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RB.L - H1 2013 Reckitt Benckiser plc Earnings Conference Call

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OVERVIEW:

RB.L reported 1H13 revenue of GBP4.99b, adjusted operating profit (before exceptional costs) of GBP1.163b, and adjusted diluted EPS of 118.3p. 2Q13 revenue was GBP2.48b. For 2013, believes to achieve total net revenue growth at upper end of 5-6% range, excluding RBP.

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PRESENTATION

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Good morning, and welcome to RB's half-year investor presentation. As a business, we have been at the forefront of engaging with consumers digitally, so it's time to engage with you all digitally too. If this works as well as our digital brand-building efforts, we will do this again.

With me today, is Adrian Hennah, our CFO.

Our three key messages for you today; our focus on health and hygiene power brands is working, and our improved growth rates over the past 18 months confirm that we're making the right strategic choices.

Our focus on 16 power markets, such as China, and the organizational changes we put in place is yet another important element of our growth strategy, and is enabling us to sustainably outperform our markets.

We continue to invest in our brands and our capabilities virtuously. We've invested an incremental GBP170 million in BEI over the past 18 months, and still grown operating margin over this period.

In summary, we are delivering strong results by executing our business strategies, but clearly we have much more to do.

Let's talk about our half-year results. We've made a strong start to the year with like-for-like growth, excluding RBP, of plus 6% in both Q1 and Q2. Health and hygiene brands grew at a combined rate of plus 9% in the half.

We invested an additional GBP70 million in the first six months of 2013 behind great innovations, such as Mucinex, Sinus-Max, and Lysol Power & Free. In fact, we once again increased investment in all three areas.

We had good growth margin expansion in the half, driven partly by the structural benefits of exiting our private label business. But we also drove gross margin expansion through improved mix, pricing benefit, and our ongoing cost saving program.

Our improvement in gross margin has funded increased BEI and investment behind capability building, particularly in emerging market areas and Health. Adrian will cover this in more detail shortly.

You will also see that our net working capital and cash conversion has improved, and we are paying an interim dividend of 60p per share; an increase of 7% over the same period last year.

So here is our five-year trend. You can see a good growth performance in the first six months of 2013, with total growth at constant rates of 6%, with FX adding another 1% to these results.

Adjusted net income was up by plus 5% at constant, to which exchanged added plus 1%, to give a growth rate of 6%.

Let's now turn to our strategic acquisitions that we made recently. Starting with Schiff, I'm really pleased with our first six months. On the integration side, we have been as sharp as ever and have already achieved harmonization of trading terms with customers, implementing our HR and operational plants, and we have made good progress on both cost and net working capital synergies. Improved in-store execution and increased BEI is driving like-for-like growth well above that of the market.

Our other acquisitions are also progressing well, with good growth in China behind our new Manyanshuning sore throat brand.

On BMS in Latin America, we received regulatory approval in May, and integration is now fully on track.

With that overview of our core business performance, I'll now hand you over to our CFO, Adrian Hennah, to take you through the book financials, and also update on RBP.

Adrian, over to you.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Thank you, Rakesh. Good morning, ladies and gentlemen. Turning firstly to slide 8, the income statement. As Rakesh mentioned, revenue for quarter 2 was GBP2.48 billion, representing a like-for-like growth of plus 4% for the Group as a whole, and 6% of the base business excluding RBP, after adjusting for movements in exchange rates and for the effect of acquisitions and disposals.

Revenue for the half 1 was GBP4.99 billion, representing a like-for-like growth of plus 5% for the Group as a whole, and plus 6% for the base business.

The net impact of acquisitions added to the growth rate by less than 100 basis points we have guided to for the full year. We expect a bigger impact in half 2.

Movements in foreign exchange rates added 2% to the quarter to your reported growth rate.

Gross margin in half 1 increased by 230 basis points for the Group as a while. There were a number of drivers for the gross margin increase, and we will return to these in a later slide.

Adjusted operating profit before exceptional costs in the half was GBP1.163 billion.

The adjusted operating profit margin was 23.3%; 80 basis point lower than half 1 last year. The operating profit margin at the base business was 20.4%; 10 basis point lower than half 1 last year.

Why, with this strong increase in gross margin, was there a small reduction in operating margin? Well, firstly, we increased investment in brand equipment, or BEI as we call it, by 80 basis points on top of last year's increase.

There was also continued investment capabilities, in particular in building out the new area teams focused on emerging markets, in healthcare R&D, and also in IT.

And in half 1 last year, we benefited from GBP30 million of corporate income. There was no equivalent this year, with a consequent 60 basis points reduction in the operating margin.

We are on track for our guidance of a maintained operating margin in the base business for the full year.

Exceptional cost charge in the half were GBP249 million. We have set out an analysis of these costs in an appendix. GBP24 million derived from programs already announced, mainly the costs of integrating the Schiff acquisition, and BMS collaboration.

We have also made a provision of GBP225 million in respect of a number of regulatory, principally competition law, investigations by various government authorities in a number of countries. These reached a point in the half where it has been possible to determine a reliable estimate of a probable liability. You will appreciate, we cannot go into detail of these items.

I expect that some of you may be wondering whether this provision might be the result of a new CFO being over-zealous. Others may be wondering whether these issues should have been provided for earlier, and that there might be more to come. In my view, neither is the case.

The greatest part of the provision relates to cases covering alleged actions, in respect of which enquiries have been progressing for a number of years, with very unclear outcomes. The issues have been disclosed as the contingent liabilities in the Company's reports for a number of years.

he competition law enquiries involve a significant number of other companies. And, while all large multi-national companies are involved in disputes of various kinds all the time, there is nothing else that is material, at present, the Board is aware of.

Lastly on this slide, you will note that the 2012 numbers are described as having been restated. This relates to the new version of IAS 19. The changes to the 2012 numbers are those we flagged with our 2012 full-year numbers in February. They involve an increase in the financing cost arising from the use of a standardized yield for the return on assets in the defined benefit fund, and the movement of this cost from operating profit to financing cost.

