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RB.L - Half Year 2015 Reckitt Benckiser Group PLC Earnings Call

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OVERVIEW:

Co. reported 1H15 revenues of GBP4.356b and adjusted net income for continuing business of GBP720m. 2Q15 revenue was GBP2.140b. 2015 like-for-like net revenue growth target is plus 4-5%.



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CORPORATE PARTICIPANTS

Rakesh Kapoor *Reckitt Benckiser Group plc - CEO*

Adrian Hennah *Reckitt Benckiser Group plc - CFO*

CONFERENCE CALL PARTICIPANTS

Iain Simpson *Societe Generale - Analyst*

Martin Deboo *Jefferies & Co. - Analyst*

Charles Pick *Numis Securities - Analyst*

Chris Wickham *Whitman Howard - Analyst*

Guillaume Delmas *Nomura - Analyst*

Toby McCullagh *Citi - Analyst*

Jeremy Fialko *Redburn Partners - Analyst*

Alex Smith *Investec - Analyst*

Chas Manso *Societe Generale - Analyst*

PRESENTATION

Operator

[Good day], ladies and gentlemen, and welcome to the half-year results 2015 conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Rakesh Kapoor. Please go ahead.

Rakesh Kapoor - Reckitt Benckiser Group plc - CEO

Good morning and welcome to RB's half-year investor presentation. With me today on this call is Adrian Hennah, our CFO.

I have three key messages for you today. Our focus on health and hygiene Powerbrands is working. We've always said that when we focus, we win. Our overall growth rate, spearheaded by our health and hygiene brands, is improving, with health in particular also making a difference to our margin progression. These results confirm that we are making the right strategic choices.

Our virtuous earnings model is delivering. In 2012, we made a conscious decision to increase investment behind innovations to drive long-term growth and build the equity of our brands. However, this has not come at the expense of margins.

In order to fund this investment, we've enhanced our focus on gross margin expansion, and more recently, fixed costs under Project Supercharge. This is what makes RB's earning model so virtuous, and this is how we are delivering excellent results and value for our shareholders.

Thirdly, as a result of a strong half 1, I am pleased that we are raising our full-year targets, both at net revenue and operating margin level. I will give you some more information around these new targets at the end of this presentation, but let's start with the first point on how our health and hygiene focus is driving growth and outperformance.

Nearly four years ago, we made a strategic shift from being a household cleaning company to one focused on health, hygiene and home. Within this, we've prioritized resources against our health and hygiene brands across all markets.



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Now I know we don't normally disclose this level of granularity, but it is important to highlight that our focus is paying off. As I've always said, for us and our industry to do really well, we need to find a way to grow in both developed and emerging markets.

As this chart demonstrates, we are able to achieve very good broad-based growth across our ENA markets, not just in developing markets. I believe a 6% in ENA in health and hygiene is a very good result.

Let me also spend a moment talking about our home brands. We have some very strong and well-loved brands in our home segment, like Vanish and Air Wick. While we are not happy with the growth on our home brands, we continue to work hard on innovating behind these brands, such as our Vanish Gold innovation in developed markets, and our Vanish Superbar in developing markets. And in Air Wick, we are launching a range of innovations under the Life Scents platform.

So we are working hard on our home brands, but the reality is that the home category is more competitive and that category growth rates are lower because the size of our developed markets business in home is more than double that of our developing markets business.

Now let's turn to my second message, which is that our earnings model remains virtuous.

I have consistently said that our earnings model begins with gross margin improvement, and I'm very pleased to say that we are delivering a healthy 90 basis points of gross margin accretion during the first six months of the year. This excellent performance was driven by a combination of positive mix from our very strong growth in consumer health brands, input cost deal wins offset by FX, and our ongoing cost optimization program which you know as Project Fuel.

Our fixed costs and non-BEI costs came down by approximately 100 basis points, driven partially by the phasing of some comparatives, but mainly from early savings achieved under our Project Supercharge program.

I'm extremely pleased at how quickly and willingly our organization has embraced the Supercharge mindset, or the treasure hunt as I call it, and not only are we going to achieve savings earlier than I first thought, but we will achieve the upper end of the GBP100 million to GBP150 million annualized savings by the end of this program.

It is important to emphasize that what we are achieving here is just more than cost savings. The objective of Project Supercharge goes well beyond cost savings. It's about simplifying our Company. It's about making us more agile, making us more competitive. [It's such] a powerful demonstration of our ownership culture and our people's deep commitment to embrace change that makes RB better and makes me so proud.

Back to the earnings model, the combination of gross margin expansion and Project Supercharge savings has created a significant amount of room within our P&L to invest further behind innovation support, healthcare professional programs and penetration-building activities, all of which build the equity of our brands.

In the first half, we invested an additional GBP43 million in BEI, which is 30 basis points of net revenue. In reality, we invested even more. Because of continued savings in both media and non-working media initiated with Project Supercharge, our investment level at the end of the first half was a very healthy 14.4% of net revenue.

So when you put all these [considerable] parts together, we delivered 160 basis points of operating margin expansion, which is an excellent result. So this is a strong set of results, and before Adrian goes deeper into the half-1 financials, let me summarize these for you.

We achieved like-for-like net revenue growth of plus 5% in both Q1 and Q2 in which our health and hygiene brands grew by 7%.

The top-line improvement, combined with the strong gross margin expansion and the early benefits of Project Supercharge, have enabled us to deliver excellent net income growth of 9% on an adjusted basis, and at constant exchange rates.

You will also see that our continued focus on working capital means that our cash conversion rate is over 100% of net income.

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We are paying an interim dividend of 50.3p per share, a 50% payout of adjusted net income, and in line with our capital allocation policy, which we communicated to you in our February announcement. You may remember that the interim dividend a year ago was 60p, but this included earnings from RBP, or Indivior and this is now called.

And now, ladies and gentlemen, for the detail and the person you've been waiting for. I hand you over to our CFO, Adrian Hennah.

Adrian Hennah - Reckitt Benckiser Group plc - CFO

Thank you, Rakesh, and good morning, ladies and gentlemen. We can turn now to the income statement slide.

