

DB Global Consumer Conference

Q&A session

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Gerry Gallagher, *sell-side analyst*

Mike Nightingale, Head of Investor Relations

Thank you. So first up a huge apology to people who are listening, for a second time around we seemed to have further problems with the feed, and I am now Gerry Gallagher, apparently. So I'm going to try and ask the questions that Gerry would have asked, you'll have to bear with me as I'll have to search through a little bit of stuff to find the questions.

I think the first question Gerry was going to ask is that accepting there are one offs in the trading update that you've announced Kingsley, yesterday morning. The revenue guidance seems to have gone up, but the EPS guidance [audio jumping] this year, Kingsley?

Kingsley Wheaton, Chief Marketing Officer

Thank you, Mike and good afternoon, everybody and apologies on our behalf for the difficulty with the connections, we'll do our best to work through this Q&A.

Yes, thank you Mike, we were very pleased in the pre-close trading update to be able to raise guidance on revenue for 2021. And that's a mark of the acceleration of our A Better Tomorrow strategy and our multi-category strategy playing out.

With regard to your specific question on earnings, obviously we've taken the opportunity, given the momentum and the acceleration in New Categories to put more marketing investment behind the further acceleration and momentum of those New Categories. We had a really good quarter for consumer acquisition in Q1, with an additional 1.4 million consumers, taking us to 14.9, so nearly 15 million consumers of our non-combustible products.

And a couple of other things which are in there as well, a little bit of negative geo mix as we see a recovery in some of our developed markets, particularly on the comparisons with 2020 through the depth of COVID. Some limited impact of transactional exchange and also a little bit to do with associate income and given the COVID situation in India.

But I think the key driver if more marketing investment to capitalise on the acceleration and the momentum we're seeing in our New Categories business.

Mike Nightingale, Head of Investor Relations

Thank you, Kingsley. Could you expand on Jacks comment that 2021 is a pivotal year, and what does this mean that we can expect over the next few years?

Kingsley Wheaton, Chief Marketing Officer

Absolutely, Mike, and I think Jack is absolutely right, 2021 is a pivotal year for BAT. I think about the three priorities that Jack has laid out for the

business, value from Combustibles, the step change in New Categories and a simpler, faster organisation. So the question is are we delivering on those and are those accelerating?

Well, I think the answer is abundantly, yes. We have a profitable and highly cash generating business. We're able to drive value from Combustibles and actually a key contributor, along with New Categories performance that that revenue growth is also the value that we're driving from Combustibles.

We're increasingly digitalising the organisation and I think that there's no doubt that BAT is a more digital technology enabled organisation these days than it's ever been, and I think we're really embracing that in terms of accelerating our transformation.

In turn, we're seeing growing share positions across our key Vapour, THP and Modern Oral markets, that has enabled us to accelerate the acquisition of consumers to the 1.4 million I talked about, where there are consumers there's volume, where there's volume there's revenue, and over time we have a clear pathway to profitability.

So our job is to create products that consumers love, for them to be assured products, backed with great science and stewardship and build really strong global brands and that's what we're doing.

And I think the reason it's a pivotal year is the strategy is accelerating, what's exciting is that the three categories that we have, all of them are growing, they're all strong and it's as if we have sort of three engines if you like of the strategy fired up, partnering with the value that we're able to deliver from Combustibles. So I think this is a pivotal year and I think we're well on our way.

Mike Nightingale, Head of Investor Relations

Okay, I think related to that is a question from the floor actually. How do you prioritise investments, both capex and A&P behind the three categories, Vapour, THP and Modern Oral?

Kingsley Wheaton, Chief Marketing Officer

Yeah, well we have pretty sophisticated market mapping tools. If you think about New Categories, generally they are working in the sort of northern hemisphere markets on a sort of swath from America, through Canada, West Europe that's the sort of Vapour heartland. Then through into Southern and Central Europe and the CIS and Northern Asia, where it becomes progressively more tobacco heating.

