful Government enforcement has seen a reduction in the levels of illicit trades.

This brings us to the end of the regional review. I will now hand over to Ben.

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

Thank you, Nicandro, and good morning, everyone. As you know, currency headwinds during the first half impacted revenue by 4%, and adjusted profit by 3%. The impact on EPS was also 3%.

While we cannot predict exchange rates, many of our key currencies remain weak against sterling. So if we translate the first half results at current spot rates, EPS would be reduced by a further 2%.

As you're all aware, our target is to improve our operating margin by 50 to 100 basis points each year. The 1 percentage point improvement in the first half means we're on target to deliver at the upper end of the range this year.

All regions contributed to this growth. It was pleasing to see margin growth in Western Europe, despite the extremely challenging operating environment, and the additional costs associated with low ignition propensity cigarette paper regulation, which was not a factor in the first half of the prior year.

I'd like to point out that operating margin is usually flattered than the first half by the timing of marketing investment. Nonetheless, we remain confident that we'll deliver at the upper end of the target for the full year.

Turning now to the income statement. Adjusted profit from operations grew 3%, to £2,839 million. Of constant currencies, growth was 6%. This reflects our continuing focus on cost management, so that we achieve good flow through from our revenue growth.

Restructuring costs were marginally higher than in the first six months of 2011. The main items were further costs associated with factory rationalizations in Australia, Germany and Argentina, Columbia integration costs, and costs associated with other restructuring initiatives, including to beginning to roll out the new operating model.

Unadjusted profit from operations grew 2%, to £2,740 million. I'll cover net finance costs on the next slide.

Despite the weakness in the Indian rupee, associates were 5% higher at £344 million. For the purposes of the adjusted earnings per share calculation, the adjusted contribution from associates is £32 million, or 10% higher, at £347 million.

The adjusted contribution from Reynolds American was 9% higher, at £219 million, and at constant rates the increase was 7%.

Once again, ITC has performed extremely well, with its adjusted contribution increasing by 12%, to £122 million. At constant rates, the growth was a very impressive 27%.

Profit before tax was 3% higher, at £2.9 billion.

Net finance costs were down 9%, or £22 million, on the same period last year. The main driver was fair value changes on derivatives, although, as you will see, both interest payable and investment income were favorable, versus the same period last year.

Our underlying tax rate was marginally below the 31% guidance for the six months, and is below the rate for the same period last year. This reduction is primarily due to the geographic mix of profits across the Group, and I'd anticipate a similar rate for the full year.

Profit for the period rose 4%, to £2,086 million, and the non-controlling interest charge rose 15% to £157 million.

The number of shares in issue reduced, due to our continuing share buyback program, and this contributed to an adjusted earnings per share of 102.4p, an increase of 7%, or 10% at constant currencies.

The main driver of adjusted earnings per share growth was operating profit, which was up 6%. As flagged at the time of our 2011 full year results presentation, we are now facing a currency headwind, and exchange rates had a 3% adverse impact on performance.

Strong performances by associates, together with the taxation, finance costs and share buyback elements that I've already addressed, all contributed to the 7% growth in earnings per share.

Moving on to cash flow, operating cash flow dropped by £485 million. This reduction is driven by two factors. Firstly, the timing of working capital movements between the first and second half of the year, and I expect this to partially unwind by year end. And secondly, higher capital expenditure as we fund our innovation strategy and the One SAP build.

Net interest and tax paid are lower, primarily due to one-off payments relating to tax cases in 2011, which do not recur. Although the timing of tax payments in different jurisdictions is also a factor.

The main driver of the higher income from associates is the Reynolds share buyback program.

Overall free cash flow is £721 million, which is below the same period last year, and as I mentioned earlier I expect this reduction to unwind before year end.

Dividends paid increased by £103 million, and outflows due to the share buyback program are higher than last year as the program increased to £1.25 billion for the current year.

Net investment activities relate to a small increase in our shareholding in the business in Bangladesh.

All this resulted in a net outflow of £1.65 billion for the period.