As you've seen, revenue for quarter 2 was GBP2,140 million, a like-for-like growth of 5%. Total growth at constant rates in quarter 2 was 4%. Effect of the K-Y acquisition was slightly outweighed by the footwear disposal. Revenue for half 2 was GBP4,356 million, also a like-for-like growth of 5%.

Looking forward into the rest of 2015, we continue to expect the net effect of acquisitions, disposals and discontinuations, made or announced to date, to be a small reduction in full-year reported growth. The exact impact will depend on the timings around the Russian hospital business.

Movements in foreign exchange rates reduced the quarter-2 reported revenue growth rate by 3%, and reduced the half-1 reported revenue by the same amount. We've set out an analysis of the impact of currency movements and net acquisitions in the appendices to this presentation and in the release.

Gross margin in half 1 increased by 90 basis points, similar to the increase in 2014. Adjusted operating profit before exceptional costs in the half was GBP953 million, an 11% constant currency increase on last year. The profit margin was 21.9%, 160 basis points higher than half 1 last year. We'll return to the drivers of these movements in a later slide.

Exceptional items in the half were an expenditure of GBP14 million. These arose under the existing restructuring and integration programs communicated to investors. We have set out in the appendix the guidance we have given for exceptional items and our progress against that guidance. We are fully on track with the guidance we've given.

Moving then to the next slide and further down the income statement, net finance costs in half 1 were GBP18 million, in line with the prior year.

The tax rate and adjusted net income, i.e., excluding exceptional items for half 1 was 23%, in line with our expectation for the full year and in line with guidance. The prior-year tax rate benefited from some one-off items.

As you will know, the Chancellor here in the United Kingdom has proposed future reductions in the UK corporate tax rate in 2017 and 2020. If enacted, these reductions will have only a small impact on our ongoing tax rate. It will have a larger one-off impact on our reported tax charge in the year of enactment, as we have a significant deferred tax liability in the UK, the size of which will be reduced by a lower future tax rate. There is no foreseeable impact on cash tax payable.

Adjusted net income for the continuing business was GBP720 million in half 1, a 9% increase at constant exchange rates, and 7% at actual rates.

Sterling has been quite strong recently. Accordingly, if the exchange rates at June 30 were to remain at that level until the end of 2015, we would expect reported earnings growth at actual rates to be reduced by slightly more in the full year than in the half year.

Discontinued net income refers, of course, to the income of Indivior demerger on December 23 last year. We understand that Indivior are reporting their half-1 numbers in a couple of days on July 29. We are pleased that judging from their published quarter 1 numbers and their share price, the business is doing well since the demerger.

The Board have approved an interim dividend of 50.3p per share, in line with our policy of paying out 50% of basic, i.e., non-diluted, adjusted earnings. This is a reduction on the interim dividend in 2014, due of course principally to the demerger of Indivior.



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We announced in February our intention to supplement our regular program of buybacks to neutralize the incentive plan share issuance with a further GBP500 million of buybacks in 2015, targeting a total of GBP800 million in the current year. We have been executing on this program, and at June 30, had bought back GBP452 million of shares in half 1.

If we could turn now to the next slide, an analysis of growth rates by business segment by quarter.

Firstly, on the price and volume components of our revenue growth, the 5% net revenue growth for the Group as a whole in quarter 2 was, as in quarter 1, oriented more heavily to volume on the one side and to mix and price on the other. For half 1, net revenue growth comprised roughly 80% volume and 20% price and mix.

With respect to ENA sales, we again achieved strong growth of 4% in quarter 2. Sales growth in North America of 3% benefited from the launch of our Express pedi product under the Amope brand and a strong performance of the new Life Scents Airwick range.

Sales growth in the rest of ENA was spread across many European markets and across Australia and New Zealand. Russia grew strongly as a result of price increases, but volume was weak.

In developing markets, we delivered 8% like-for-like growth rate in quarter 2. The geographic pattern of growth was similar to quarter 1.

We saw continued gradual improvement in India, and a continued strong performance in China and in Turkey and the Middle East.

We saw a mixed performance in Africa. West Africa, and Nigeria in particular, continue to be a weak economic environment. And South Africa continued at a modest level.

We saw continuing challenging market conditions in Latin America, especially Brazil, and also in South East Asia, especially Thailand and Indonesia.

In food, we called out at the slightly earlier timing in Easter and boosted the quarter-1 numbers, and you can see the correspondingly slightly lower growth in quarter 2, an encouraging 3% growth in the half. Revenue outside the USA, while still small, is growing well. And the core United States French's and Frank's brands continue to show great strength.

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

Turning then to the next slide, an analysis of revenue growth rates for our principal product categories.

Firstly health. We delivered a growth rate of 13% in quarter 2. The performance of the Scholl brand, together with Amope in the Americas, continued to be very strong. The Velvet Express pedi range continues to be an important contributor, but also, a new range of insoles. Durex also continued to perform strongly across many geographies. Mucinex was weaker with a strong comparative.

In hygiene, we delivered 3% growth in line with quarter 1 and with last year. Finish had a stronger quarter, and Mortein also grew well, with strong pest seasons in a number of countries.

In home, we delivered 2% growth in quarter 2, with good Air Wick growth from the Life Scents range.

Portfolio brands were down 6% in quarter 2. This category includes the food business, which grew at 1% in quarter 2. We have recently created a separate team to focus on much of the rest of this category, and do expect to see improvement in time. Outside the food business, reported revenue is likely to remain quite volatile.

Turning then to the next slide, an analysis of margins.



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We delivered a strong, 160 basis points operating margin improvement in half 1, equal to the level of increase in the 2014 full year. This was more than we expected to achieve in half 1. As always with margin improvement, it is important to understand how was it achieved, was it done in a healthy way, and is it sustainable.

This chart shows that of the 160 basis points improvement, 90 basis points came from gross margin. We reinvested 30 basis points in increasing brand equity, and 100 basis points, therefore, came from non-BEI SG&A expenditure.