We show the numbers in an appendix to this presentation. The changes have increased operating profit in half 1 2012 by GBP4 million, and decreased net income by GBP4 million.

Moving then to slide 9, and moving further down the income statement, other net finance costs were GBP10 million; a small increase on half 1 2012, reflecting the somewhat higher total borrowings following the Schiff acquisition and BMS collaboration, and a current still very low cost of borrowing.

The tax rate for half 1 was 26%. This is higher than the 25% rate we guided to for the Group as a whole for the full year. This is for two reasons. Firstly, a further reduction in the UK corporate tax rate was, in IFRS speak, substantively enacted in July, i.e., after the end of half 1. This will benefit the half 2 and the full-year numbers.

Secondly, we do not expect the exceptional costs to be fully tax deductible. A tax rate in adjusted net income, i.e., excluding exceptionals, in half 1 was 25%.

We expect the tax rate for the full year to be in line with guidance for reported net income at 25%, and we expect the tax rate in adjusted net income to be lower at around 24%.

Adjusted diluted earnings per share in half 1 was 118.3p, an increase of 7% on last year. This is above the 2% growth in constant rate operating profit, due to the reduction of tax rate in adjusted net income on half 1 last year; the weakness in sterling; a small reduction in the non-controlling interest in net income; and the share buybacks over the last year.

Turning then to slide 10, an analysis of revenue growth segments by business segment, by quarter. Rakesh has described the main drivers of our revenue progression. I will add only a few more detailed points on the reported growth rates by segment on this slide, and by category on the next slide.

Firstly, on price and volume changes across the geographies we operate in. The 6% growth in the base business in half 1, and in Q2, was split broadly evenly between volume on the one side, and mix and price on the other.

With respect to ENA sales, as Rakesh has highlighted, the Group maintained in quarter 2 the increased rate of growth achieved in quarter 1. As in quarter 1, revenue was assisted by stronger and longer-than-normal flu season.

Turning to RUMEA, as we signaled in October, and in February, growth in RUMEA continued to be held back by the up-scheduling of some presentations of Nurofen in Russia in quarter 2 2012; by continuing competitive intensity in Turkey; and socio-economic and operational challenges in parts of Africa. We continue to expect some of these headwinds to persist through much of 2013.

In LAPAC, we saw further strong performances in India, China, Brazil, and a number of other emerging markets, offset by slower growth in the developed markets of Japan, ANZ, and Korea.

In RBP, the minus 12% revenue decline in quarter 2 was determined by a combination of continuing strong market growth, most notably continuing low double-digit growth in Suboxone prescriptions in the United States; by a complete end to RBP tablet sales, which accounted for high teens of sales volume in the USA at the start of the year, and an effectively all-gone-to generic competitors; and the lower price of film compared to tablets.

We have again included, as an appendix, a reconciliation of the reported to the like-for-like numbers in this slide.

Turning then to slide 11, an analysis of revenue growth rates by their principal categories set out in our strategy in February last year.

Firstly, Health. The progress in the gross trend is clear, and is further evidence that the focus the Group is putting on its category choices is delivering results. As mentioned in connection with the ENA growth trends on the previous slide, however, the quarter 2 growth rate benefited from the longer-than-normal flu season in, especially, the United States. We should, therefore, not expect this level of growth to continue.

Portfolio brands were down 5% in quarter 2. The decline in footwear sales, which impacted quarter 1 strongly, have a smaller effect in quarter 2 due to the somewhat lumpy nature of shoes sales.

Beyond footwear, the market in laundry detergents and fabric softeners in Southern Europe, which form a material part of the Portfolio brand, continues to be volatile.

Within Food, the weaker growth in quarter 2 was driven mainly by a weaker market in the United States, and by competitive pressure.

Turning then to slide 12, and analysis of gross margin and Brand Equity Investment, in respect of gross margin, as mentioned earlier, the Group continued the strong performance in half 2 last year into the first half of this year. The growth has been driven by a number of factors. Firstly, the disposal of Propack, the private label business, added about 100 basis points.

Secondly, the strong growth in the Health category helped gross margin mix, and offset the slightly negative gross margin effect of the higher growth in emerging markets.

Thirdly, half 1 saw a slight improvement in net prices realized.

Fourthly, we continued to see a more stable commodity and input cost environment.

And lastly, the Group benefited from a project fuel cost savings program, which was targeting GBP50 million per annum, and of which a substantial part was delivered during half 2 last year.

On BEI, on brand equity investment, you can see the 80 basis points increase in the level of spend in half 1 in the base business, on top of the 60 basis points increase in the level of spend in 2012. We signaled in February that our BEI spend increase will be weighted to the first half this year.

Turning next to slide 13, this shows an analysis for operating profit before exceptional costs by business segment for half 1 and half 2. The Group delivered a 10 basis points reduction adjusted operating margin in the base business in half 2, and an 80 basis points reduction for the whole business including RBP.

You can see the significant reduction in the RBP operating margin, 660 basis points. This is the result of firstly, the lower margins on film, and on tablets; secondly, as signaled previously, some increase in investment behind the pipeline; and then thirdly, as with most specialty pharmaceutical business, the relatively low level of variable cost in the business compared to net revenue. Accordingly, the 12% reduction in net revenue has impacted quite significantly on the margin.

With regard to ENA, mixed benefit from strong growth in health sales, and the early and strong delivery of cost savings in half 2 2012, drove a strong margin delivery.

With regard to RUMEA, as signaled with the full-year results, the margin was held back by continued important investment in BEI, and the establishment of the new area. We expect this to continue through 2013.

Turning to the next slide, slide 14, and a summary of the Group's net working capital position. You can see that the strong overall position continues, with only small movements in each of the components of working capital, and the Group's key focus on this area will continue.

Turning, therefore, to slide 15, the cash flow statement. As you can see, the Group had another good half of cash generation. Free cash flow generated in half 1 was GBP893 million. This again exceeded 100% of net income, even adjusting for the effect of the exceptional charge.