And finally, net debt, which has increased by £1.5 billion since year end but is very much in line with the same period last year.

That's the end of the presentation, and I'll hand back to Nicandro for the Q&A session.

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

Thank you, Ben. In summary, the underlying business continues to perform well, despite the global economic uncertainty, and the adverse impact of exchange rates.

Our growth strategy continues to deliver. Constant organic revenue growth of 4% reflects moderating volume declines, good GDB performance and continued good pricing momentum. The productivity element of our strategy is delivering, as evidenced by the continuing improvement in operating margin.

Excluding the benefit of Japan, constant organic profit would have been up 8%. At 102.4p, EPS is up 7%. Excluding the currency impact, it would have grown 10%. These results are at the upper end of our strategic metrics.

Thank you for watching this webcast. We will very shortly start with your questions. Before asking your question, please do not forget to state your name and firm. Thank you.

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**QUESTION AND ANSWER**

**Operator**

Thank you. (Operator Instructions). David Hayes, Nomura.

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**David Hayes - *Nomura - Analyst***

Three from me, if I can? Just firstly on Brazil, obviously it looks like, with the Americas volumes, that the volume's holding up pretty well there, I just wondered whether you can be a little bit more detailed on what you're seeing in terms of down trading and the illicit trade control at minimum price points, and then competitor reactions to the price increase that you took back in April?

Secondly, on Indonesia, can you just be a little bit more specific, or just remind us maybe, of when the delisting started of the local brands? I'm just trying to get a feel for when that lapse, whether that started early in the first half, or whether that was more recent.

And then finally, just a bit more broadly, you probably saw one of your competitors a couple of weeks ago or so was talking in quite a lot of detail about their development of the reduced harm next generation products, which they're saying they're going to be commercially launching in the next two to three years.

I just wondered whether you can give us an update on where BAT are with that side of the research and development, and then whether you'll be confident of having similar kind of progress in that timeframe. Thanks very much.

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

Well, David, let me start with Brazil. In terms of Brazil, we had the change in excise structure in May, this year. We went for a price increase, and it was followed by the competition.

In terms of one of the outcomes of this new structure, this change in excise structure, as I said in the full year, was the introduction of minimum price. And the volume that goes through the formal trades, it looks like that the competition is abiding by the minimum price, so it's a good sign that things are moving in the right direction. Because usually when you take a price increase of above 20%, that was the case, it was around 21%, you have a surge in illicit trades, and you haven't seen this happening in the last couple of months in Brazil. That's a god signal that it's working. So that's the first point.

So numbers in Brazil, I cannot be very specific about Brazil, because they are publishing the results in one week or so, but it looks good.

In terms of Indonesia, we had the change in excise legislation, and we had to lift the price of our low price brand portfolio, and it took [advantage] to delist some of the brands, so at the beginning of this year. But the good news in Indonesia is that part of this loss was offset by some new brand introductions, such as Dunhill Mild Kretek, that is the most successful launch of international brand Indonesia.

The brand was launched at the end of March, in a very good price position, and the brand has been growing. It's very early days, but in three months it has reached already 0.5% market share Indonesia. So this is good news.

But in terms of delists, and raising prices of the local brands. Raising the price of local brands has started at the end of last year, the leasing started this year.

Going for the third question about reduced harm products, well, let me tell you, our work in this area is very well known. We have been actively investigating opportunities of development reduced harm of our products for some time.

And we set up Nicoventures to investigate technology in this area, and as you know, we talk about this, about the full year. We are making good progress.

But personally, I would prefer to wait for something tangible before making any ambitious predictions, so we have to wait and see. But there are a lot of work being done in this area. We work in Southampton in our R&D, with research on the measurement of development of cigarette toxicants.

We work to investigate the potential for reduced toxicant smokeless products, and the work as I said, tobacco, nicotine products, there are a lot of work in this area. But I am not in a position to make any predictions of launches, because it has to have approval of the health organizations in the countries. So there is a long way to go. But we are quite well advanced in this area as well.

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**David Hayes - Nomura - Analyst**

Okay, that's great. Thank you very much; thank you.