Firstly on gross margin. Improvement in half 1 was the same as in 2014, an increase of 90 basis points. It continued to be driven by a number of factors. Mix improvement, arising from the faster growth in health sales, was the single most important driver.

Commodity price sale wins continue to be helpful. The transactional foreign exchange effects were, however, negative, in large part due to the weakness of most currencies against the dollar. Our own efficiency programs continue to be important.

Secondly, we increased our investment in brand equity at 14.4% of revenue in half 1. This delivered a \$43 million increase in absolute BEI at constant rates. And we also reinvested the material efficiency savings emerging from our Supercharge initiative.

Thirdly, we succeeded in reducing our non-BEI SG&A expenditure by 100 basis points to 21.3% of revenue. This was the result of the organizational simplification and the range of initiatives we have under our Supercharge program. These are yielding benefits faster than we expected. They come from a wide range of expenditure types and geographies, as you would expect from a program of this nature.

We do not have large pots of unnecessary spend to remove. We do have lots of activities which can be done in an incrementally better way if one deploys the right energy in looking for them, and executing on them.

Examples of activities where we are making improvements include the more routine elements of the way we produce advertising copy and deliver it across the Group for use with consumers; or the way we use market research data that we have acquired across the Company; or the way we design, procure, and deploy point-of-sale material in stores; or the way we assure we avoid inventory approaching the end of its shelf life, and the way we handle it if it unavoidably does.

The list is a long one. A significant number of the opportunities have been made possible by organizational simplification, in particular, the creation of the Power of One teams. These teams are providing a more effective link between the creative activities in our global category teams and the channel execution in our markets. This drives simplification in copy production, in the use of market research data, and so on, and so on.

We see all these savings as materially sustainable, and momentum that this earlier-than-expected delivery has given us will enable us to deal more effectively with the 100 basis point margin headwind we have from the comparator in half 2.

Turning then to the next slide, this shows an analysis of operating margin before exceptional items by business segment for half 1.

Within ENA, we saw continued strong margin progress, 160 basis points increase. In gross margin, mix was an important contributor, and our own efforts in supply too. Supercharge savings were strong.

In developing markets, we also achieved, coincidentally, 160 basis points increase in the half-1 margin. Within gross margin, price was an important contributor, as one would expect given the higher price inflation in a number of the markets served. Mix too was important; and Supercharge savings were strong in DvM too.

In food, we achieved a 320 basis point increase in half-1 margin following the planned modest reduction in margin in 2014. A significant part of the increase arises from the timing of marketing spend and will reverse in half 2. A substantial part comes also from gross margin improvement, where focused attention to mix and to cost has delivered a good improvement.

Turning to the next slide, and a summary of the Group's net working capital position.



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You can see that the strong overall position continues. We have achieved improvements in payables during half 1. The level of payables, however, can be variable, and our goal remains to maintain net working capital at around the level achieved in 2014, a negative 9%.

We are finding opportunities for improvement in working capital, as in costs. These are offsetting the slight headwinds receivables and in inventory levels as we increase the size of our consumer health business. The Group's keen focus on this area will, of course, continue.

And turning lastly in this part of the presentation to the cash flow statement, as you can see the Group had another good half year of cash generation. Free cash flow generated half 1 was GBP756 million. This was 107% of net income.

The Group had net debt of GBP1.8 billion at the end of the year.(sic - see presentation slides "1H15-end") This was up from GBP1.5 billion at the end of 2015.(sic - see presentation slides "2014") Half 1 saw good cash generation, and also, the GBP566 million payment of the final dividend, and the GBP452 million payment of share buybacks.

And with that, I will hand back to Rakesh.

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

Thank you very much, Adrian. I'm now going to talk to you about some of our innovations for the second half of 2015. As usual, I've had to cut them down to show you, as the list is long. Let's start with health.

Now we have a strong pipeline in health; strong performance of our innovations of the past, but also strong pipeline for the future. Let's start with Mucinex.

Now Mucinex has become a leader in the US cough, cold and congestion market because we are better at understanding what consumers want and what consumers need. With that in mind, we are launching an innovative Mucinex liquid gel range to provide fast-acting relief from the most bothersome cold and flu symptoms in the consumer-preferred format.

When people have a cough or cold, they want a product that works, and works fast. This new range dissolves fast, unleashing the maximum strength ingredients so that they can quickly get to work on pain or on cough, congestion and runny nose, for example.

Now the range comes with three different formulations and includes a variant for sinus relief, as well as a combo pack for both day and night.

From Mucinex, let's move to Scholl, a brand that has been fully transformed under RB ownership.

Now Scholl is an iconic foot-care brand, and under RB, we have really reignited its potential by offering modern, innovative foot-care products, and creating new sub-categories, such as the electronic hard-skin remover.

Scholl is now creating a new electronic nail-care category to make nail-care effortless. Toe-nail care is an even more frequent habit than hard-skin removal. The device files, buffs and shines the nails, leaving them healthy and shiny. The new Velvet Smooth nail-care system allows people a complete professional pedicure in the comfort of their home, a great example, I would think, of our continued efforts to become an even faster company, and confirms that our innovation machine is working as well as at any time, because we've fast tracked this launch by one year to the second half of 2015.

Moving on to Strefen, which is what we call the range of sore throat products that contains the anti-inflammatory ingredient flurbiprofen.

Now you know that our Strepsils range comes in a lozenge format, but some consumers have more severe sore throats which they want to treat with a stronger medication which lasts for longer. This is why we've created a new formulation in a spray format using a unique, clinically proven active ingredient called flurbiprofen. This targets and treats the inflammation at the source of the sore throat and, therefore, gives longer-lasting relief of up to six hours.



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This is now being launched in [13] markets over the next few months, followed by other markets as and when we get regulatory clearances.

Let's talk about VMS now. With Schiff, we applied four strong and trusted brands: MegaRed for heart health, Move Free for joint care, Digestive Advantage for gut health, and Airborne for immunity support. While MegaRed is the largest brand, Airborne and Move Free are not far behind in size.

