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PRESENTATION

Nicandro Durante - *British American Tobacco plc – Chief Executive*

Good morning everyone and welcome to the British American Tobacco 2016 Interim Results Presentation. I am Nicandro Durante, Chief Executive of British American Tobacco, and with me this morning is Ben Stevens, our Finance Director.

And as always, a warm welcome to those of you who are listening on the conference call or watching via our website, BAT.com. As usual, after taking you through the results presentation, there will be an opportunity for those of you on the call to ask questions.

During the first half of 2016, the global economy remained fragile. However, against this difficult backdrop, I'm pleased to say that BAT has produced another good set of results.

You will have seen from the announcement this morning that EPS for the first half of 2016 was up 11% at current rates and 13% at constant rates, exceeding our high single figure earnings growth target.

This is an excellent performance, given the fact that we have absorbed a 6% transaction of Forex impact on operating profits. Excluding this, EPS would have been around 19%.

This has been driven by strong top line revenue growth; another good volume performance well ahead of the industry; continued strong growth corporate share growth; another excellent performance from the GDBs and improving underlying margin; and as well as the benefit of a strategic M&A investment. All of this enabled us to deliver double digit constants and current EPS growth, making these results one of our strongest first half performances.

I will now hand over to Ben who will take you through the detail.

Ben Stevens - *British American Tobacco plc - Finance Director*

Thank you, Nicandro, and good morning, everyone.

As Nicandro mentioned, the group delivered another good underlying performance, driven by strong volume, revenue and share growth. As anticipated at the prelims, transactional FX headwinds impacted reported profit, although this is largely offset at the EPS level by the benefits of mergers and acquisitions.

Cigarette volume was up 3.4%, with organic volume up 2.1% as a result of our continued share growth of 30 basis points. On a like-for-like basis, excluding acquisitions and inventory movements, volume was up 1.5%, outperforming the industry which we expect to be down around 2.5% this year.

The global drive brands continued to drive our overall share growth, with volume up 10.8% and share up another 80 basis points.

Price mix was around 4%, driven by good pricing, with pricing in some high inflation markets offset by the impact of increased geographical mix dilution.

Constant currency revenue grew 7.8% and operating profit 1.8%. On a constant organic basis, revenue grew 6% and profit 1.6%.

Translational headwinds started to abate, however transactional FX remained a challenge, impacting operating profit by 6%. Excluding this, organic operating profit would have arisen by around 8%.

Underlying operating margin was up around 50 basis points, although on a reported basis it was down 240 basis points. Like-for-like margin was down 170 basis points. As at prelims, I'll give more detail on this later.

We continue to see the benefits of our investment in Reynolds and Souza Cruz with reported earnings per share up 10.9%. At constant rates, earnings per share increased by 13.4% to 113.6p. And excluding transactional FX, EPS would have grown by around 19%.

Currencies remain a key feature of the results. As you can see from the chart, translational FX was a 4% headwind on operating profit at the half year. However, for the full year, with the recent devaluation of Sterling, we'd estimate this will turn into a tailwind of 4% on operating profit and 6% at the EPS level, based on today's rate.

The transactional FX impact is largely driven by the movement of emerging market currencies against the US dollar and the euro, as well as the timing of hedges rolling off. This resulted in a 6% headwind at the half year. Based on our current exposure and hedging positions, I'd anticipate the full year transaction exposure to remain around 6% on constant currency operating profit.

Our roll out of TaO and other cost reduction initiatives continue to improve underlying operating margins, despite our investment in rolling out Vype and our growth in emerging markets with lower margins. Reported margin was affected by transactional FX. Our acquisition of TDR included retailing interests, which obviously operate at lower margin.

As we said previously, the significant transactional FX headwind will continue in the second half and impact the full year reported margin, although we will continue to make good progress on an underlying basis. Notwithstanding the impact of currencies on margin in 2016, we remain confident that on average, over the years, we can grow operating margin between 50 and 100 basis points per annum.

Turning now to the regions.

In Asia Pacific, share was up 20 basis points, leading to volume growth of 2%. Strong revenue performances in Bangladesh, Indonesia, Pakistan and Vietnam, were partly offset by excise-driven market decline and associated down trading in Australia and Malaysia, which negatively impacted price mix. Adverse transactional FX led to a profit decline of constant currency of 2.7%. Excluding transactional FX, profit would have been up around 4%.

In Australia, profit was down due to industry decline, down trading and the pricing environment. However, our market share grew, driven by Rothmans. In Japan, share growth led to an increase in volume in an industry down over 2%.