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**Operator**

Erik Bloomquist, Berenberg Bank.

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**Erik Bloomquist - Berenberg Bank - Analyst**

Could you just discuss what drove the approximate £450 million negative working capital swing? You talked about it in broad terms, but is it really primarily driven by the SAP preparation? Because it seems like on a year comparable, six month basis, it seems unlikely that will reverse. So if you could talk about that in more detail?

And then secondly, it sounded like, from the interview this morning, that BAT is not particularly optimistic on the outlook for the plain packaging challenge in Australia. Could you update us on that, and also what you're seeing with respect to the WTO challenge, and the UK consultation on plain packaging? Thank you.

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

Okay, good morning Erik, it's Ben here. The increase in working capital is primarily excise-related stock movements. So we've got the introduction of pictorial health warnings in the GCC, so we've built stock for that, and some of that also went into trade debtors.

And also, we've got a price increase in Russia, in the middle half of this year, which normally happens at the start of the year. So those are the two major changes on working capital, and for those reasons, we expect them to reverse in the full year results.

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

Regarding plain packaging, we are waiting for the outcome of the court case of Australia and, as you are aware, there is a consultation in the UK that has been postponed one month, for up to August 10. As expected, we are submitting our views to the Government on that one.

Let me be clear, BAT is not against regulation. We're just in favor of regulation that's evidence base, and that we think will meet public health goals. So I don't see that plain packaging falls in this category, and BAT will be challenging any legislation in this area, whenever they appear.

Regarding WTO, well, we're waiting for the outcomes. There are some countries that have challenged this regulation, at the WTO arena, and we are waiting for the outcomes of that.

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**Erik Bloomquist - Berenberg Bank - Analyst**

Thank you.

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**Operator**

Jon Fell, Deutsche Bank.

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**Jon Fell - Deutsche Bank Research - Analyst**

A couple of things. First of all, Ben, I think you mentioned in your Cantos interview that you'd be expecting CapEx to go up a little bit over the next few years, partly SAP. But I was interested to see, as well, that you need more machinery to back up the innovation effort.

Can you talk a bit more about why that's necessary? I had an impression that innovation was something that you're already putting a lot of resource behind, so I was slightly surprised to see that you need to ramp that up still further.

My second question was on the Philippines; can you just update us where we've got to with the potential changes in the excise regime there?

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

Yes, two of the reasons, as I said in the Cantos interview, CapEx, the whole of the SAP program will obviously push CapEx up. So I've guided people towards an ongoing CapEx level for the next couple of years, gross CapEx this is, of around £700 million.

Innovation will result in marketing spend being transferred into CapEx, so I was really just trying to highlight the fact that some of the marketing spend that was traditionally in operating profit does move into CapEx, simply because we do, as we roll out very significant innovations, need to spend money on machinery.

And obviously, we've got a lot of very significant innovations in the top drawer. At the moment, we're currently rolling out the innovations we have around the world, because we believe that we've got to take the benefit of innovations we've got before we actually move on.

But there's more innovations to come, and with those innovations will come some increases in CapEx.

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

In the case of Philippines, as you are aware, there is a proposal from the Philippines Government to change the regulation on excise. And this change of regulation has a lot of components.

One is a huge increase in excise level, and one of the components is to create a level playing field in Philippines that you don't have today.

We are supporting this change of regulation there. It has been approved in the Lower House. Now it's going for a vote in the Upper House, and we are waiting for the outcomes. But we are supporting the Bill, because it just allow us to play in Philippines with the same tools of the competition. So we're very supportive of the potential change of the legislation in excise.

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**Jon Fell - Deutsche Bank Research - Analyst**

Do you know when the vote in the Upper House is going to be?

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

I think that, as far as I'm aware, I can be more precise with you later, but as far as I'm aware, the vote should come before the end of this year. We are expecting at the beginning of quarter 4, but I can be more precise than that after the conference call.

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**Jon Fell - Deutsche Bank Research - Analyst**

Thanks very much.