And obviously if you think about our multi-category strategy it's good, I think for three reasons. The first reason is that consumers are not homogenous, consumers are different everywhere, tastes and preference vary. The regulatory landscape is different everywhere, and in some

markets some categories are able to grow where others aren't, so Japan would be a good example of that. And finally I think by having those three categories that inherently mitigates, if you like, the risk of our growth going forward.

So as we think about prioritising investment, we're trying to prioritise based on the highest revenue growth and margin growth opportunities for the future of the business. I think our job is to be a sustainable higher growth business, to accelerate that growth, and our prioritisation therefore is what gives us the best chance to grow the business, hit the £5bn target 2025, to hit our 50 million consumer target by 2030. So that's how we think about prioritisation.

Mike Nightingale, Head of Investor Relations

Thank you, Kingsley. So one for Jennie now, does meeting your ESG targets have any implications for margins? How does BAT think about that, do you care - by that I mean ESG considerations may mean that margins and profits could be lower, but the associated multiple could be higher and therefore more value is created for shareholders?

Jennie Galbraith, Head of ESG

Yeah, sure, so I think there are two parts to that question. Firstly, we're investing to grow the number of non-combustible consumers as fast as we can. And secondly, we're investing to deliver the rest of our ESG targets.

So I think in terms of harm reduction, non-combustible consumers, we've worked really hard to put in place all of the capabilities that we need to win, so this is consumer insights, digital, distribution. And now we've largely got these in place, we expect to be able to still increase our spend on New Categories but reduce their loss over time. In fact New Categories will now contribute to earnings growth for the first time.

I think in other areas of ESG we do have a fully costed guide path to meet our targets. And yes, obviously there is investment required, but it's really important not to think about this as just one additional one-off cost. The embedded approach that we take to ESG, that I spoke about in our presentation means that many of these costs are absorbed into our existing ways of working. So whether it's through our field technicians and enhanced training and monitoring on child labour, or by replacing plant, fleet or machinery as part of our scheduled upgrades.

We also expect to see efficiencies of scale, particularly as we scale up New Categories. And we're also exploring lots of new technologies **and** materials, both with start-up entrepreneurs and with our existing supplier base.

So you're absolutely right, ESG does also result in savings, and we see it as a real value add. So there are efficiencies in removals, things like carbon reduction, energy efficiency, removing plastics from the packaging, changes to freight, all reducing savings. And plus all of these efforts also create a really compelling consumer proposition, with our brands with purpose. And they also help us attract and retain the very best talent.

So yes, there's investment required, but this is fully costed. But we prefer to focus on the value that ESG delivers to building a strong business for the future.

Mike Nightingale, Head of Investor Relations

Thank you, Jennie. One for David now, David, in your presentation you highlighted that nicotine does not cause cancer. Maybe I've been around the industry too long, but nicotine not causing cancer is up there with tobacco has real pricing power, there's lesson number one for the tobacco analyst. To what extent does having to highlight that very basic point, illustrate the size of the task the industry has in terms of New Categories and getting key stakeholders on side?

David O'Reilly, Director of Scientific Research

Well, thanks for the questions, it's a good question. There is a lot of focus on nicotine at the moment, not just in BAT but elsewhere. The science is very clear on nicotine. I mean nicotine, whilst it can be addictive, has a very good safety profile. And that's not just me saying it, it's other organisations, including the WHO.

The problem is the perception around the safety of nicotine, and you know research, time and time again, shows that not only do consumers and the public misperceive the safety profile of nicotine, but also public health professionals, including medical doctors.

And so whilst that's disappointing it's also an opportunity, because you know by publishing good science, by communicating the science, you know we and others hope and anticipate that we can change that. That whilst nicotine is addictive, it's the products of combustion that cause smoking related diseases. And that's why our New Category products in VELO, Vuse and glo, which don't rely on combustion are reduced risk products and that we back that up with science.

Mike Nightingale, Head of Investor Relations

Thank you, David. Another one for Kingsley. Kingsley, in your presentation you said that you want to be defined not by the products you sell, but by the consumer needs you meet. Could you explain and expand on that please?