Volume and profit in Malaysia declined as a significant excise-driven price increase in 2015 led to an increase in illicit trade with an industry decline. As a result, Dunhill and the premium segment were impacted by down-trading and although Peter Stuyvesant grew share, overall share was lower.

In Pakistan, share was up significantly and profit increased, driven by good pricing and cost savings. Volume was lower following the excise-driven price increase in 2015 and growth in illicit trade. In Indonesia, Dunhill continued to drive volume and share growth. Profitability was impacted by marketing investments, including the recent launch of Lucky Strike Mild, FX headwinds and cost inflation.

The GDBs has performed well, growing strongly. Volume is down 0.2% driven by the industry decline in Malaysia and Pakistan, offset by good performances from Dunhill in Indonesia, Kent in Japan and Rothmans in Australia. Excluding Malaysia and Pakistan, GDBs would have been up 12.5%.

In the Americas, revenue grew over 10%, partly due to pricing in high inflation markets, including Venezuela and Argentina. Profit at constant rates was slightly lower, down 0.6%, and good performances across much of the region were offset mainly by lower profit in Brazil and Mexico. Excluding transactional FX, profit would have been up around 3%. Volume was down 6.6%, largely due to industry contraction in Brazil and Argentina.

In Brazil, the macro environment remained challenging. Higher inflation and significant VAT and excise increases led to a reduction in industry volume and down-trading. This impacted profit with share declining from previous all-time highs due to aggressive competitive pricing activity. However, despite the declining premium segment, Dunhill remained resilient with its share stabilising towards the end of the period. Both Minister and Lucky Strike grew market share.

In Canada, revenue and profit grew due to good pricing. Volume and share were down due to competitor activity at the lower end of the market however Pall Mall continued to perform well.

In Mexico, profit was lower but volume and share increased, driven by a good performance from Pall Mall.

The GDBs performed well across the region with volume up over 14%, following another excellent performance from Pall Mall in Mexico, Canada, Argentina and Peru, and Lucky Strike in Chile.

The Western European region performed well with an increase in revenue, profit and volume. Organic volume was up 5.1% or 3.7% after adjusting for inventory movements.

Organic revenue at constant rates increased 6.1% and organic profit grew 7% as growth in Germany, Romania, France and the Netherlands were partly offset by decline in Italy, Denmark and Switzerland.

In Germany, good pricing and growth from Lucky Strike led to an improved mix and higher profit on broadly flat overall volume, although share declined.

Romania had another good performance growing profit, volume and share. Dunhill and Pall Mall both grew share and Pall Mall is now the fastest growing brand in the market.

In France, profit, volume and share grew, driven by a good performance from Lucky Strike.

The GDBs grew volume 10.7% and now account for 61% of our portfolio in the region. Notably performances include Dunhill in Romania, Lucky Strike in France and Germany, Pall Mall in Romania and Poland, and Rothmans in Italy and the UK.

In EEMEA, strong share growth of 110 basis points, organic volume growth of 5.7% or 4.6% after adjusting for inventory movements, with good performances in Russia, in Turkey, Ukraine and Algeria. This, together with good pricing, led to constant currency, organic revenue growth of 7.4% and profit up 4.6%. The depreciation of the Russian Rouble and the Ukrainian Hryvnia, amongst others, against the US dollar, resulted in a larger transactional FX impact. Excluding this, operating profit would have grown by over 17%.

In Russia, good share growth was driven by Rothmans and the resilience of Kent, which held premium segment share. This, together with inventory movements in the prior year, led to higher volume. Profit grew as good pricing more than offset the impact of transactional FX.

Volume in South Africa was down as the local low price segment, where BAT does not compete, continued to grow. Market share declined, despite growth in Benson & Hedges, Pall Mall and Dunhill. Profit was down due to adverse transactional FX, lower volume and down-trading.

Profit in Turkey grew, driven by good pricing and higher volume as a result of strong market share growth, led by Kent and Rothmans.

In Ukraine volume was up substantially as a result of significant market share growth, driven by strong performances from Kent, Rothmans and Priluky. Profitability was impacted by the aggressive pricing activity but recently we've been able to start raising prices.

The GDBs delivered an excellent performance with volume up 19.3%. This was led by Rothmans in Russia, Ukraine and Nigeria, with Kent, Lucky Strike and Pall Mall also performing well.

Adjusted EPS at constant rates was up 13.4% at 113.6p. This was driven by operating profit growth, offset by transactional FX, together with the benefits for our investment in the enlarged Reynolds American business.