Working capital and capital expenditure deployment remained disciplined.

The Group had net debt of GBP2.8 billion at the end of the year. This was up from GBP2.4 billion at the end of 2012 due principally to the upfront payment on the BMS collaboration, and GBP279 million spent on share repurchases.

Okay, so turning now, if we can, from the numbers for the Group as a whole to an update on our RBP business; this is on slide 16. You will all be aware that generic tablets from two manufacturers were approved by the FDA in February, with product coming onto the market effectively in March.

You will also be aware that RBP discontinued shipment of its tablets in March, in line with a previously announced schedule.

Since March, generics have gained around 13% volume share of the buprenorphine market in the United States, effectively taking the remaining share held by our tablets.

We explained earlier how this loss of the tablet sales in the USA grew the 12% revenue reduction in quarter 2, and the 660 basis points margin reduction in half 1. We cannot give you guidance on specifics looking forward, however, you should bear in mind that quarter 2 was effectively a transitional period for these drivers. Accordingly, you should expect the revenue decline in quarter 3 to be in the high teens, even if the film were to sustain its current market share.

Turning into the longer term, you will also be aware that Orexo have received FDA approval for their tablet. Indeed, over time, it will be normal to see further branded competitor entries, such as Orexo. On the one hand, this will add to competitive pressure; on the other, remember that this is an underserved market that is growing very strongly, with tremendous potential in the United States, currently, by some margin the largest part of the world market and beyond.

And remember that we are by far the largest player in the market, with a deep operational infrastructure, developed over many years, that gives very high levels of service and support to customers.

Turning into the next slide and slide 17, this shows our film volume market share in the United States over the last year. You can see that film share climbed steadily into February this year, when generic tablets launched, and has been essentially flat at 68% to 69% since then.

We continue to believe that we will not be able to maintain this share of the current level in the face of competition from generic tablets. It has been our consistent view that over time a proportion of especially the more cost-oriented pharmacy plans will seek to have patient prescriptions switched from film to tablet, notwithstanding the clinical and patient preference advantages of the film.

The recent decision by CVS to delist our film for a proportion of their managed pharmacy plans is an example of the mechanisms by which we expect this tension between price and clinical preference to play out. However, we are very pleased with the performance of the film to date, and believe that we are continually improving the long-term future of the business.

Let us remind you of the clinical value underpinning some of the current preference for film. So turning to the next slide, slide 18, this is, indeed, a brief reminder of the advantages of film over the generic tablets. Firstly, patients stay in treatment longer; secondly, it is less subject to diversion; and thirdly, it has child-resistant packaging.

With regard to the first advantage, remember, opioid dependence is a chronic relapsing disease, and retention in treatment is an important indicator for successful clinical outcomes. Staying in treatment longer can improve patient outcomes, and this in turn typically leads to less use of healthcare resources, and a resulting cost saving to payers. For example, the cost of treating an overdose in an emergency setting can typically be in excess of $2,000. For a health plan, improved patient outcomes from suboxone treatment is a significant financial benefit.

Secondly, there is continuing evidence that diversion and abuse rates of buprenorphine tablet formulations, with and without naloxone, consistently exceed the rates for buprenorphine-naloxone combination film.

Recent analysis has found that suboxone tablets were 12 times as likely to be diverted, and twice as likely to be abused, as suboxone sublingual film. Diversion and misuse are costly and damaging public health issues, and are a high priority for payers.

Thirdly, the unit dose and child-resistant packaging of film helps to avoid unintended pediatric exposures.

We continue, of course, to collect and to deploy with physicians and payors additional data demonstrating the advantages of the suboxone film over other options.

Turning then to the next slide, slide 19, and a few comments on recent news flow and on our RBP pipeline. As you are probably aware, a generic manufacturer has filed an abbreviated new drug application, an ANDA, with the FDA. As many of you know, this type of action is common in the pharmaceuticals industry when the exclusivity period comes to an end. The exclusivity period for the film ends in August.

There is, in this situation, a fairly standard procedure to be followed. Under the Hatch-Waxman Act, we have 45 days to launch patent infringement lawsuit proceedings against the company, which we will. By virtue of filing this patent infringement lawsuit, the FDA cannot approve a generic entrant until the earlier of 30 months, or the end of the patent infringement proceedings.

There are a number of formulation and process patents surrounding the film. The most recent of these is a formulation patent Orange Book listed in RBP's name which extends our IP cover until 2030. We are very confident about the strength of the patents, and we will vigorously defend them against any potential infringements.

Our confidence in the future of the RBP business is also based on our clinical pipeline. As previously mentioned, we have increased investment in the pipeline. This reflects progress on, in particular, the depot injectable product for opioid addiction, which is in Phase II trials. We have been in constructive discussion with the FDA on this product, and expect to enter Phase III trials in quarter 1 of next year.

The increased spend also reflects good progress on two other products in Phase II trials. We will brief you on progress with these products during 2014.

Finally, RBP is continuing, despite the distractions of some recent news flow, to focus very successful on what it has always done; bringing pioneering, life-transforming treatments to addicted patients.

With that, I will hand back to Rakesh.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Thank you, Adrian. Let me now take you through a selection of our new initiatives we expect to support strongly in half 2, and beyond.

Let's start first with Health, and first with Mucinex. Just a few years ago Mucinex was only a coughs and congestion brand, albeit one which enjoyed trust and loyalty of its consumers. Now we took that equity and extended it to mainstream cold and flu with the launch of Fast-Max, first in liquid, and then in tablet. We are now launching a powerful product for nighttime cold and flu relief in both liquid and tablet form. Just for perspective, nighttime is a $600 million market in the US.

Mucinex Fast-Max is stronger than any other OTC nighttime product available to US consumers because it contains an active for nasal congestion which competition does not have.

Moving to the next one, which is Move Free One, there is a very nice and exciting initiative from the Schiff acquisition. Move Free One Ultra is our most effective joint-care formula. It delivers two times better joint comfort for total joint health, as proven in clinical trials, versus existing product which has glucosamine and chondroitin combination; and with just one small softgel, it is easy to swallow versus the usual two tabs.