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**Operator**

Rogério Fujimori, Credit Suisse.

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**Rogério Fujimori - Credit Suisse - Analyst**

I think you referred to, in your opening remarks about global drive brands and your international brands accounting for about 53% of Group volumes. I was wondering if you could talk a little bit about the actions that is taken to improve your competitive position, or the actions taken regarding the tail brands, particularly in markets like Turkey, Italy. I think you're already addressed Indonesia, but any color on the tail brands would be appreciated. Thank you.

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

Rogério, Just as you said, the GDBs now is at one-third of our volume, and international brands plus GDBs are 53% of our volume, which doesn't mean that we don't support some of our local brands. There are larger number of local brands that are very important for our portfolio, and then we support those brands.

They are fundamental in places like Canada, like Brazil, or Turkey, and so on, so forth. But there are some of the brands in the tail brands that we don't support them. And we try to migrated these, not a normal migration, but we expect that there is cannibalization of these brands for the global drive brands and international brands. So there are an element of local brands that we are very supportive with.

In terms of what's going on in the market, it's market by market. And when you look at Indonesia for example, we thought that some of the local brands, they are not strong enough to remain in the market, with the change in legislation. So we decided to move for brands like Dunhill; that's part of our strategy.

And in Turkey, we keep supporting some of the local brands, such as Tekel 2000, because we think that there is some equity in the brand. So it's market by market, Rogério.

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**Rogério Fujimori - Credit Suisse - Analyst**

Thank you, Nicandro. I just have one quick question to Ben, on, you mentioned about margin expansion in the full year, close to the upper end of the targeted range. I was just wondering if you could please talk about marketing spending as a percentage of sales for the full year? Do you still plan for the same level versus last year?

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

Yes, in terms of operating margin, we always have a higher operating margin in the first half than we do in the second half, because marketing spend tends to be skewed towards the second half of the year.

We're continuing to invest in marketing, so you'll see marketing spend as a very normal trend in 2012.

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**Rogério Fujimori - Credit Suisse - Analyst**



So similar to last year?

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

Well, we spend more in marketing each year, as the business grows.

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**Rogério Fujimori - Credit Suisse - Analyst**

No, I mean as a percentage of sales.

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

Yes, there's nothing unusual happening in marketing spend.

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**Rogério Fujimori - Credit Suisse - Analyst**

Okay, thank you.

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**Operator**

James Bushnell, Exane BNP Paribas.

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**James Bushnell - Exane BNP Paribas - Analyst**

Two questions, please. You've spoken, or at least spoken in the release about the various moving parts in the Americas division. You obviously can't talk too much about Brazil or the minorities growth which suggests it's been reasonably strong. Could you perhaps talk about how you see those moving parts developing over the remainder of the year, and whether you'd expect better like-for-like profit growth in H2 than you had in H1, in the Americas? That's my first question.

And on my second question, you're also mentioning a more positive development in South Africa, which seems to be an improvement in, at least on last year's trends. How do you see things playing out there over the next year or so? Thanks very much.

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

Okay, just on Americas, we had, in Mexico, an excise gain last year, so the Americas profit is depressed by that. The underlying growth in Americas, excluding that, is about 9%. So I think the performance from Americas, for the full year, will certainly be stronger than the half year.

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

Regarding South Africa, yes, illicit trade has grown in South Africa. If you look at the first half of this year, against the same period of last year, it has grown 4.5 points. In spite of that, because of the economy, in terms of disposable income in the country, unemployment and GDP growth, overall volume in South Africa is up.

Industry volume, we predicted that was going to be around 4% up this year, against 2011. And our volumes are up as well. We have a very good position in South Africa, maintaining our very strong position in term market share. Peter Stuyvesant, and Dunhill especially, are doing extremely well in premium, and has been driven the volume share and profit growth.

But the main issue that we have there is the growth of illicit trade, and I see this as an issue, but I see it as an opportunity as well. If the Government enforces legislation and bring it down, we have a huge opportunity there. We are playing nowadays in 80%, 72%, 73% of the market.