Kingsley Wheaton, Chief Marketing Officer

Thank you, Mike. That's a really great question, because I think it cuts right to the heart of our multi-category strategy and I'll try and explain if I may.

If you go back quite a long time ago, the needs, the consumer needs that smoking met were many, it could be concentration, socialisation, relaxation, me time, and so forth. And what's happened over time is that regulatory and societal shift has pushed back the boundary for smoking combustible cigarettes to meet those consumer needs.

However, those consumer needs are inalienable, they never go away, they are rather intrinsic to the human make up if you like. And therefore, I think our challenge is to build a new portfolio, a new portfolio of products and innovations of brands which are able to meet those consumer needs. And that is first of all in the tobacco and nicotine reduced harm space for the 1.1 billion smokers out there that we can switch, encourage to switch to scientifically substantiated reduced risk products. And then in also the beyond nicotine space.

So it's absolutely the centrepiece of our strategy, it's really, really important, and I think it's what the A Better Tomorrow purpose is all about, it's at the heart of our transformation and what will enable us to be a sustainable, high growth, multi-category consumer business long into the future.

Mike Nightingale, Head of Investor Relations

Thank you, Kingsley. Another question from the floor, can you give evidence on the stickiness of THP users to glo sticks, once they are no longer on a price discount? So I think there's a couple of parts to that question.

Kingsley Wheaton, Chief Marketing Officer

Yeah, there's a couple of parts and I'll try and take it part by part. So at the moment I think that our products, our Vapour products and our Tobacco Heating products are better than they have ever been, in terms of the satisfaction index that they deliver and to enable consumers to move from Combustible products to reduced harm alternatives.

The proximity of that satisfaction is really important. So I think in glo Hyper, which is making great strides in Japan, but also in key parts of European geographies, in Russia, in Kazakhstan, in Ukraine, in Romania, in Poland and also in a market which has historically been difficult for us like Italy and it's making great progress. And the same is also true of Vuse and Vuse Alto and ePen 3.

Now if those products are becoming more and more satisfying, we would want to get as many devices of our products into peoples' hands as we possibly can. And I am very pleased to say that in our T5 Vapour markets we have the number one position in terms of device share, I think we

have around about 50% device share. So getting consumers to try the products, which is the first journey of the consumer disposition funnel, before going through regular usage, loyalty and advocacy, it's really important. And one of the mechanisms, the marketing investment mechanisms for that is through device discounting.

And I think that you see, we've now had five quarters of sequential consumer acquisition growth. The last three quarters alone read 0.8, 1.1, 1.4 - that are products are getting sticker and sticker. And obviously we have to time and manage as we start to think about those devices becoming discounted less as we build scale of the brands, we build the revenue of the brands and so on. And that's something that we work on through what we call MSE, marketing spend effectiveness to see where our marketing spend is most appropriately angled into the consumer disposition funnel.

But for the moment it's about consumer acquisition, the volume that follows, the revenue that follows and we have a clear pathway for margins through to 2025, on the back of this year being the first year where losses will in fact reduce in New Categories.

Mike Nightingale, Head of Investor Relations

Thank you, a question actually for Jennie, a topic that we get in a number of meetings on ESG. Jennie, you highlighted that you have a target for zero child and forced labour by 2025, laudable as that aim is, does it raise the question as to why those metrics aren't already zero?

Jennie Galbraith, Head of ESG

Yeah, absolutely. You know we're committed to zero because that's the only option. But it's also - I want to stress that child labour and I think to a lesser extent forced labour are endemic across all agriculture and they are really complex issues to address. That is why we focus on addressing root causes, which is a long-term approach and it's something we've been doing for over 20 years.

One of those root causes of child labour in particular is poverty and that is why enhancing farmer livelihoods is central to our approach, because as I've said if farmers have a profitable enterprise - then they don't need to use cheaper forms of labour, which includes their children.

Our extension services provide multiple levels of support right through the crop season, including things like new seed varieties that improve yield by up to 20%, we're introducing new curing barns that reduce labour hours by 50%. So some really good initiatives there to make sure farmers have got a strong livelihood.