Moving to Durex, our global sex survey tells us that four in five people have tried something to improve their sex lives, with 32% of the people claiming to have used gels.

We are rolling out our new Durex Embrace pleasure gels in 25-plus countries in a breakthrough and disruptive packaging. But beyond disruptive packaging, this innovation consists of two gels, one warm, one tingling, one for each of you, which combine for a fantastic sensation.

Turning to Hygiene, let's talk about the Lysol/Dettol Power & Free launches we made in 2012 and 2013, and which have enjoyed great success.

We initially launched in [service triggers] and toilet bowl cleaners, and now building on we have in-market success we are extending into new segments. For the first time ever, the Power & Free benefit is now available in both a dilutable cleaner, as well as a wipe.

And just a reminder, the Power & Free products contain hydrogen peroxide, which kills 99% germs -- 99.9%, in fact, germs, and cleans better, without the harshness of a chlorine bleach. So we are very excited about this.

Moving to Finish, you might remember, six months ago I talked about the launch of Finish power gels into two of our largest markets. Since then, it's proven to be a great success, thanks to its superiority on shine, versus competition, also winning the Product of the Year in the US. So, as a result of it, it's now being rolled out into another 35 countries in 2013.

Turning to Veet, well, for Veet we have an exciting initiative being rolled out now, as we speak. We are extending this brand into facial depilatories, which is now 20% of the total depilatory market. Now, as you can see, facial depilatories is a year-round consumer need, with a high degree of relevance as your face is always on show. It's a facial pen, and a soothing cream in one product.

Returning to pest, as you know, Mortein is our global power brand in pest control. In Brazil, we own the market-leading brand, called SBP, and we are launching an incredible electric mosquito repellant, with a hidden refill for safety, but also an auto-off benefit, so it only works when you need it; another example, I would say, of an innovation for driving our emerging market growth rate.

Turning to innovation and home care, let's start with Airwick. I've talked in the past quite a lot about Airwick, and also our candles business, and we are continuing to build on the success of our growing candle range, which helped grow Airwick candle net revenue actually by six times in the past four years.

Now, we are launching an innovative gel candle. This contains pearls infused in essential oils that release a burst of fragrance just when they melt. This way, people get an additional burst of fragrance from each pearl so that the experience never fades.

Moving to Vanish, we are launching a Vanish SuperBar, which I believe is an exciting and great initiative, specifically targeting emerging markets. We want to step-change category brand penetration in emerging markets by making Vanish much more affordable for those people where price remains a barrier to trial, and people where still wash their clothes by hand. The Vanish SuperBar is a stain remover, and delivers a superior performance versus existing laundry bars.

So we're excited about this pipeline, and now let me just summarize where all this leads us. Overall at RBP, we are very pleased with the performance, and remain confident that this business is sustainable with its patients and doctors preferring film and a promising pipeline of innovation.

For the business excluding RBP, at the beginning of the year we set some targets; total net revenue growth of plus 5% to 6% constant and including a net impact of M&A, and also to maintain our operating margins.

As highlighted, we continue to face challenging market conditions, which we see continuing in the second half. Despite this, we have been very encouraged by both the performance of the core business, and of our recent acquisitions. With this, and combined with our sustained investment behind the equity of our brands, I do believe that we can achieve full-year total net revenue growth at the upper end of the 5% to 6% range, excluding RBP, whilst still maintaining operating margins.

Our mid-term targets remain.

Thank you very much for listening, and now Adrian and I will be happy to take your questions, if any.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Iain Simpson, Barclays.

Iain Simpson - *Barclays - Analyst*

Just a couple of quick questions from me, if I can. You talked about the flu season going on a bit longer this year in the US. Are you able to give us any indication as to how we should think about the benefit you got from that in the second quarter? Was it roughly comparable to the benefits that you got in the first quarter? That would be extremely helpful.

And then secondly, you carried out some smaller acquisitions, other than Schiff, in recent months; any update on how those are going would be very welcome. Thank you very much.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Thank you, Iain. Let me start with the first question. We clearly did have a longer-than-normal flu season, particularly in the US, but let me put a context. All our healthcare brands are performing well, and a lot of them are also non-seasonal in nature, brands like Durex, like Scholl Footcare, like Gaviscon, and so on, and so forth.

I would say that we did have an impact on the flu season in the second quarter, as normal -- more than normal and a longer flu season, but our healthcare brands continue to perform in these strong conditions.

It's very difficult to quantify the exact value associated with an extra flu season. All I would say is that you should certainly not expect the kind of growth rates we have achieved in the first half on healthcare to continue in the second half, for two major reasons. Of course, there has been some tailwind from a good season; but also, our comparators in the first half versus the last year first half, and also the comparators of the second half, are quite different.

On your second question, how are we doing on our other acquisitions, first of all, the two other acquisitions/collaboration agreements, one is in China. I've already said that we are very happy about our acquisition in China. It's got off to a good start. We have achieved all the milestones that we expected to achieve at this point in time in terms of integration, in terms of synergy, in terms of working capital, but, more importantly, in terms of brand quality, and in market performance.

So I believe that it's going to be a very nice acquisition for us in the future; not just, I would say, for establishing a healthcare business from the sore throat brand that we acquire, but hopefully over a period of time also to form an important platform for consumer health in China.

And on the last one, on BMS, we have just completed the regulatory transition in May, so it's really early days. But, again, our first instinct on BMS in Latin America is that we've acquired a very high quality portfolio or acquired, rather collaborated, on a very high quality portfolio of brands in both Mexico and in Brazil, and we remain very excited about the opportunity there.

Iain Simpson - *Barclays - Analyst*

Thank you very much.

Operator

Erik Sjogren, Morgan Stanley.

Erik Sjogren - *Morgan Stanley - Analyst*

Two questions from me, please. Firstly, can you talk a little bit about the competitive environment, and how you see the promotional levels, particularly in the household business in Europe and North America?