We continue to learn and make progress on this exciting category which has good, long-term growth potential. Recognizing this potential, we are rolling Airborne in a number of European markets in 2015 with a wider rollout plan thereafter. The Airborne range contains a unique blend of vitamins, minerals, herbs, and a blast of Vitamin C to help provide immunity support. The immunity market today is primarily Vitamin C products, whereas Airborne's immunity blend is unique to the world outside the US.

So from VMS and health, let's move to hygiene, which as I've said, is the foundation of good health. And let's begin with Dettol.

We all know the importance of hand washing in leading a healthy life and preventing the chain of infection. However, hand washing is an underdeveloped habit in emerging markets.

Consumers prefer liquid hand washes over bar soaps because they tend to get soggy and germier as the time goes by. However, liquid hand washes also tend to be more expensive. So [next], this is something of a challenge for RB people to take on.

So we devised an innovative delivery mechanism that gives people the same superior Dettol protection against germs at the price of a bar of soap. Our new hand wash comes with a flip top squeeze bottle that has proven to kill 100 illness-causing germs. I wish I could show this to you personally.

Moving on from Dettol to Lysol and Harpic.

Now people want to keep their toilets shiny and smelling fresh all the time, not some of the time. While our liquids help with deep clean and disinfection, our new Click gel is a self-sticking case-less gel that sticks onto the bowl with an easy to use applicator and lasts for a week [per] Click gel. And as you can see maybe, if you pay close attention to the slide, this is a box of four or five, which means you have four or five weeks of Click gel in Harpic and Lysol.

Now we've launched this innovation under Lysol in the US, but also under Harpic in a number of additional markets in Europe and beyond.

So moving to home, and let's focus actually on Air Wick.

Earlier this year, we launched a range of Life Scents air fresheners. The Life Scents technology offers a unique multi-dimensional, constantly changing fragrance experience.

In the second half, we are enhancing this range with the launch of a premium aerosol range. These aerosols have been designed to release a finer mist and particle size compared to the market-leading aerosol, which means a better fragrance dispersion, lesser fallout.

And to close the innovation section, another innovation from Air Wick. This is Air Wick Wax Melts. This contains a starter kit that fits the home decor trend that we see in the market, plus wax refills that contain three different and constantly changing fragrances with the Life Scents technology to give people the most true-to-life fragrance experience possible. For consumers, this product offers a safer option to candles.

So this is a snapshot of our exciting half-2 innovations and brand rollouts that we will believe will help us to deliver 2015 targets and beyond. So let's move to the 2015 targets.

At the beginning of the year, we set two key targets. Firstly, we set a like-for-like net revenue growth starting at 4%. From a macro perspective, I think ENA markets on the whole remain fairly stable, although Russia will have some volatility. In developing markets, I would expect a similar picture to half 1; a slight recovery in some markets, but other markets such as Brazil and parts of Asia, continuing to remain tough.



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Given these expected market conditions, our strong start to the year, and performance of our innovations, we are now increasing this target to plus 4% to 5% on a like-for-like basis.

And then on our operating margins, you will remember I gave you a [heimlich] target of moderate to nice margin expansion. You've seen what we've delivered in the first half; 160 basis points of margin expansion. Fortunately, there's no English word for this.

In the second half, you might remember that we are lapping a very strong comparative which included a number of non-sustainable cost savings initiatives which we undertook in the half 2 of last year which we estimated at that time to be of the order of 100 basis points. So you could say we start half 2 this year at minus 100 basis points.

Having said that, we do expect a number of the margin drivers from the first half to remain relevant in the second half, including the input deal wins and the beneficial mix.

Given all of these moving parts, but primarily driven by the [accrued] savings we expect to gain from Project Supercharge, we are now targeting moderate to nice adjusted operating margins in half 2, which is in addition to the 160 basis points we delivered in half 1.

So thank you very much for listening, and now Adrian and I will happily take any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Iain Simpson, Societe Generale.

Iain Simpson - Societe Generale - Analyst

Two questions from me, if I may. Firstly, Project Supercharge is clearly coming in ahead of schedule and now looks to deliver savings at the top end of the range. Are you able to run through at all why you've managed to execute better than you'd hoped on Project Supercharge and if there are any takeaways in terms of future cost savings programs to follow on from that?

And then secondly, if I may, looking at health. It seems in general that various bits of your health portfolio are doing very well, but VMS overall, I think you called out a couple of brands as having mixed results. Is this just a coincidence or has your thought process around VMS as a category changed at all?

Thank you very much.

Rakesh Kapoor - Reckitt Benckiser Group plc - CEO

First of all on Project Supercharge, why have we managed to deliver faster and why are we going to deliver at the top end of the range, I think the answer is actually cultural rather than financial.

The answer is cultural because RB people just love a challenge. We continue to underestimate the impact of the culture of RB on our financial results, because somehow, it's very difficult to model this. But I think any mountain that we create in RB is a huge challenge for RB people to climb and, therefore, this drive for continuously raising the game, continuously challenge ourselves to do even better, drives this organization.

And then I said actually Supercharge should not be seen as a cost savings project, although it is a material cost savings improvement. I think there is something more that we are trying to achieve with Supercharge. We are trying to reignite the culture, get people to simply --



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I mean, organizations become bigger and bigger. We are becoming bigger; and bigger organizations are not necessarily faster. And I want to curb the organization's natural momentum of doing things rather slowly as we become bigger by creating a simpler, a more transformed cultural organization that can be more agile, more competitive in the fast-moving world we live in today.

We want to be the most competitive in our industry. To be more competitive, we need to be a simpler company, not to be a lethargic Company. We need to be a more sharper company. Less is more. And I think that is not just true for cost; it's also true for how we organize ourselves.

And I think this is the mentality we are trying to create in the Company; to create cost savings which you see tangibly, but also cultural agility that is so vital to our performance.

So that's how I feel about Project Supercharge.

Moving on to health. Our performance is fantastic on health, and I think it's very broad based. Obviously, there's a less seasonal impact in Q2 versus we had in Q1, which showed the underlying strength of our healthcare brands and how we are innovating behind them and how we are driving investment and market performance, which is all very pleasing.

VMS continues to be a very large and now growing category. There was some growth hiccup last year in the VMS category. We are seeing some growth coming back, which is what we expect because, the underlying dynamics that will drive VMS remain very intact.