Non-controlling interests were lower due to the buyout of the Souza Cruz minority.

Net finance costs increased, mainly due to M&A funding and the effective tax rate was slightly lower at 29.9%.

The translational FX headwind was 2.5%. This delivers current rate, EPS growth of 10.9% to 111.1p.

Now on to cash flow. Overall free cash flow was £559 million, which is £207 million below the same period last year. Movements in average exchange rates provided a benefit of £71 million. Depreciation is the main component of non-cash items. Working capital outflows at £1,017 million were higher than this time last year. As always, I'd like to caution that the timing of working capital movements tends to absorb cash in the first half, largely due to the timing of leaf purchases. In addition, this year, half year working capital movements were impacted by higher stock levels related to the implementation of the Tobacco Products Directive in Western Europe and excise payments following year end 2015 stock builds. I expect the increase to partially unwind by the year end.

Net capital expenditure of £126 million is below the same period last year. For the full year, I expect gross capex to be higher at around £650 million, mainly due to investments in next generation products and innovation.

Pension fund outflows related to the shortfall funding for the UK schemes are £30 million lower than last year, in line with our funding plan.

Outflows for finance costs were slightly higher at £276 million. Tax outflows were £620 million and were lower than the same period last year due to timing differences in payments.

Dividends paid to non-controlling interests reduced due to the purchase of the non-controlling interest in Souza Cruz towards the end of last year.

Restructuring outflows were higher mainly as a result of escrow payments linked to the Quebec class action law suit.

Dividends from associates increased, driven by investment in the enlarged Reynolds business following its acquisition of Lorillard in the second half of last year. This delivers free cash flow of £559 million.

Net debt increased by £2.9billion to £17.7 billion with £1.2 billion driven by FX movements. However, our credit rating remained unchanged at A3 by Moody's in March and A minus stable by S&P in July.

The interim dividend of 51.3p represents an increase of 4%, being one third of last year's full year dividend as usual.

The business is performing well and we remain committed to rewarding shareholders with an increase in dividend.

Thank you and I'll hand back to Nicandro.

Nicandro Durante - *British American Tobacco plc – Chief Executive*

Thank you Ben. As most of you remember, when we revised our strategy in 2011, we put the consumer at the heart of it. It is our vision to be the "world's best at satisfying consumer moments in tobacco and beyond". Importantly we have worked hard to build a strong portfolio of differentiated brands supported by world-leading innovations, designed to satisfy clearly the identified consumer moments.

This is working, as demonstrated by yet another excellent performance from the GDBs with volume up 10.8% and share up 80 basis points, easily beating industry trends.

Dunhill continues its good performance in the first half and is now in its tenth consecutive year of growth. Volume was up 3.4%, driven by Indonesia and South Korea. Share was slightly higher, with good performance in Indonesia, South Africa and Romania, offset by share declines mainly in Malaysia and the GCC.

Moving on to Kent, volume was up nearly 7% as the result of good performance in Japan, Russia and Turkey, as well as the migration from Belmont to Kent in Chile. Kent grew shares in Japan, Turkey and Chile, and held share in Russia, driven by innovations. The brand also became premium segment leader in the Ukraine. We are constantly working to ensure that our brands remain relevant to their consumers. This year we've begun the rollout of Kent new brand imagery, 'Spark,' which includes a new packet design and a pipeline of new products and innovations. So far, Spark has been rolled out to Turkey, Romania and Ukraine, and early results are encouraging.

Lucky Strike volume was up 13%, another excellent performance. This was mainly driven by the success of the Black Series. The brand has been particularly successful in South America, with share and volume growth in Colombia and Chile, as well as in Eastern - Western Europe, where growth has been driven by France and Germany.

Pall Mall saw good organic growth in key markets, including Romania, Mexico, Poland, Canada and South Africa, offset by industry contraction following excise-led price increases in Pakistan and the impact of the migration to Rothmans in Italy. The brand grew share ten basis points, driven by good results in Pakistan, Mexico and Romania.

Rothmans delivered another outstanding performance, growing volume by nearly 49% and share by 50 basis points, reaffirming its status as the fastest growing international brand in the industry. This growth was mainly driven by Russia, Ukraine, Australia, Italy and Turkey.

Rothmans plays a key role in strengthening BAT's portfolio of international brands in the growing value for money segment.

Together, the GDBs are a key driver of our overall volume of share and now represent 47% of our portfolio.