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**James Bushnell - Exane BNP Paribas - Analyst**

Okay, great. Thank you very much.

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**Operator**

Chris Wickham, Oriel Securities.

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**Chris Wickham - Oriel Securities - Analyst**

One, I was wondering if you could perhaps give us a bit more detail on your performance in the Middle East, or GCC?

And the second thing is, just going back to the comments and with your reply to Erik, and talking about science-led regulation, which you mentioned on the interview. I was just wondering, when you're talking about science-led, how realistic that is, given where we are, or whether you saw any opportunity if we were moving in that direction, to actually see some reverses in some of the things which haven't really had that kind of impact on volumes? I'm thinking particularly about display bands, which are more ubiquitous and, obviously, any plain packaging so far.

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

Talking a little bit about the Middle East, we had a very, very good performance in the Middle East in the first half of this year. And you take our position in places like Saudi. Dunhill's performance has been fantastic, the growth of market share behind Dunhill. And our growth in the Middle East, mainly Saudi, that's the main market in the Middle East, has been fantastic.

The downside of the Middle East is that you still have some countries that are going through some issues in terms of political instability. But overall, the performance in the Middle East is very, very strong. We have been growing volume share and profit for the last, at least, four to five years. It's very strong.

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

Remembering also that there was a stock build in the Middle East as well, ahead of the pictorial health warnings. But underlying performance is still very, very strong.

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

Yes. If you take the underlying performance, forgetting a little bit the stock build, as Ben just highlighted, the performance is very strong; growing share, volume of profit.

Talk about science-led regulation that we have highlighted several times, which is our mantra. The reality that, if you look at what's going on around the United States with the FDA, and the kind of legislation that is under discussion, it's pretty much -- we hope that the signal is that it's pretty much science-led. And I think that is a good development for the industry.

That's something that, every time that you engage with regulators, we try to get the message through. So it's very difficult to be precise with you how is going to be the development come in one, two, three or four years. But I think that, with the leadership of FDA in this area and the way that things are moving, I think that we are moving in the right direction.

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**Chris Wickham - Oriel Securities - Analyst**

And do you think there's any scope then to see any regulation reverse, if that is set at the standard?

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

I find it difficult, but it's very difficult to predict how what's going to happen the next 5, 10 years. But I find it difficult.

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**Chris Wickham - Oriel Securities - Analyst**

Okay. Thanks.

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**Operator**

(Operator Instructions). Adam Spielman, Citi.

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**Adam Spielman - Citi - Analyst**

Two questions. First of all, as far as I can tell from the press release, organic profit in Australia and Canada was flat or slightly down. And I believe it was also that was the same case in the second half of last year. So I'm wondering when we can expect to see profit growth in those countries, or whether you feel that the combination of high prices and increasing illicit in Australia actually means to say that profit has probably got about as far as it can go in real inflation adjusted terms? So that's one question.

The next question, you've alluded a couple of times to the SAP rollout. And my understanding is that it's going to be implemented first in Malaysia in September. But I was wondering if there was more detail you could give on this about how you think it's progressing and how fast you intend to roll it out, and really, any color you can give? Thank you.

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

Okay. Profits in Australia were up, in terms of currency, but essentially flat in constant currency terms. And that's really the development of ultra-low price segment in Australia; there's been a lot of discounting there over the last year or two.

In terms of SAP rollout, yes, what you do with SAP is, firstly, you define your standard processes; you build the organization structure you want. Then you put SAP onto the back of those processes. So all of that's been done.

And now, we're actually putting the very first instance of SAP into Malaysia. So we've tested it there; very good news in the tests, in the sense that the pilot model worked very, very well. A number of changes we have to make to the business in Malaysia to standardize it, the new VAT standards. So that's going in, in quarter 3 of this year. And then after that, we'll carry on the rollout, probably with Australasia next.

At the same time that we're doing Malaysia, we're also doing our central treasury functions in the in-house cash modules of SAP. So it's quite a big September for us in terms of the first actual implementation of SAP. And assuming that those are successful, then we'll carry on rolling it out around the world.