And we are still early in this VMS game. I want you to remember; about 1.5/two years ago, I presented at -- we did our Investor Day. We did our Investor Day, and if you take out my slides from the Investor Day, you will have seen that on Scholl we were still finding our feet. We were finding our feet on Scholl. We were two years into the acquisition and it was a rather, I would say, multi-dimensional brand. Let me put it this way.

And managing that for perfection is not easy; doesn't come immediately. But having done two more years behind Scholl, we've figured out how exactly to create a powerful brand and powerful growth brand from Scholl. I feel very confident about how we are managing Scholl and how we have done so much better than what it was being managed for before. Also, on Durex, by the way.

And VMS is just a bit like that. We are too early in the process. We are learning a lot. We are rolling out VMS. Not everything is going perfectly, but I did not expect everything to go perfectly. On the other side we are also making progress.

So I remain positive about BMS as a category, and I remain positive about the quality of our brands, and we need to just keep -- be [at it], as I say, because one day, we'll figure out just how to make it even more impactful for our healthcare, long-term healthcare growth.

So I remain, as I was at the start of the acquisition, that we have four great brands; we need to learn and we need to constantly make progress, which is what we are doing.

Iain Simpson - *Societe Generale* - Analyst

Thank you.

Operator

Martin Deboo, Jefferies.



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Martin Deboo - *Jefferies & Co. - Analyst*

Could I just ask a couple of questions around what I would call the moving parts of margin in H2? First of all, pricing versus commodity costs; I guess the way to phrase it is would you expect prices still to -- price mix still to be in positive territory in H2? And what would you expect your commodity basket to do in H2?

Secondly, just remind me were -- was the work off of Indivior's stranded cost a feature of the margin landscape in H1? And if that's the case, where does that go in H2?

Those are the questions.

Adrian Hennah - *Reckitt Benckiser Group plc - CFO*

Martin, it's Adrian. On Indivior stranded cost, that's easy. They're immaterial. We said they were immaterial once the initial costs had gone out. So there's nothing material going to happen from Indivior costs, either in H1 or H2, or beyond that.

As regards your wanting us to break down prospectively the components of value growth, no, this is ridiculous.

Martin Deboo - *Jefferies & Co. - Analyst*

Okay. Never mind.

Operator

Charles Pick, Numis.

Charles Pick - *Numis Securities - Analyst*

I wonder if you could break down, please, the element of the 100 basis points overhead cost reduction that you spelt out that came from the Supercharge project. And also, there was GBP200 million of costs associated with that project. How much was incurred in the first half, please?

And on the health operations, there was a warning about the flu boost in Q1 and how the 13% like for like then you didn't feel to be sustainable for the year, which you haven't mentioned again today but presumably still applies. Can you comment on that? And was the flu boost material still in Q2?

And does the BMI (sic) increase in the first half apply too for the full year on that basis, up 30 basis points?

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

So let me just take the second one and then Adrian can come in for the first.

Clearly, the flu season impact will always be much more material in the first and the last quarter, because that's when most of the world's flu is. And any other quarters, even if there's a good flu season, or relatively good, its impact will be more modest.

So was there some overhang of the flu season in March/April? It seems so in March and April, which is where we have proper results across from the market group data. But again, in the second quarter, the impact of the flu season is less material than the first quarter, actually.



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In the quarter, while the flu brands did well, but I also said that the non-flu brands are doing well. And the same is true in the second quarter. All our health brands are doing well, but the impact of the flu season in the second quarter is less material, even if there's a little bit of a positive flu season seen in April as a hangover to March, from March. But it's less material.

I don't still believe that 13% growth rate, which is fantastic, is a growth rate that you should use as a way of thinking about our healthcare business, the healthcare category as a whole. I expect in the medium and long-term to grow at 4% to 6%. And, of course, we want [ARPU] from that.

So that's how you should think about our long-term ambition in health. It's a good growth category, and we want to outperform that good growth category through our innovation, through our investment, and so on.

Adrian Hennah - *Reckitt Benckiser Group plc - CFO*

Yes. In terms of the 100 basis points non BEI SG&A improvement, Charles, I think you can say that the bulk of that you can attribute to Supercharge. It's [not impossible] to reconcile these things precisely, but the bulk of it is due to Supercharge.

And as regards exceptionals, you can see we had a GBP14 million total spend on exceptionals in the first half. A large proportion of that was Supercharge. You might ask: isn't that relatively small compared to the full GBP200 million we expect in the program? I think we still absolutely believe that GBP200 million is the right number for the full program compared to benefits we now see at the top end of the GBP100 million to GBP150 million per annum region.

I think a number of the programs that take us a little longer to plan and execute tend to be the ones that require rather heavier exceptional spend, which is why you see us starting well in cost reductions on Supercharge but somewhat more slowly in the incurrence of exceptional costs on the program.

Charles Pick - *Numis Securities - Analyst*

Thanks very much. And the final one, actually, was the BMI spend. Does that --? Sorry; BEI spend. Does that increase the same order of magnitude for the full year?

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

We do not have specific targets to give out on each line of our P&L, Charles. As I've always said, we continue to invest behind our brands, and that has been true in each of our years, and we will continue to do so.

There's something that I would point out specifically and I'd like to just reiterate, which is that the amount of investment that we are putting behind our brands is not simply evident from our BEI investment lines in pure financial terms because there is an element of Supercharge also in BEI.

For example, copy production, advertising we produce, and we have lots of advertising across the world. And the cost of producing that advertising, not just airing that advertising, is part of BEI cost.

Now our new Power of One organization is simplifying how we make copy. We're making one copy when earlier we made five. We're making the best copy being rolled out in every market rather than five suboptimal ones, with a lot of efficiency, but also impact being created with Supercharge. And, therefore, some BEI costs are also coming down, but we are reinvesting all that back.

So I think what I would like to tell you is that when it comes to investment, BEI always gets my [focused] strategy, and continues to do so.



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Charles Pick - *Numis Securities - Analyst*

Okay. Thanks very much.