And then secondly, on RB Pharma and the margin development here, the investments you're making in the business in terms of the pipeline, etc., will they remain pretty constant during the second half of the year, or is this more phased in any way? Thanks.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, Erik, I'm going to take the first question, and then I'm going to defer to the CFO to answer the second one. On the first one, the competitive environment, to my mind, remains as it has been for some time already; very tough, very challenging, no better, no worse.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

An equally short and sharp one here, second question. Pipeline investment fluctuates. It has to fluctuate because it's determined by the pipeline. That said, we expect it to be somewhat higher than it has in the past, but not hugely variable.

Erik Sjogren - *Morgan Stanley - Analyst*

Okay, thanks very much.

Operator

(Operator Instructions). Harold Thompson, Deutsche Bank.

Harold Thompson - *Deutsche Bank - Analyst*

Two questions from me. The first one is on your healthcare business. I think Iain tried to, I guess, get a number from what the flu benefit is, and I guess we won't get that.

So maybe in a slightly different way of asking the same question, how broad based do you see the success of your healthcare divisions, whether it's in terms of expanding current brands into new segments, a bit like you're doing on the Mucinex, so going into the night market? Or how global is the portfolio today? Or maybe more relevant to you, how is progress being made in terms of rolling out on a global -- where your portfolio brands in terms of Health, all that, to try and see what the sustainable growth rate of that health franchise is?

My second question is on RBP. Adrian, you said that the mathematics of shifting from tab to film will mean we'll see a high-teens decline of that. Is that in reference to the US business specifically, or is that number quoted in the totality of the RBP business? Thank you.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Again, Harold, I'm going to take the first one, and get Adrian to answer the second one. I think when you have a tremendous growth rate like we have enjoyed in the first half of the year, it can't be pinned to one factor.

We had clearly a very good season this year in the first six months against a very modest one in the previous year, so the comparators are very different.

We've had strong innovations going through the marketplace. We've got -- not just on Mucinex, the example that I've given in both the January presentation, but also in this one. We've constantly innovated behind Mucinex, what this brand used to be. Just two to three years ago to where we have taken it is just an amazing example of how you can take power brands and make them relevant in new, interesting segments.

And we've done that also for Nurofen, for example. Nurofen, we've launched into Nurofen [teens] in a number of markets; we've launched Nurofen patches. So geographic and segment expansion is the core driver of our healthcare business, and will remain so as we go forward.

Now clearly, as you know, in healthcare you don't switch on and switch off so easily; you have to wait for regulatory approvals, you've got to make sure that you've got the right conditions for entry. But we are not focused on just one element of healthcare, we are focused on a number of elements of healthcare.

But in terms of growth rates, I think the only sensible answer I can give you in terms of what kind of growth rates you should expect for healthcare, you should expect, on a medium-term basis, healthcare to be growth accretive to Reckitt Benckiser. That's why we have said that Health and Hygiene form, in combination, the core focus in terms of growth into the future.

But I don't think we are ready to tell you exactly what kind of growth rates you can expect, except to think that we are focused on a number of levers on health; growing our core brands; expanding them into new geographies; making them relevant in the new segment; and supporting them with fantastic innovations; and backing them with the [high] investment; but also building capabilities in R&D in regulatory, in clinicals, and so on so forth.

So it's quite a lot of work which has been done, and will be done, to make this business growth accretive to Reckitt Benckiser.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Howard, on the RBP question, yes, the indication we gave of high-teens decline in quarter 3 and quarter 4, if share remains constant, was for the total business. And that really derives from the fact that the US is such a very large proportion of the total business.

I would just take the opportunity to point out one other thing, and that is in the first half you'll have seen that the margin decline of 660 basis points was for the half as a whole, but the revenue decline was very much confined to quarter 2. So you should bear that in mind when you think about the margin implications in half 2 of the high-teens decline in the top line.

Harold Thompson - *Deutsche Bank - Analyst*

Thank you very much.

Operator

Rosie Edwards, Goldman Sachs.

Rosie Edwards - *Goldman Sachs - Analyst*

Two questions from me. Firstly, on RUMEA, the sequential slowing was a slight surprise, and it seemed like the incremental issue there was in parts of Africa. Could you give a bit more detail in terms of which countries, and where you're seeing the biggest driver of that slowdown?

And secondly, in LAPAC, obviously, margins maintained there. I'm assuming that is whilst BEI is also being increased as well. What is the main driver offsetting that increased BEI investment? Thank you.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, let me just point out to RUMEA first. We've always flagged that conditions at RUMEA for our business have a number of different kind of challenges. There's not one thing I could point out. But on the other side, I also think RUMEA's a very fighting area for us.

So let's point out to some of near-term issues that we've seen. One is that we do see some socioeconomic issues. Some of them grab the headlines, that you know, in North Africa, for example, but also in other parts of Africa, but not everywhere. So Africa, there are some challenges in socioeconomic terms, but also we have some operational challenges to take care of in Africa. It's not all outside. I think we are working through some of our own operational challenges in Africa.

In Turkey, we have a fantastic business in Turkey. We've always had a great business in Turkey. We have, just at this point in time, a competitive intensity in Turkey, which has been quite different from what has been before. And we will navigate through that competitive intensity, as we always do. So it's a question of wading through our competitive challenge, and it will even out, and then we will see this business turn into the kind of growth business, or high growth business that we've always seen it to be.

And then the third bit is in Russia. Our business in Russia is very big, is very strong, we like it a lot. But one of the big brands in Russia has been Nurofen, and some product lines of Nurofen have been what is called up-scheduled, behind the counter from front of counter. And we did flag that some months ago and said that, that effect will continue, particularly in the first half of this year.

What do I think about RUMEA going forward? First of all, RUMEA we carved out as a special area in the future because the combination of Russia, NAMID, which is North Africa, Middle East, Turkey, there's a very large Arab cluster, but also the African market remain very exciting in the future. Six of the 10 fastest-growing economies in the world are in Africa.