Returning to our strategy for a moment, the second part of our vision, ‘Tobacco and beyond,’ recognises the opportunities we see in Next Generation Products. Our strategy is to invest in a range of products across the risk continuum that satisfy different consumer moments, and that’s why we are investing in all three categories, Vapour, Tobacco Heating Products and Medicinally-Licensed Products.

The vapour category continues to grow at a fast pace. Today, consumer sales outside the US are estimated to be around £2 billion, and we believe that the category will grow at around 30% per annum, to reach almost £9 billion by 2020.

Vype’s international launches mean that we are now present in the five biggest vapour markets outside the US.

In the UK, Vype has continued to grow, reaching a record category share in retail of over 9%. We recently launched our first high powered device, the eBox, in the UK to complement the existing Vype range, which includes eStick, ePen and eTank, and a range of eJuices.

Vype has already reached an estimated category share in retail of 5% in France and 8% in Germany, where it is now available in over 5,000 stores nationwide after a few months.

In Italy, following the successful city test in Florence, Vype is now available in five cities, with further distribution expansion planned in the second half.

In Poland, the CHIC acquisition means that we are the market leader, with a share of more than 65%, and Vype is already accounting for more than five percent of total CHIC sales.

We continue to make good progress on our two THP platforms. While it’s still early days, the launch of iFuse early this year is going well, with awareness, trial and sales growing. The product is now available in 650 outlets across Bucharest, with plans for a countrywide rollout in the next 12 months. In addition, consumer research for Glo, our electronic tobacco heating product, was very encouraging, and we are on track with our plans for a test market launch around the year end.

Turning to medicinal products, this is likely to be the smallest of the three categories. Voke is a technically-complex product and, as we said at the prelims, must be manufactured to very strict standards. We are working hard to comply with these and should be ready to launch sometime in the next 12 months.

As we have already said, we remain excited about the opportunity in NGPs, and we are making great progress.

In addition, investing in markets with long-term profit growth potential has long been part of our growth strategy. For example, we have seen strong growth in markets such as Ukraine, Iran, Pakistan, Bangladesh and Vietnam. As part of our growth strategy, we have said that we would seek out strategically and financially attractive M&A opportunities.

M&A was a key feature in 2015. The benefits of a strategic investment in Reynolds and Souza Cruz are now a strong driver of EPS growth. In NGPs, the acquisitions of CHIC and Ten Motives give us a strong market share position of the largest vapour market in the world.

Finally, we have continued to make excellent progress on our cost base, with good underlying margin improvement, although transactional forex led to a decline in reported margins.

The implementation of the TaO / OneSAP programme is now complete. However, we are only part-way through the TaO journey, with many opportunities for savings and efficiency improvements remaining.

So, in summary, we have had a good first half and the business continues to perform well, driven by a combination of strong organic growth and the benefits of M&A.

We have good volume share growth momentum, powered by the continued success of the GDBs. This, together with good pricing, is driving top-line revenue growth.

Transactional forex remains a challenge this year and continues to impact the reported margin. However, excluding the 6% headwind, operating profit on EPS would have been up 8% and 19% respectively, demonstrating the underlying strength of the business. We expect profit growth to be stronger in the second half, mainly due to the timing of transactional forex impact in the prior year.

The trading environments continue to be tough, with challenging conditions in markets, including Brazil, South Africa and Australia. However, I am confident that we are on track for another good year of earnings growth on a constant currency basis. And if the sterling remains weak, reported earnings should benefit from a currency tailwind.

Thank you. I will now open it up for questions.

QUESTION AND ANSWER

Operator

Thank you. Ladies and gentlemen, if you wish to ask a question could you please press 0 and then 1 on your phone keypad now in order to enter the queue, and then after I announce you, simply ask that question. And if you find that question has been answered before it's your turn to speak, just press 0 and then 2 to cancel. And there will be a brief pause while questions are being registered.

Our first question is from the line of Fulvio Cazzol at Goldman Sachs. Please go ahead, your line is open.

Fulvio Cazzol – *Goldman Sachs – Analyst*

Yes, good morning gentlemen.

A couple of questions from me, the first one on mix. In the Cantos interview this morning, Nicandro, you stated that geographic mix headwinds would double versus last year. I just wanted to confirm, last year you had a 150 basis point headwind on geographic mix, is this correct?

And then, further to this, did product mix have a meaningful impact to first-half results? I'll ask my second question after, if you don't mind.