Operator

[Chris Wickham], Whitman Howard.

Chris Wickham - *Whitman Howard - Analyst*

Congratulations on a good Q2. I'm just wondering if you can give us an indication of that cash conversion number by category. In particular, you've obviously got some categories which, although they were growing slower than Group average, are still recording very high margins; for example, food; and clearly, would have very good cash conversion. And I just wonder whether there's an argument for, even though some of these businesses are non-core, keeping them in the Group for some time to act as funding for your clear M&A ambitions in the main part of consumer health.

Adrian Hennah - *Reckitt Benckiser Group plc - CFO*

Well, there's at least a couple of parts to that question, I think Chris. Are there differences between the cash generations of the different businesses? We do point out that the healthcare business does require slightly higher receivables and slightly higher inventory by its nature. Pharmacists in Southern Europe, for example, have notoriously long receivables [terms] and we organize production in healthcare in a more centralized way around the world for a set of reasons, and that tends to lead slightly [higher inventory].

So there are slightly different cash characteristics between the businesses. That doesn't affect our overall goal for cash generation.

As regards the food business and its position in our portfolio, we're very happy with the food business. It is not core. You can see the way we designate it. But we're very happy with the performance of our food business; some extremely strong brands that are doing extremely well. And that's the position as it sits at the moment, Chris. And really, I don't think we want to go beyond that.

Chris Wickham - *Whitman Howard - Analyst*

That's excellent. Thank you very much.

Operator

Guillaume Delmas, Nomura.

Guillaume Delmas - *Nomura - Analyst*

A couple of follow-ups for me, please. First on the VMS, I think in the press release, you talk about MegaRed still remaining challenging. You refer how to what I understand to be a limited success, at least for now, in Europe since you launched it, or are you seeing some challenges as well in the US?

And moving to Airborne, you announced today a rollout in Europe. What gives you the confidence that the Airborne rollout will be more successful in Europe, at least in the beginning, than MegaRed?



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And my second question is on the brand equity investments. You've further increased them in the first half of the year despite some continuing savings. So my question is: how do you spend this incremental money? Is it more in consumer education programs, initiatives with long-term benefits, or more the usual in-store activation, innovation support?

Thank you.

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

Some excellent questions, actually; so one philosophical actually and the other one quite tangible.

So let's start with VMS. I think when we applied VMS, 12 months thereafter, we actually made the brave attempt to launch it in 23, I think, markets in Europe, 12 months after we got into the category for the very first time. And we were all very excited about it. We remain excited about it, but we launched it in 23 markets across Europe.

And clearly, when you launch it in 23 markets, it's possible, and this has happened, that you are not going to be successful everywhere. And I think we've had some success in markets; unexpectedly, actually, in markets like Spain and Italy, which is more pharmacy-driven markets, if you want, where we've been able to put a retailing program, where we've been able to educate the pharmacists about what heart health is, versus some markets, such as even UK, where we've chosen the route of going direct to consumer.

Now one of the things we've learned is there are some VMS categories which are quite obvious. So vitamin C, people know what it is for. But when you're trying to create a new category like heart health, it does take some time. You need to put a lot more behind the education rather than specifically a normal consumer marketing program.

So this is what we've learned, and this is what has made us launch Airborne in a different way. We're not launching in 23 markets, actually; we are launching in about half of those. And where we are launching it, we are launching it with much more education in mind and much more [deliberate part].

But our ambition to create a VMS business has not diminished, it remains strong, because we fully believe in the underlying structural characteristics of VMS.

Think about the wonderful picture, which I want you to remember each time you see me, which is the picture of a young child. In fact, a few publications ago in the Time Magazine, there was this picture about -- front page picture of a young child, and the caption says: this child will live to be 142 years. 142 years; a child being born today might have a life span of 142 years. That's fantastic news for our children, but fantastic news also for me and my people, because we have 142 years to serve people; not just 78 years. Think about that.

And I think VMS is a lot about wellness, about health. It's about looking after yourself even when you're older; not just at any stage. And that's why this category transcends economic trends. Demographic trends become important. [Social] trends become important. And I think we need to rise beyond the quarter of MegaRed to think about the larger structural opportunities.

And there is no meaningful branded player in this market. There's a huge market with no meaning. So imagine the prize of cracking this. Just imagine the prize of cracking it versus the effort required. It could be quite good.

So I think I'm never phased by such small quarters. I remain very focused on the long-term opportunity here that we could get to. It will take effort. We will have to learn. We will have to continue to try and make progress. And when we get it, the prize will be huge.

This is how -- I always give a parallel to Scholl, because Scholl also is quite multi-dimensional; not easy to get to. But once you get it, the prize is enormous.

So that's what I think about MegaRed and Airborne.



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And do I believe Airborne will be more successful in those parts of Europe where MegaRed has been [poor]? I hope so. We are launching with enthusiasm. We are launching with positive intent. And that's what we hope to see.

On BEI, where are we spending this money? Over the last three and half years/four years, we've increased our BEI spend, I think, by about GBP350 million. I'm making this number on the top of my head; GBP350 million or so. And that's a lot of money.

Actually, it's gone not just behind traditional advertising. It has gone behind healthcare professional programs. It's gone behind our healthcare endorsement. Building brand equity from the very solid foundation. As I just told you the example of MegaRed, once you convince the pharmacist that your brand is good and is better, you have lasting relationships because the pharmacist knows what to dispense, what to talk about. The same is true for doctors.

So we have spent and I won't give you the breakdown, a fair bit of money on healthcare professionals. We've continued to spend money in penetration-driving programs. The mums that we visit before they give birth to their children in hospitals around the world, the programs we run in schools to promote good hygiene practices, form an important and material part of our investment in brand equity.

And, of course, there's this traditional advertising which more and more is being put behind digital, not just television. In some markets, a bulk of our money now is in digital, not in traditional.

So you're right to ask how we allocate resources. We allocate resources of course for the short to medium-term impact of advertising, but also on the long-term brand-building efforts which is driving new people into our brands and our categories with penetration programs like the one I described, but also through healthcare professional endorsement programs.