So we are very excited about the opportunities of RUMEA, but we also recognize that there are some near-term issues that we will navigate through, and hopefully we will see a stronger business in the future.

Then we come to -- and, therefore, I'm not -- none of the growth we've seen in Russia has surprised us. We fully expected it to be like it is, and we do, however, back the long-term opportunity of RUMEA.

In terms of LAPAC, we've had a very, very good LAPAC growth, I would say, for the last many quarters in a row. We have very strong businesses in LAPAC. And we continue to invest very strongly in both BEI, but most of the BEI investment is going through for our brand building. Penetration levels in LAPAC are still very low. Take the example of India or China, where penetration of dishwashers is less than 1% or 2%.

So we have in LAPAC area in Brazil, in India, in China, and [back] markets like that, brand building at a very, very basic level of investing for long-term penetration growth.

But then we also back our recent innovations that we've launched in the market. I've just given an example of a Vanish SuperBar that we've launched; the Mortein SBP product in Brazil; and we launched new innovations to support penetration, support brand building, and we're investing behind that.

So LAPAC, I think is in a very strong place right now, and we are constantly excited by all the opportunities in building our brands in this area.

Rosie Edwards - *Goldman Sachs - Analyst*

Okay, so my question was more you're increasing your investment and yet your margins are flat, so what's enabling you to do that, top line leverage?

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Yes, and I think if you look at -- let's take a look at-- when you think about LAPAC, it's very difficult to talk about LAPAC for even one half. We need to think about these markets for very long terms.

And this is the reason why -- let's take a look at the last 18 months in LAPAC. We've grown 18 months by 11%. And during that 18 months, we've also improved our operating margins in LAPAC. I think that shows the strength of both our brand portfolio, category choices, but also the virtuous model we have put in place.

LAPAC margins in the first six months, I think up plus 10 basis points, or something like that. But I'm not concerned by that. I think we've invested strongly in the first half behind our brands, behind our penetration program, and we fully expected it to be like this. So I don't know whether you find that to be a surprise for you, but we --

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Rosie Edwards - *Goldman Sachs - Analyst*

No, it was the difference relative to RUMEA I just thought was interesting in terms of your margin.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

I can explain that. I can explain why there's such a big difference between LAPAC and RUMEA. Well, RUMEA is -- actually, if you think about what we did 18 months ago, RUMEA's a new area. By and large, that's a new area organization, a fully new [area]. So I think it's still -- when you look at how much investment we're making in building RUMEA as a unique area, as a standalone area, I think that's where you see quite a lot of the difference is.

And secondly, of course, the growth rate in the first six months between LAPAC and RUMEA is different; LAPAC grew at 11%, RUMEA grew at 6%. And I don't have to tell you that there is an operating leverage, which is much in LAPAC than what it is in RUMEA. So there is a combined impact of both a new area, and a very different operating leverage structure between these two areas.

Rosie Edwards - *Goldman Sachs - Analyst*

That's very helpful, thank you.

Operator

(Operator Instructions). Chris Wickham, Oriel Securities.

Chris Wickham - *Oriel Securities - Analyst*

It's just a small question, really. I was wondering if we actually could expand a bit more on what happened with Food in the second quarter, and where you would expect that to go in the second half of the year, please.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, let's take a look at Food. The current Food category in the US is in a tough place. Competitive environment is very tough; the market growth environment is tough; there is more Food inflation that perhaps was driving food categories for a long time. But we have a very strong portfolio of brands in Food. We know how to operate in a Food environment in the US.

And although I don't give specific numbers and guidance for Food growth rate, in the first half the business has been flat. And we will navigate through all these tough challenging environments that we have, both from a competitive point of view, but also from a market point of view. I remain very confident that in Food we have a very good set of brands, and we have people in that business who know how to do well.

Chris Wickham - *Oriel Securities - Analyst*

And the margins as well? I presume, obviously you're talking about Food inflation, that would be the main contributor to the margin dip, but what chance of the margins turning round in the second half?

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Again, we are not giving a specific guidance on Food margins for the second half.

Chris Wickham - *Oriel Securities - Analyst*

Okay, that's fine. Thanks very much.

Operator

Iain Simpson, Barclays.

Iain Simpson - *Barclays - Analyst*

Thank you very much for allowing me a follow up, gentlemen. Just on the Suboxone film/tablet mix, I think you've previously said that we should think of film as being around 1,200 basis points below tablet in terms of price, with round about a 1,000 or 1,200 basis point lower margin, so implying EBIT per scrip, if you will, 20%/25% below tablet. Could you just update us of whether or not this has changed at all as the competitive environment in Suboxone has heated up? Thank you.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Well, in the most significant way it's changed is we're no longer selling the tablet. So there is no comparison any more to make of that regard. I think the numbers you're indicating are consistent with the ones we gave you quite a while ago. But there is no more tablet to compare it against.

Now what we have said is that the generic tablets have launched at a nominal price, at a list price somewhere between our old tablets, the discontinued tablets, and the film, and, to our knowledge, that broadly remains their list price. But, clearly, they offer significant discounts to their pharmacy customers that take the discounted price of their product beneath the price of our film. But for details on that, you need to ask them more than you need to ask us, I guess.

Iain Simpson - *Barclays - Analyst*

Thank you very much. But I'd be correct in thinking that your film price has not changed materially over the last six or 12 months? That's what I was trying to get at.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

I think that's a fair assumption.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Yes, exactly.

Iain Simpson - *Barclays - Analyst*

Thank you very much.

Operator

Guillaume Delmas, Nomura.

Guillaume Delmas - *Nomura - Analyst*

Two questions from me. First, on competition, to follow up on a previous question, could you shed some light on what you're seeing in Brazil in Mucinex? Reason being, Brazil, one of your key competitors there has been quite vocal about the fact that it has entered the surface care category, so I'm wondering if you've seen any impact for your Veja brand in Brazil.