The other issue at play here is cultural. So it's really important to us that we work with local communities so that they understand the risks around child labour and can help us - or can support us in addressing those risks.

Last year we had over 390,000 attendances at 38,000 farmer training sessions, and they'd cover the whole community, not just the farmers that we contract with.

And while we know it isn't the only solution, we are also very aware and very committed to having robust monitoring in place across our farmer base. So last year we monitored I think 99.7% of farms, we identified just 0.5% of those had an instance of child labour on and overall we identified just 5 instances of forced labour.

I think these figures are very low and I think that is testament to the work we've done over the last 20 years. And it gives me confidence, that despite the complexity of the issues, we are well on our way to hitting those targets of zero by 2025.

Mike Nightingale, Head of Investor Relations

Thank you, Jennie. Okay, one for David, ahead of the recent world No Tobacco Day, the World Health Organisation said e-cigarettes are not proven cessation aids and that the tobacco industry is the single greatest barrier to reducing deaths caused by tobacco use. Against those two comments how can the industry continue to make progress towards completely switching smokers to reduced risk alternatives as per one of your key commitments to achieving A Better Tomorrow, when the WHO refuses to recognise reduced risk alternatives currently exist?

David O'Reilly, Director of Scientific Research

Thanks for the question. Yeah, you know it's disappointing that the WHO yet hasn't adjusted its policy on tobacco harm reduction, given the overwhelming weight of evidence in support of it - it's probably the most effective public health policy in reducing smoking related disease and premature death.

However, there are many other health institutions like the FDA in the US, the National Academy of Sciences, Public Health England and others that do see the benefits of tobacco harm reduction. And you know hopefully the WHO will revise its policy in due course.

But in spite of that millions of smokers are becoming educated and they are switching to reduced harm products. And as we've seen in our own business, we've acquired 15 million consumers who have switched from cigarette smoking to our NGPs. So that's a great story.

So I do think that science and the evidence that is building rapidly will shape public health policy going forwards and hopefully with the WHO too.

Mike Nightingale, Head of Investor Relations

Thank you, David. I think we're up on time now so a final question for Kingsley. Investors typically make money by not considering where a

company is but where it's going. Investors don't seem to think that way in terms of New Category growth in tobacco in the context of ESG. How easy is it to convince investors of your ESG credentials? How has that changed over the last 12 months? What can you do differently? Are investors missing anything in terms of your ESG credentials?

Kingsley Wheaton, Chief Marketing Officer

Thank you, Mike. I actually think that, you know, 25 years working in this industry this is one of the most exciting times for us in terms of our transformation and to demonstrate our ESG credentials.

I think we should think about ESG and building a sustainable enterprise for the future, not about the starting point, but about where we're going to. Perhaps put another way if you think about it in terms of impact. And I think the societal value that we can deliver and therefore the multi stakeholder value we can deliver by transforming our business from Combustible products that cause the harm to the non-combustible products that cause less of the harm is very profound indeed.

So I would think of it in impact terms. And I think that a societal problem, the problem that smoking causes, addressing the problem is a very, very strong ESG story indeed. you know we have the value streams from Combustibles that we can invest, and we have invested in accelerating New Categories. We are increasingly becoming a more technology and digitally enabled business. We are growing our consumer base; we're accelerating that growth. From that comes the volume, the revenue and the profit. And I think we are building very, very strong global brands in all relevant consumer segments, which is really important.

So I think the story is about impact, about change over time, about the difference that we can make in pursuing A Better Tomorrow.

Mike Nightingale, Head of Investor Relations

Thank you, Kingsley. So I think today proves you don't work with animals, children, or technology.

I'd like to thank you on behalf of Gerry and Deutsche Bank for joining us today and answering these questions. And I hope people listening in will excuse us for the technical difficulties we have again had today. Once again, my apologies and I hope this has been a useful session. Thank you.

Kingsley Wheaton, Chief Marketing Officer

Thank you, Mike. Thank you everybody.

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