Nicandro Durante- *British American Tobacco plc – Chief Executive*

Okay. Fulvio, you are right in terms of the geographic mix has doubled in the first half of this year, but we think that it's going to – we believe that it's going to moderate in the second half. So in terms of geographic mix impact for the year, I don't think that it's going to be radically different than in 2015. In terms of the product mix, the impact for this year was similar than last year.

Fulvio Cazzol – *Goldman Sachs – Analyst*

So that's another 150 basis points?

Nicandro Durante *- British American Tobacco plc – Chief Executive*

Yes.

Fulvio Cazzol *– Goldman Sachs – Analyst*

Okay, thanks for that. And then the second question is on Indonesia, can you comment a bit on Indonesia? I was particularly interested on the progress of Dunhill and your expectations for the Lucky Strike Mild launch. That is, do you expect to replicate Dunhill's performance in this market?

Nicandro Durante *- British American Tobacco plc – Chief Executive*

Well, let me start with Lucky Strike. We expect, I think that we have an outstanding product, an outstanding market mix, and you have high expectations with Lucky Strike.

If it's going to repeat Dunhill's performance, it's very difficult to predict because they have just launched the brand, so they have to wait a little bit. We cannot forget that Dunhill was probably the most successful launch of a brand in Indonesia, in the last years. It's an international brand, the kretek segment.

It's a brand that – if you take the top 15 cities, it's a brand that has 5.6% market share and has helped us to drive our strategic brands in Indonesia, that is Club Mild, Lucky Strike and Dunhill, to have 91% of our portfolio. We only started this journey with the acquisition of Bentoel. We had around 3% to 4% of the portfolio strategic brands. With all the work that has been done, it's 91%, so we have a very good quality share and we are well placed to grow for the future. So the investments behind Indonesia has worked quite well.

Dunhill has had a stellar performance, and we expect that Lucky Strike to have a very good performance as well, but very difficult to predict now, after one or two months after the launch, how this is going to end up. But high expectations for the brand.

Fulvio Cazzol ***– Goldman Sachs – Analyst***

Thank you.

Operator

We are now over to the line of James Bushnell at Exane. Please go ahead, your line is open.

James Bushnell – ***Exane BNP Paribas – Analyst***

Thank you and good morning. I have two questions from me, please.

The first one is about Australia. You mention in the commentary that profits are down, despite there being price increases due to volume declines and down trading. I just wondered if you could elaborate a bit more on that. Was it that the price increases were not as significant as the overall tax or retail price increases, or just that the volumes and down trading were so severe that it was outweighed? And linked to that, how you see the outlook in H2 and, perhaps beyond, for profits in Australia? That's my first question, please.

Nicandro Durante - ***British American Tobacco plc – Chief Executive***

Okay. James, in terms of Australia, the decline in terms of profitability in the first half of this year has been much lower than decline that you experience one year before, so the comparables are easing. There was some decline, but not substantial. I'm not going to quote profit by market, but it has been easing.

We had some pricing last year, but the pricing did not compensate some of the down-trading that you saw in the market of some volume reduction, because we are still in the 12.5% excise hike [inaudible]. So you saw some volume decline and you saw some down trading, but the comparables are easing and the level of decline in profitability has been reduced significantly. We still have some pricing to go, we have an excise coming September, so you have to wait and see how it is going to evolve in order to talk about profitability for Australia.

But what I can say that the business is in a better shape now than it was one or two years ago, when you saw a significant drop in terms of profit driven by down trading and driven by volume decline. In the down trading, we see less down trading now than we saw one year ago. Don't forget that all the players are playing now in the low-price segment, and that was not the case three or four years ago.

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

Great, got it. Thank you very much. And then my second question was on vapour. You mentioned that the category is growing 20% to 30% and therefore is likely to become fairly big over the next few years. I just wondered, on a pro forma basis, after your recent acquisitions, what sort of proportion of your Western European sales do you think this will make up in 2016?

Nicandro Durante – ***British American Tobacco plc – Chief Executive***

You're talking about the two acquisitions?

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

I'm talking about your total eVapour business in Europe, so including Vype and Ten Motives, and everything.

Nicandro Durante - ***British American Tobacco plc – Chief Executive***

Okay. Let me talk a little bit about vape in general, and then I'll try to come back. If I don't have the numbers, I will send it to you after the Q&A. But we have quite a strong business in the UK; we have 9% market share with Vype. The Ten Motives is in UK; we have around – our retail share is another 25%, so together it becomes 34%, so this is the size of UK. Out of the 34%, 9% is Vype, the old Vype, our franchise, and 25% is the acquisition. If we go to Poland, we have 65% market share. Out of the 65%, 5% is Vype, because we launched after the acquisition, and 60% is still the portfolio that we acquired from CHIC. So that's the situation in the two markets.