On Mucinex, you clearly had another strong quarter in Q2, so should we read into this that Perrigo is having a little impact that you've been able to offset with innovation? Or is the Perrigo impact yet due to materialize?

My second question is on market growth. You continue to talk about some slowdown in emerging markets. In fairness, you've been talking about this for almost 18 months now; just wondering if you saw further slowdown in Q2 related to Q1.

I guess what I'm getting to is the fact that you revised up slightly your sales guidance for the year in a context of what seems to be slowing market growth. So does it effectively mean that your level of outperformance relative to the market will be in excess of 200 basis points for the year? Thank you.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, let's deal with the competition question first. No, we do see competition intensifying in markets where everyone wants to get more growth. Think about it, there's always been great competition in Europe, but everyone also wants to also drive markets like Brazil, like India, like China to get more growth for their business. So we should not be surprised to see more competition. Indeed, we are offering more competition to our competitors in many of these markets.

Is our Veja brand facing more competition today than it was two to three years ago? I do think so. Will it face more competition in the next two to three years versus today? I also think so, just as the way Veja will provide more competition on more segments to our competitors. I think this is something which we fully expect, and fully know how to deal with.

It's the predictable nature of competition that we are very happy to deal with; it's the unpredictable nature which you then don't sometimes figure out too. I think is whether there's more competition today in surface care in Brazil? Absolutely.

As we know, Veja is an amazing brand, a brand that has tremendous scale, scope, and opportunity in Brazil, so we remain very confident that Veja has all the drivers of growth to help our Brazilian business, and our LAPAC business to grow.

In terms of Mucinex, I believe that it's too early to call on what exactly is the impact of the generic situation going to be in the US because Mucinex generics only started to appear somewhere in the Q3 area.

And although we also said that the flu season was a better flu season in Q2 versus prior year comps, and then a normal flu season that you expect in the second quarter, well, on the other side, Q3/Q4 seasonality might be very different in terms of the size, at least, if not how it compares with the prior year. I would say the Mucinex generic impact is more likely to be properly felt in the second half versus the first half, and more particularly the second quarter.

But I would step back from this because Mucinex generic is very different to a generic in RBP. This is a brands business, and consumers choose brands over private label when brands offer great value; offer great value through superior benefit, and superior value propositions.

If you look at our track record on Mucinex, I've always emphasized just how much you can do with innovation. So although I do know that the impact of generics in Mucinex in the second half will be more than the first half, simply because it did not [practically] exist in the first half, but equally, we also know that this is a brands versus private label side.

As we know how to in many other markets, we've got to make sure we convince consumers of the superiority of Mucinex versus private label, which we believe we can. And secondly, we've got to launch great new innovation, which we are. So that's how I would call the Mucinex bit.

I think you also talked about emerging markets slowdown. Yes, I have called that a long time ago. But I think when you look at emerging markets you see the whole concepts of these markets on the one side, but also the opportunity for us on the other side.

Although the markets in second quarter was maybe somewhat slower than the first quarter, I would say, in emerging quarters somewhat slower, but I don't look at that too much. I think -- I also look at our opportunity to drive growth through penetration, through innovation, through building capability, and through executing extraordinarily well, through investing.

So, in [sum], I am fully aware of the market conditions in emerging markets; I have always been fully aware. But internally, I'm much more focused on how well we can outperform these market conditions. Now we cannot always go against the market, that is always true, that at the end of the day we cannot walk on water all the time, but we will try.

Guillaume Delmas - *Nomura - Analyst*

Okay. And just to follow up on that, so we've got slowing market growth. You've achieved another 6% like for like, so clearly your level of outperformance seems to be in excess of your guidance or your target of 200 basis points. Is that simply a function of a good flu season in the US? Or are you actually gaining more shares than you anticipated?

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

No, I think the first thing is that the flu season improves the market, doesn't it? So, in that sense, we can't count it in one but not count it in the other.

And the other thing is that our market outperformance target of 200 basis points remains. But I don't personally judge it if we are ahead in the first three months, or a bit behind in the first three months; I think it's a medium-term target. It's a target which tells you that we want to substantially and sustainably outperform our markets.

I put a number of 200 basis points to say that's the type of outperformance you should see. Are we doing in that range in the first six months? Yes, we are. But if it was 100 basis points on the other side, I would not be dramatically too excited, or too upset, simply because it's a medium-term target, to show that we have the capacity to outperform the markets we play in and not just be, let me call it like this, a victim of the market. We don't want to be a victim of the market.

I think if you look at the whole strategy we put in place two years ago, the whole strategy was about changing the market conditions that we operate in ourselves.

We said Health and Hygiene are faster growing categories versus the other that we operate in. By growing our Health and Hygiene business faster than the others, we will be in faster growing markets. So if nothing changes, nothing, over the next five years, I believe we can add to the market growth rate simply by restructuring our portfolio over this period of time. And then if we outperform that market, we should be in a good place. And that's the essence of the strategic move we have made over the last 18 months, or so.

So, yes, we are outperforming the market by 200 basis points in the first six months. Is it more or less? I don't want to get into this exactly because it's not a six-month type of thing. Medium term, that's what we want to do, and we are on track.

Guillaume Delmas - *Nomura - Analyst*

Thank you very much.

Operator

Chas Manso, Societe Generale.

Chas Manso - *Societe Generale - Analyst*

A few housekeeping questions, really. Just on the margin drivers, could you remind us what your BEI target is for the full year? You said 80 basis points in H1, and it was weighted to H1, so just trying to get a reminder of where you expect that to be for the full year; and maybe whether that's the right level at the end of the year, or you need to do more BEI investments incrementally after that.

And on what you've termed capability spends, how many basis points was that? Was it material? I guess it must have been, seeing as you called it out. And how much more is there to go there?

On the private label, you mentioned that the gross margin benefited 100 basis points due to the lack of private label this time round. What was the impact of that at the EBIT margin level? Thank you.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Do you want me to take any of these, or will you --

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Well, fine. Chas, we haven't given, and we're about to give, targets for BEI spend for this year. We did have a target last year in 2012 for BEI, but that was special circumstances. So we're not giving this particular target this year. We've given an intent to maintain overall operating margin, and that really is as far as we're going.