Guillaume Delmas - *Nomura - Analyst*

Thank you very much.

Operator

Toby McCullagh, Citi.

Toby McCullagh - *Citi - Analyst*

Just one from me, I think. It's on the health growth, which clearly continues to surprise positively and be extremely strong. I just wonder if it's possible to say how much of this growth is coming from new market entry or new geography entry, filling white spaces. Because if we look at some of the bigger health brands, whether it's Durex, Gaviscon or Scholl, over the last two or three years, each of those brands appears to have been launched in north of 30 or so new markets.

And so is it possible to quantify how much of your market outperformance is through some of this white space filling, or how much the growth is in constant geographical terms?

And then actually, a half, if I can add onto this, is that on Project Supercharge you said that it is going to -- that you've been getting the gains early, and you said that they're probably going to go to the top end of the GBP100 million/GBP150 million previous guidance range as well. Is it still reasonable to expect that this will take the full three years, or do you think that the high point of that range could be achieved sooner?

That would be great. Thanks.



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Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

Right, thank you. So let me answer the first one.

First of all, if we did not have any white space, would our healthcare growth rate look very good indeed, the answer is, yes. We would have had very high growth rates on healthcare even if we didn't have any white space.

But we have had white space. The most prominent example actually is the launch of Amope in North America and in Latin America; a completely new brand, actually. It's not just, let's say, normal rollout; it's the creation of a new brand.

And that has gone well, actually. We just talked about MegaRed in Europe; a bit less mixed, if you want. But on Amope, we have actually [stated] a good initial early success. I never call 12 months or so victory. We need to create brands over a long period of time. But clearly, Amope in the US has had strong, positive reaction from consumers; strong, positive momentum. [I'm intending] to push behind expanding that franchise over time.

So there is an element of Amope in our numbers, clearly, as there might be some other white space aspects. But even without those, our health growth would have looked very, very good indeed.

The other question is: do I expect GBP150 million to happen earlier than three years? I do expect, because of the nature of some of the programs and the Supercharge, that it will take three years to get to the GBP150 million, although, of course, the start is very, very pleasing indeed.

Toby McCullagh - *Citi - Analyst*

Great. Thanks.

Operator

(Operator Instructions). Jeremy Fialko, Redburn.

Jeremy Fialko - *Redburn Partners - Analyst*

A couple of questions for you on the growth of your hygiene and home business. The first one is: can you tell us roughly speaking what you think the markets grew at in those couple of categories combined? So whether you think you're above or below the markets.

And the second question is perhaps on a more medium-term basis. How much outperformance of the markets would you expect in hygiene and home given the fact that you are putting more of your innovation, more of your brand equity disproportionately behind the health side because you can get such good growth from that division?

Thanks.

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

First of all, I have been keen to emphasize that we continue to work very hard on our home innovation, and our home innovation machinery is not being diverted for the exclusive use of health and hygiene. We want to make sure that we are successful in our home brands as much as I want to be successful in health and hygiene.

So this notion that we are diverting innovation, which is why I was keen to emphasize that we are launching two more innovations, Air Wick alone in the next six months, to back up what we launched in the first half. So that's the one thing I'd like to point out.



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We don't disclose -- and I think -- targets by category group. We don't set targets by category group saying this is how much you should expect us to grow by. However, I did say that the long-term trends, and this is what -- if you again refer back to the Investor Day, I said that the long-term expect -- I long-term expect health to be 4% to 6%, hygiene to be 3% to 5%, and home to be zero to 2%. That's what I said.

My expectation of growth for the market, I did not say that we will outperform every box by a certain number. Neither can you predict that. We set targets for the Group as a whole, and we manage our brands as a whole, but I did not -- my expectation of market growth rate of the medium term are in that ballpark.

Is the hygiene market growing at 3% to 5%? Perhaps at the bottom end of the range, actually. So that's how you should see it.

Jeremy Fialko - *Redburn Partners - Analyst*

Okay. Very helpful. Thanks.

Operator

Iain Simpson, Societe Generale.

Iain Simpson - *Societe Generale - Analyst*

Just taking a look at some of your brands, you mentioned that Finish has done a bit better in the second quarter. Are you able to give any more color on what's driven that? You called out one of your innovations, but is there anything else going on? Is it share gain or geographies?

Then looking at Mucinex, you've clearly done a great job of rolling that out into new categories in recent years. Are there any other adjacent categories remaining that you think Mucinex could longer term work in?

Then just lastly, if I could, we mostly hear about your Powerbrands, rather obviously. What are the brands that you think outside of Powerbrands look most exciting? Are there any brands outside of your Powerbrands that could potentially be Powerbrands in future, or that you feel do have big growth opportunities?

Thank you very much.

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

Right. So let me just start with the first question on Finish.

We called out Finish doing better in the second quarter because that's what it did. And we remain, I would say, satisfied. I'm never satisfied. It's difficult to articulate satisfaction in some things, but I think we've done okay.

Finish remains under sharp focus of the Company. We are innovating. We are gaining ground, I would say, in a number of parts of Europe. The fight in the US remains as intense as it has ever been. So in that sense, it has not changed.

So Finish has been in half 1 an okay, overall okay performance, but it is one of our [brand shows], and we are going to continue to put sharp focus under this brand. We remain okay with what we have done, so I have nothing to add on this one.

On Mucinex, tremendous track record of innovating, of category expansion, of creating sub-categories; really out-innovating [market] competition. And that's what we are trying to do again with this launch.

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Do we see other opportunities to innovate? Constantly. I think we have tremendous ideas of innovation on Mucinex, as indeed we have on other categories. So I would not -- Mucinex is doing well from an innovation point of view; really very well.

Finally on do I see brands outside my current Powerbrands which have the potential of Powerbrands? The answer is: all of them. This is the scope of my ambition; this is the scope of our imagination. We have to be constantly looking at brands that can be taken on a much more global worldwide stage. That's what we are trying to do with MegaRed. That's what we are trying to do with Airborne. That's what we are trying to do with Optrex. You saw in January/February, I announced Optrex being rolled out.