If you go to other markets, we don't have any acquisitions, so in France after two months of launch, we've got 5% market share. This shows the strength of the pipeline that we have now, that we've spent the last five years developing products, and we have been discussing this in the last year, and it's paying off now. In Germany, after less than three months, we came to 8% market share. I gave you these numbers just to show the strength of the portfolio. Now we've said the vaping category is going to grow when you have good products, outstanding products. And nowadays, in our last survey for example, in 2016, out of the 100 new vaping users, 20% of them become regular users, and regular means people that smoke at least once a day. So that's a category that, with new products, with strong products, we are starting to develop strongly. We believe that the rate of growth that you saw in the last two years is going to continue. The vaping category in the five biggest markets outside the United States, the ones that we are present in now – Italy, France, UK, Germany and Poland – they are 60% of the category outside the United States, so the bulk of the category. And 60%, we have with that position a 10% of retail share. In 2013, retail – consumer sales – was around £1.3 billion. In 2015 it was £2 billion. We think that this rate of growth will continue.

James Bushnell – ***Exane BNP Paribas – Analyst***

Okay. Thank you very much.

Operator

Our next question is from the line of Jon Leinster at Berenberg. Please go ahead, your line is open.

Jon Leinster ***- Berenberg - Analyst***

Good morning, gentlemen.

Question on margins in the second half. Given that you're stressing the price mix is not going to accelerate sharply in the second half, it looks like you're saying it's going to go just above 4%, and given that the currency transaction impact is going to be not-too-different in the second half, would you expect margins year-on-year to be up in the second half, or should we look for them still to be trending slightly downwards?

And as a second question, with regards to Japan, can you give your thinking as to why you think your – well, why yourselves decided not to follow any of the price increases that was put through by JT, at least on one of its main brands and, indeed Philip Morris was - suggested that originally that it would through on two of its brands. Can you suggest why, from your perspective, that wasn't a good idea to follow suit?

Ben Stevens ***- British American Tobacco plc - Finance Director***

Hi Jon, it's Ben here. I'll do the margin question, then hand over to Nicandro to talk about Japan.

We always said – we said for the first quarter, at least over the last year, that we expect profit growth to be skewed towards the second half. So I expect our margin in the second half will be higher than our margin in the first half. And I actually expect our margin in the second half of this year to be up slightly on the second half margin for last year, as well. So we're expecting an improvement in margin in the second half of this year, largely caused by the timing of marketing spend.

Nicandro Durante – ***British American Tobacco plc – Chief Executive***

In the case of Japan, the market didn't move prices up. We had, in the case of one of our competitors, moving up some SKUs of one brand, not the whole family. And the other case, we have JT moving up the Mevius. We don't think that they should move until the whole market moves up, that's why we have not done that.

Jon Leinster – *Berenberg* – Analyst

Okay. Thanks very much.

Operator

Okay we now go over to the line of Rey Wium at Standard Bank. Please go ahead, your line is open.

Rey Wium – *Standard Bank - Analyst*

Hi, good morning, guys. Just two questions.

Just in terms of the volume outlook for the remainder of the year. Obviously you had a good start on an organic basis, I think it's about 2.1%. I just wonder, I mean, you talk about the market as a whole, probably down 2.5%. Now, I just want to get an understanding of, given that the first half was so strong, I mean, where, just where are we likely to end up for the year? I mean, I know initially it was sort of – it was guided around about the 1% decline but I, but based on what I'm seeing now, I find it difficult to get to that sort of number.

And just my second question is just a little bit more on the overall excise landscape. I mean, you know, with Malaysia, Pakistan, Brazil, Australia, you know, we've seen, you know, quite substantial excise tax increases coming through, so I just want to know, you know, if you can still sort of say that the landscape is modest or, you know, should we, I mean, get a bit more concerned about the excise environment, especially, you know, with the global growth environment that's not that flash.

Thank you.

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

Okay, the first question about volume, how it's going to unfold for the second half – we have a very strong first half of volume. We think that it's very difficult to predict for the second half, we still have some price to go. We had 80% of the pricing of the [inaudible] we have 20% to go. We don't know how the sales are going to go because like when you talk about 2.1% it's a mix of 200 countries. So, it's difficult to talk on average, but we believe that we are going to become much stronger than the industry decline. The industry decline is going to be – we believe that it is around 2.5% for the year, and I have no doubt that it will come stronger than that. It's what we can say about volume.