Clearly, we call out the BEI as we go along, because it's an important element of our spend, and you can see that we've invested strongly in it in the first half.

I will repeat what we did say in terms of forward-looking guidance, if you like, and that is we told you last February that we intended BEI to be stronger in the first half than the second. We intend it to get off to a fast start, and that's exactly what we did do. But beyond that, it's not sensible for us to get into minutiae of those sort of numbers.

In terms of the level of capability spend, Chas, what we tried to explain was with a 230 basis points increase in the gross margin we had an 80 basis points increase in BEI spend in the first half.

The corporate income effect, if you take the GBP30 million of corporate income we had in half 1 last year and the GBP0 we had in this year, is about a 60 basis points effect.

There is a little bit of a Propack effect, you're quite sharp to pick that up, in that the EBIT improvement on Propack was less than the gross margin impact, quite significantly less. That was the nature of its business. So that also accounts for part of the difference between the 230 basis points gross margin, and the minus 10 basis points at the net margin.

But the difference is capability investment. It is investment in the areas we've called out. Healthcare R&D, this is an area we're focusing on, obviously, as we become bigger in consumer health. The investments at the area level within emerging markets that Rakesh explained in response to an earlier question on RUMEA; and also, some level of IT spend, which as the world becomes more digital there's plenty of opportunities in that area.

All those areas we've invested in somewhat over the half. But nothing surprising there in our view. This is part of ongoing good management of the business, good management of the margin, and I'd say no surprises from our perspective at all.

Chas Manso - *Societe Generale - Analyst*

So would you say then that the capability spend is at least equal, if not greater, to the BEI spend this half?

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

I'm not going to put a number to it. But just what I would repeat again, the mathematics; 230 basis points gross margin; 80 basis points BEI; 60 basis points effect of the corporate income; a little bit of effect of the Propack net margin impact you're calling out; and the rest of it is capability. So, yes, it's not trivial, that's why we're calling it out. But we're not going to get down to total minutiae.

Chas Manso - *Societe Generale - Analyst*

Okay, thank you.

Operator

Martin Deboo, Investec.

Martin Deboo - *Investec Bank - Analyst*

My question is on the provisions. Adrian, if you did mention this on the call and I missed it, I apologize. But I just wanted to get more of a sense of what is in that GBP225 million, just anecdotally what are you allowing for? And specifically, does that include any allowance for the FTC referral on RBP?

I guess second question, just following up from Chas' on margins, I understand you're up against a tougher EBIT margin comp in the second half, but you've got very strong growth. You seemed to hint just then, Adrian, that the A&P increase should be H1 loaded, and you haven't got the tough comp of the corporate windfall, so it just feels to me like margin could be strong in H2. Can you give any commentary on that? Those are the two questions.

Adrian Hennah - *Reckitt Benckiser Group Plc - CFO*

Sure, thanks Martin. In terms of provisions, I'm afraid if you didn't hear earlier, I'm sorry, maybe you'll have to listen to the transcript. But we can't say more than we said before, which was that these are a small number of historic cases that have been going on for a while. They reached the stage in the half where under the IRF rules it's appropriate to provide for them, and we provided for them. Really, that's about as much as we can tell you. I'm sure you'll appreciate that it's not an area that makes sense to go into in any great detail.

In terms of the margins going forward, no, we're not changing our guidance. Our guidance for the year is to maintain operating margins.

Yes, we did mention that BEI was going to be stronger in the first half than the second half. But there's a whole load of components of margin, not least how much do you invest behind the business. It's always possible to push up margin. But we're managing this business for the long term, and the level of investment that goes into the business is a very critical factor of what we consider in margins. And looked at in the round, we're not changing our margin guidance for the full year.

Martin Deboo - *Investec Bank - Analyst*

Okay, that's very clear. Thank you.

Operator

Alicia Forry, Canaccord.

Alicia Forry - *Canaccord Genuity - Analyst*

Just with regards to the 6% core like-for-like outlook that you're giving us for the full year, we've heard this morning on the call that we expect Health to slow a bit in H2; RUMEA and Food aren't necessarily expected to improve in the second half. So I just wonder if you could talk a little bit about what categories, or geographies, you expect will accelerate in H2 to offset those slight pressures and allow you to maintain the top line momentum that you've reported thus far this year.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, let me just first and foremost clarify, Alicia, that we have set targets for the full year. The full-year targets are 5% to 6% of total net revenue growth, including the impact of net M&A. What I've said today is that I expect full-year total, net revenue, including the impact of net M&A, which I have said earlier in the year to be just over 100 basis points, that we will now see it at the upper end.

So just to correct the perception that I am from now saying that the full-year target like for like is 6%. I'm not saying that, I'm saying full-year total net revenue target is expected to be at the upper end of the 5% to 6%, including the net M&A effect.

In terms of which categories do I see in the next six months versus the first six months, well, clearly Health, for example, is never going to -- [I know] is a very big number, the way to say it, but Health, to get 14%/15% growth rate in six months is an amazing achievement. I do not expect that to be the kind of growth rate you should expect from Healthcare.

Healthcare category is growing, by and large, in, I would say overall, in normal conditions at somewhere under the mid single-digit range. And we need to outperform that kind of normal market.

So I don't want to give specific category by category target, but I don't think you should assume us to do as well in the second half on Health, as we did in the first half. If we did, I would be delighted. I would be thrilled. But I don't think it's reasonable to expect, not reasonable to expect. And I can't give you any more specifics on what kind of growth rates by which category, where.

Alicia Forry - *Canaccord Genuity - Analyst*

Okay, thanks.

Rakesh Kapoor - *Reckitt Benckiser Group Plc - CEO*

Right, in case there are no further questions, can I just thank you for joining us on this call. We'd like to hear your feedback, how you felt about this. And, hopefully, we'll see you all shortly. Thank you very much.