So the ambition continues to be to take our brands more global. And when they become sizeable, and when they become even more successful, they will catapult themselves to the stage where they will develop and command the Powerbrand status that we all want to have.

Iain Simpson - *Societe Generale - Analyst*

Thanks very much.

Operator

Alex Smith, Investec.

Alex Smith - *Investec - Analyst*

Just a couple of follow-ups, please. Maybe you could talk a little bit more about home. I think you mentioned some competitive pressures there. I think you flagged Finish in the US. I think stain removal was one in Brazil that you mentioned in Q1. Has there been any change in the picture there Q2 versus Q1, or any new pockets of competition in home?

And then back to the question on brands. I was wondering if you could talk a little bit more about Amope. You said good momentum. What's the potential for that brand in the US? Do you think you can umbrella it and replicate, I guess, Dr. Scholl in Europe in the US market?

Thanks.

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

Well, I think the competitive position on home or other categories has got to be the same. I don't -- even the US, Finish that I called out as an example of the kind of competition, is nothing new.

I think the markets remain competitive. There is no massive change from the last time we spoke. Stain removers in Brazil, Finish in the US, is a good example of the kind of competition we have.

We are fighting hard wherever there is competition. We are growing our brands. We're doing well. But are we going to face these kinds of pressure across many of our brands and markets? Yes, all the time. We're used to that; there's nothing new. This is why Supercharge is important. It helps us realize competitive gains even more, and that we all love. We love to be more competitive. Life would not be as much fun if it was not -- there was no competition.

In terms of brands and Amope, I think it's too early to say whether we can roll out the Dr. Scholl range of Europe into US. It's not often that you can create in a market like US a completely new brand in consumer goods. It's not often. These things don't happen. But we have entered without fear and with a lot of courage and conviction, and so far, we are doing well. And if it continues to show the momentum that it has created in the first I would say now nine-ish months, we will continue to evaluate how to actually to expand this franchise.



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Alex Smith - *Investec - Analyst*

Thank you.

Operator

Chas Manso, Societe Generale.

Chas Manso - *Societe Generale - Analyst*

Could you say a few words about hygiene, please? While health goes from strength to strength, hygiene, there's been no sequential improvement. 3% is below what you said in answer to a few questions ago that the category is growing in the middle of the range of 3% to 5%, so maybe a suggestion of a bit of share loss.

And more generally, could you talk about penetration rates of the categories in hygiene? Is the poorer macro having an impact on penetration growth? And if so, what can you do about that?

Rakesh Kapoor - *Reckitt Benckiser Group plc - CEO*

I think, first of all, I said the hygiene growth rate at 3% to 5% in a micro long-term sense, and I said that I firstly see the hygiene growth rate at the bottom end of the range. It does not imply a share loss in hygiene.

Anyway, but moving beyond specific growth rates, etc., we continue to focus hard on hygiene brands. I just talked about our Finish in some measure. You've seen the innovation that we put behind that; or in Lysol, and so on.

Now remember. Hygiene brands also have some kind of exposure, a different type of exposure to emerging markets versus home. Home have, as I said, a higher exposure to developed markets; hygiene, in some cases like Dettol, where we have an example, or Harpic, have a higher exposure to emerging markets.

As we know, all the emerging markets are not in the best health, and therefore, you are likely to see the hygiene growth rate that we've seen from the category over the past few years, or some years ago actually now, to be less pristine and less linear, as we've seen before.

So I think there is a market factor here on hygiene. When you look at markets like India or -- sorry, not India -- India was tough -- but Indonesia, Thailand, some of the markets that we've called out, you can see that it would have had an impact on market growth rates on hygiene too.

So I think you should not be highly surprised that there are some macro factors here at play which are making the growth rates to be what they are.

Would we like to do much more? Of course. Is that how the markets are? Yes, they are. So I think on balance and on judgment, I think our hygiene performance is not any cause for concern. In fact, in many of our hygiene brands, we continue to innovate, we continue to make progress. But we just have to remember that the market conditions are not as pristine as they were.

Moving beyond that, I think there's a larger point here at work, and I don't know whether we have specifically called that out enough, which is that beyond categories, there are also geographies in large, in whole. And we should not ignore that in a few years, we have made significant progress in how we have started to grow our whole brand portfolio as a whole in Europe and North America, in developed markets.



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This has been a market where people are finding it very difficult to find growth, and I think our strategic focus has managed to create conditions through which we can grow and outperform in these markets.

This is the real story. We can point out to one geography or one category here and there, but think about the broader picture here. The broader picture is that our strategic focus has helped us pave the way of growing this Company, but more importantly, growing our developed markets at a healthy rate, really healthy rate. That is what we want to see. Every business has to find a way of growing in developed markets.

And I've said this persistently that the test of a good company is one where we don't rely on one market to grow over the other; where we can find broad-based growth. And this strategy helps us find broad-based growth.

Can we just take one last question, please?

Operator

Yes, certainly. Charles Pick, Numis.

Charles Pick - Numis Securities - Analyst

Just two quick follow-ups, please. At the time of the Q1 results, you indicated regarding M&A you weren't in any hurry to write the next check. Does that still apply?

And then if we look at the tough geographies in the developing markets, Brazil, Russia, Nigeria, etc., which are probably going to get worse second half on first half, what percentage of your developing markets sales would those comprise?

Rakesh Kapoor - Reckitt Benckiser Group plc - CEO

So the easy one is the second one. We don't give out those kind of numbers.

On the first one, I think when you write a check in a hurry, you can make mistakes. You can write more than what you should write. So never be in a hurry to write checks. We need to be very [considered].

The longer-term opportunity on health remains intact. Any fragmented market like the consumer healthcare market is will over a period of time offer opportunities, but those opportunities should not be taken with a blank check, faster growth mindset.

Charles Pick - Numis Securities - Analyst

Okay. Thank you very much.

Rakesh Kapoor - Reckitt Benckiser Group plc - CEO

Okay. Thank you very much for joining the call, and see you at some point in time in the future.

Thank you very much.



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Operator

Thank you. That will conclude today's conference call. Thank you for your participation. You may now disconnect.

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