The second one is about excise. We had some steep excise increases in some of the markets around the world in the last 12 months. You saw the case of Malaysia, for example, that has led to an increase in illicit trade, some down trading. You saw the case of Brazil because of the challenged economic situation. We had federal excise increase, and have a state increase as well. We had the case of Pakistan with a price increase. So we have some markets that we saw a substantial hike in terms of excise. Do I expect this move in the second half? Probably not, because most of the excise hike happened at the beginning of the year, and they already happened. So I don't expect anything for the next six months or so. I would be surprised if something happens, but for the next year it is very difficult to predict now. We have to wait and see.

Rey Wium – *Standard Bank - Analyst*

Thanks

Operator

Our next question is from the line of Chas Manso at Société Générale. Please go ahead, your line is open.

Chas* Manso– *Société Générale - Analyst

Yes, good morning. Two questions from me, one on price mix and the other on margin. So on the price mix question, it seemed there's almost 90% of your price mix in the half came from the Americas, something like 17%, if the numbers are right, so could you say how much of that is real and how much of that is really just inflation passed through? How sustainable is that?

And I guess it's really about the other regions, because it means that the other regions' price mix is, you know, very low, less than 1%. And I know you called out, you know, geographic mix, but really could you talk a little bit more about what's driving the slowdown in those markets? And maybe the price mix question first.,

Ben Stevens - *British American Tobacco plc - Finance Director*

Yeah, I mean price mix is certainly helped in Americas by high inflation markets like Venezuela and Argentina. We've always had negative price mix in Asia, as long as I can remember, because you've got a lot of growth in markets like Pakistan and Bangladesh. And, you know, that's driving the performance from Asia. So I don't think there's anything particularly unusual about that this year. Pricing has started to recover in Europe. We've had slightly bigger geographic mix this year, as Nicandro said earlier, in terms of pulling down overall price mix. And price mix is a little bit lower, which it always is when volume is a little bit better. So, you know, I don't think there's anything particularly unusual there, though you're absolutely right, obviously we've benefitted from higher pricing in high inflation markets.

Chas Manso – *Société Générale - Analyst*

Do you expect that sort of imbalance to be the pattern going for the rest of the year?

Ben Stevens - *British American Tobacco plc - Finance Director*

Well, we did say that, you know, we've had a bigger hit from geographic mix in the first half, and as Nicandro said earlier, we expect that to moderate during the course of the year. Portfolio mix, you know, eventually we start lapping the growth of Rothmans, and then portfolio mix also gets a little bit better. But you know, you've got to look at price mix really on a market by market basis, because when you look at it on a global basis you get these significant movements in geographic mix, and the overall portfolio mix clouding the numbers.

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

We expect to have a price mix in the second half stronger than the first half, as we said before.

Chas Manso - *Société Générale – Analyst*

Yeah. Okay, and on the margin question, I think the underlying margin improvement this time was 50 basis points? Against 120 basis points, first half last year. And I was wondering what was driving that difference, I mean, is it all investments into next generation products, or is there more to it than that? Excluding your investments in next generation products, would it, you know, broadly have been about the same improvement?

Ben Stevens - *British American Tobacco plc - Finance Director*

Well, we said that profitability is going to be skewed towards the second half this year. We warned of that in the first quarter and, indeed, at the full-year last year. And that's largely the result of the timing of marketing expenditure this year. So I certainly expect operating margin to improve in the second half of the year over the first half. And I think because this year we've had more front-end weighting on marketing spend, we expect operating margin to be stronger in the second half than prior year as well.

Chas Manso - *Société Générale – Analyst*

So is that – does the phasing of marketing spend explain all the gaps?

Ben Stevens ***- British American Tobacco plc - Finance Director***

Well, it's the phasing of marketing spend and of course we are rolling Vype out around Europe as well, and that has costs in terms of margin. You've got to remember, also, that we've got structural changes in our business as well, with things like the acquisition of TDR, but we've stripped that out of the underlying operating margin growth, and we're still growing 50 basis points.

Chas Manso ***- Société Générale – Analyst***

Great, thank you.

Operator

Our next question is from the line of James Bushnell at Exane. Please go ahead – sorry, sorry, I apologise – our next question is from the line of Carl Walton at UBS. Please go ahead with your question, your line is now open.