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**Adam Spielman - Citi - Analyst**

Fine. Just coming back to the question on Australia and Canada. When would it be reasonable to expect profit to start growing in those two markets? Should we assume that the worst is over and we can get back to the previous trends we've seen, or would you expect discount to continue, basically preventing growth in those two markets?

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

Adam, Nicandro speaking. I think it's very difficult to predict the next year in terms of profit delivery for those two markets, but I'm optimistic. And if we look at Canada, let's start from Canada, and we had some -- as you'll remember, in the last two conference calls that we had, we were discussing the overall share decline in Canada. And the good news coming from Canada is that, if you look at the first half of this year against the second half of last year, so six months against six months period, the share has gone up strongly.

So the market's coming back, and we have very good developments with our brands and premium brands. We have the leadership in the premium segment and below premium. We had, this year, a more favorable excise environment. And because of the more favorable excise environment, we have lower price increases, so the profit that was essentially flat, slightly down.

But I think that's a huge improvement for what we have seen the last two years. So if this improvement continues, I expect Canada doing much better in the coming year, also.

Regarding Australia, as Ben just highlighted, we have the development of this low price segment. We had a brand there as well; we just launched a brand in that segment as you are aware. There has been more than [talks too]. And so this has -- the down trading didn't allow us to increase profitability; that was essentially flat.

But it'll be pretty much dependent on the pricing element of Australia. We are taking costs down; we have done so this year. We are expecting that the other cost base will go down. So with the SAP implementation, we have benefit in Australia as well.

So I think that this is what I can say about Australia.

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**Adam Spielman - Citi - Analyst**

Okay. Thank you very much. And while I've got the floor, I was just wondering if you could give a precise spot market share in Japan? It would be very helpful for the latest spot market share.

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

Yes. Our market share in Japan is around 12.1% nowadays. It's a little bit higher than 1% that we had at the end of 2010, before all the issues that is facing Japan last year.

So we are trying to build our market share on top of this number in the coming months. And we have a very good pipeline going to Japan. We have just launched one brand last month, a quite important one, a new variant of Kent. And we have a good pipeline coming for the coming months, but the share that we are today is -- the last month reading is 12.1%.

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**Adam Spielman - Citi - Analyst**

Thank you. And just very finally, what was interesting about that particular Kent variant?

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

It's a 1 milligram nano, and is product upgrade menthol.

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**Adam Spielman - Citi - Analyst**

Thank you.

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**Operator**

Chas Manso, Societe Generale.

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**Chas Manso - Societe Generale - Analyst**

Could you give us an idea of what your Asia Pacific margins were in the first half, excluding the Japan hurdle?

Also, your price mix of around about 6%, ex-Japan, could you tease out perhaps the price element and the mix element? Given the weak macro, are you seeing any change in the balance between those two elements?

And the weak demand in the EU in the April, June quarter is well documented, any other regions where you've seen industry volume slowdowns? I think, in the interview this morning, you were talking about global industry volumes down this year between 1% and 1.5%. I guess you were talking about the full year. What do you think that was for the first half? Thank you.

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

Chas, it's Ben here. Chas, the impact of Japan in the first half of the year was just under £50 million, in terms of profit. So if you take that off the year chart at the end of the accounts, you can work out the impact on margins. There was a very significant mix effect in Asia, with the growth in lower net turnover countries like Pakistan, and that offsets the development elsewhere, so it comes out broadly in the wash.

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

In terms of industry volumes, it's very difficult to be precise of the size of the industry in a six months' base. So we keep talking about what we expect to be this year, that's around 1% to 1.5%. So I think that, in the first half, probably it's around that, because we have a lot of movement like the stock build that you had in Mexico at the beginning of last year; the stock build that we had in the GCC in June.

Look at shipments is almost impossible to make any correlation of the industry growth or decline. So my expectation is going to be around 1% to 1.5% this year. That's much lower than it was the previous three years, so the industry decline is moderating.