Carl Walton ***- UBS - Analyst***

Morning everyone. Thanks for the questions and just a couple, one on FX. I mean, obviously lots of volatility but, if things stayed as they are at this stage, current spot rates, is there any guidance you could give on FY17 in terms of potential FX dynamics there?

And then, one on Russia. Just a couple of comments from a competitor around the pricing environment being more competitive but obviously you've commented, you know, good pricing and great dynamics with Kent and Rothmans, etc. So just, just your view on the Russian market here today. And then the last quick one on Australia, just a follow up. The market share has improved quite significantly, obviously, with good success from Rothmans. Can you update us where you are with market share and, you know, it seems like you're kind of where you need to be there, is that right? Thanks guys.

Ben Stevens ***- British American Tobacco plc - Finance Director***

Okay, hi Carl, it's Ben here. I'll take the FX question.

So, we've said that on a transactional basis we see FX hit at 6% in the first half. We think it'll be about the same the second half. There are still some transactional headwinds in '17. It's very early days to start talking about transactional FX in 2017, but remember the naira was floated in Nigeria a month or two ago, that's going to give us a transactional FX hit. So current sort of guesstimate is about half of what the transactional hit was this year, so about 3% next year in terms of transactional FX. In terms of translation, we said at Q1 that we thought that the translational benefit would be about 1% at operating profit level. It's now 4%, so quite an improvement in terms of translation. And we said about 3% at EPS level, and it's now 6% at EPS level. So an improvement in translational FX, and I'll lead you to – leave you to do the maths on the impact of that in 2017.

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

In the case of – let me start talking about Russia. Russia, we are doing very well in Russia. I confirm that we have a very solid price environment. I don't see any big issues in Russia in terms of pricing. Our performance is because we have a strong brand. Kent, for example, has been maintaining its market share in a market that is down trading, which means that the brand is doing extremely well to be able to do so. Rothmans is the star performer of Russia nowadays, so don't forget that Rothmans is playing the value for money segment – the international value for money segment – and you have international brands at prices below Rothmans. So Rothmans is growing because it's a very good offer for the consumers.

So in the case of Russia we are growing, Russia is growing 70 base points, a very solid price environment. What I can say is that usually when we have a price increase, you have some mountains of stock to be sold with the old price, which is quite normal in the Russian environment, it has been happening like that for years, so I don't see anything changing there. In the case of Australia, our net market share in Australia has – is around 40% nowadays, as it has been for the last years. We had some dip in the last one, two – one and a half years – it went into 38%, it's back to 40%. So quite a stable share. It's not a huge – it's not a significant gain, it's very stable, 40%.

Carl Walton – *UBS - Analyst*

Great, thanks guys.

Operator

We are now over to the line of James Bushnell at Exane. Please go ahead, your line is now open.

James Bushnell *- Exane BNP Paribas - Analyst*

Hi, sorry, I did have a follow up but it was the – it was the transactional FX question that's been answered. Thank you.

Operator

Okay, in that case our final question is from the line of Rey Wium at Standard Bank again. Please go ahead, your line is open.

Rey Wium *- Standard Bank - Analyst*

Yeah, this is maybe just a technical one. The acquisitions – I see in the EEMEA region that you've added, look there's volumes of about 1 billion FX. Can you maybe just elaborate on that if that's maybe the, a little bit [inaudible] business? And then I just want to know the effective dates of the acquisition of CHIC in Poland.

Ben Stevens *- British American Tobacco plc - Finance Director*

Yeah, the acquisitions, we've got two acquisitions out there. One is TDR, which is in the Balkans, we've also got a small acquisition in the Sudan as well, which gives you the organic difference on EEMEA when you're looking at M&A activity. And the effective date of the acquisition of CHIC in Poland is just being scribbled on my sheet as we speak, and it's December 30th.

Rey Wium - Standard Bank - Analyst

Okay, yeah, so that volume increase in the EEMEA region, are you saying that we – from – did you say Sudan?

Ben Stevens - *British American Tobacco plc* - Finance Director

There's a bit of Sudan in there as well, yeah.

Rey Wium - Standard Bank - Analyst

Okay, and TDR, that's accounted for in Europe?

Ben Stevens - *British American Tobacco plc* - Finance Director

Yeah, that's right. Yeah.

Rey Wium - Standard Bank - Analyst

Okay, excellent. Thanks.

Operator

Okay, we'll now hand back for any final comments. Please go ahead.

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

Okay, thank you very much for joining us in this conference call. More than happy to have further questions to Mike after this meeting. Thank you very much.