The issues that we are facing today is that the declines that we see nowadays is mainly in places like Southern Europe, mainly Southern Europe, which means that geographic diversity help us, because we are less exposed to the difficulties of this region. But Southern European countries like Italy, like Spain, like Greece, we see some steep declines in terms of industry.

Also, you have the instability in the Middle East. We saw what's happened in Egypt this year. The illicit trade in Egypt went from almost nothing to 20%. We withdrew from Syria, because the international sanctions. So we have some instability in the Middle East that has affected our volumes for the first half of the year as well. So these are the two main factors for the volume performance.

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**Chas Manso - Societe Generale - Analyst**

Okay. Could I ask quickly an extra one on your market share? You're saying your top 40 market share was basically flat, and you mentioned a couple of factors affecting that, Indonesia and South Korea. Could you, perhaps, comment on your market share momentum? Are we right to detect that maybe it's improving of late, and if so, where?

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

Well, if you look at the market share in the first half of this year, and usually, it's good that you see against the previous six months of the year, and I think that is showing a growing trend. And I'm very optimistic, because it's showing growing trend, mainly, in premium. We are growing much faster our market share behind premium than the overall market share. That's spot on, on our strategy. That's the first point.

You look at Americas, for example, I think that every half-year presentation that we have here, you're talking about the problem child that we have. But you look at Mexico and Canada, the first six months of this year against the previous six months, they have grown market share consistent. In Mexico, for example, in the last 12 months, we have been growing market share month by month. So the numbers look better.

In terms of the issues that we have today, one is the Indonesia that I think that I have talked about that already; the decision that we have taken there to strength our portfolio and release some of the brands. And raising the price of the low brand portfolio; we lost some share there.

We have the issue of South Korea, because South Korea, we raised price in May last year. And so the first half, we have South Korea with just BAT going for a higher price than the competition for two months.

Also you have the issue in Turkey that we're still losing share in the tail brands. But we are doing the right things there, investing behind international brands such as Kent, Lucky Strike, and Pall Mall. In the case of Lucky Strike, showing good signs in Lucky Strike in terms of performance, mainly in the big cities. So we are doing the right things. Those are the main issues that we face.

The other country that we lost share out of the top 40 was Italy, but the loss of share of Italy was very small, and if you compare to last three year, this was at least much smaller than we lost in the past. So the portfolio is starting to work and the global drive brands are growing. Some of the brands such as Lucky Strike is having a very good performance.

But the point is, the majority of the top 40 markets, we grew market share. It's very difficult to talk about these one-offs, but if you take two of these countries out, the market share grew strongly because the majority, we did extremely well, so I'm very happy where we are. I'm very satisfied where we are.

I think the fact that we're in a growing trend, and growing premium, is very important for us and very important for the margins. In places like Russia, I was talking about having 45%, 46% market share of the premium segment in Russia, and how important it is to us, in February of this year. Now I can say that we are above 50%, so this is fantastic. So we are very happy where we are in terms of share, with a growing trend.

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**Chas Manso - Societe Generale - Analyst**

Thank you.

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**Operator**

Erik Bloomquist, Berenberg Bank.

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**Erik Bloomquist - Berenberg Bank - Analyst**

With respect to uses of cash, obviously buyback has been stepped up this year, but it was interesting to see the increase in the BAT Bangladesh stake. Do you see that as a way that you'll use excess cash, going forward, perhaps buying in more minorities? Thank you.

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

Yes, the BAT Bangladesh stake was a very small stake increase, so it's not particularly significant. The buyback, we'll complete the buyback this year. We don't make announcements on the buyback at the half year, so there'll be more news on that with the full year results.

In terms of other minority stakes, we continually keep those under watch. But we haven't made a lot of movements on those over the last few years; a slight increase in Chile where we bought out some minorities, but that's pretty much it.

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**Erik Bloomquist - Berenberg Bank - Analyst**

Thank you.

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**Operator**

We'll now hand back to Nicandro Durante for closing comments.

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

Thank you very much for joining us in this conference call. I look forward to seeing you in the next one in February next year. Thank you very much.

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**Operator**

This now concludes the call. Thank you for joining us.