

2020 Second Half Pre-Close Trading Update

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Operator

Hello and welcome to the British American Tobacco 2020 Full Year Pre-Close Trading Update.

My name is Molly, and I will be your coordinator for today's event. Please note that this call is being recorded and for the duration of the call your lines will be on listen only. However, you will have the opportunity to ask questions. This can be done by pressing *1 on your telephone keypad to register your question.

If you require assistance at any point, please press *0 and you will be connected to an operator.

I would now like to hand the call over to your host Mike Nightingale, Head of Investor Relations, to begin today's conference. Thank you.

Mike Nightingale, Head of Investor Relations

Thank you, Molly. Good morning everyone, I'm Mike Nightingale, Head of Investor Relations and with me this morning is Tadeu Marroco, our Finance Director.

Welcome to our Full Year 2020 Pre-Close Conference Call.

Just before we begin, I need to draw your attention to the cautionary statements regarding forward looking statements contained in the trading update.

I will now hand over to Tadeu, who will say a few short words on the current trading before we open it up to questions.

Unless otherwise stated our comments will focus on constant currency adjusted measures. Over to you Tadeu.

Tadeu Marroco, Finance Director

Thank you, Mike. Good morning everyone and welcome. Thank you for joining us this morning.

In 2020 we are transforming BAT and continuing to grow the business against the challenging global backdrop caused by COVID.

Throughout the year our priority has been the health and the wellbeing of our employees. We have made no redundancies or furloughs as a result of the crisis and we have continued to pay all our employees in full.

It is the commitment and dedication of our people around the world that has ensured that we are on track to deliver a strong set of results in 2020.

We are committed to building a better tomorrow, delivered by our continued focus on the three strategic priorities; reducing the health impact on our business through providing a range of enjoyable and less risky products is the greatest contribution we can make to society.

We continue to be clear that combustible cigarettes pose serious health risks and the only way to avoid this is to not start or to quit. BAT encourages those who would otherwise continue to smoke to switch completely to scientifically substantiated reduced risk alternatives.

We are continuing to increase investment and to drive a step change in new categories. We are very proud to now have around 30 million consumers in non-combustible products.

We are growing value share in Vapour, volume share in THP, and delivering strong revenue growth in Modern Oral.

Our New Category revenue performance is accelerating in the second half, despite a strong prior period comparator.

We have continued to drive value in our Combustible business and are on track to deliver savings of at least £300m from Quantum.

In addition, the radical transformation of the organisation and increased agility brought about by new ways of working has enabled us to quickly and effectively to adapt to navigate the challenges caused by COVID.

The business performed strongly against an environment which remains uncertain due to the global pandemic. We are on track to deliver on our 2020 guidance.

Cigarette and THP volume has improved over the second half, driven by continued resilience in the developed markets and some improvements in emerging markets such as Brazil, Bangladesh, and Turkey. We expect to outperform industry volume, which we now expect to be down - around a 5% decline, with the US industry volume broadly flat.

Given this continued strong pricing and the reduced full year revenue headwind from COVID of around -2.5% we now expect to deliver revenue growth at the top end of the 1% to 3% guidance range.

In this improving trading environment and thanks to our strong cash generation and tight cost management we have taken the opportunity to further increase New Category investments in the second half by close to £200m. This represents a total additional New Category investment of around £450m in 2020.

We continue to expect to deliver mid-single figure constant currency adjusted diluted EPS growth. This is despite the further increase in New Category investment, absorption of a one-off impact of New Category revenue of £50m, following our decision to withdraw Glo Sens from the Japanese market, the effect of a strong prior period comparator and associated income from ITC that is significantly negatively impacted by COVID.

We expect a translation headwind of 3.3% on full year 2020 adjusted diluted EPS, with the impacted expected to be between 2% to 3% for the full year 2021, applying current foreign exchange spot rates.

Turning now to trading in the New Categories. In Vapour Vuse Vype is the fastest growing international vapour brand, growing value share of its top five markets by over 7 percentage points to 26% year to date. The brand has now achieved value share leadership in closed systems in four of the five largest vapour markets, exceeding 50% value share in two of them.

Vuse Vype is number one in device sales in all top five markets, with the Vype's volume share in excess of 50%.

In the US, Vuse is the fastest growing brand with 24% value share of total Vapour year to date, driven by Alto at 19%.

Vuse continues to close the gap on the market leader and has achieved value share leadership in seven states.

Vuse also took market leadership in Canada in August, having commenced the brand migration from Vype in May. Canada is the first market within the top five to migrate to Vuse and they achieved a 100% retention rate.

Market share for Vuse at the end of October reached 64% driven by the success of ePod.

Migration to Vuse in the remaining top five markets will be completed during 2021.

In THP, the continued success of Hyper was reflected in Glo reached record total nicotine volume share in Japan on nearly 6% in October, with Hyper reached 2.3% nicotine share.

Hyper has maintained a conversion rate in excess of 50%, two times higher than any previous Glo product.

Glo continues to grow volume share in ENA, with a THP category share of around 15% across the top eight markets. In Moscow Hyper drove Glo's volume share of total nicotine to a record 3.3% in October and was the top performing THP brand across all tracked social performance metrics.

We expect growth of close to 20% in THP volume in 2020, reflective of the successful launch of Hyper in Japan in April and its subsequent rollout into key cities in ENA.

THP revenue is expected to be down, mainly due to the year-on-year impact of the withdrawal of Sens and excise amortisation in Japan.

In Modern Oral we continue to grow strongly and to consolidate our leadership position outside the US. In the US, in November we announced the acquisition of Dryft. The acquisitions significantly strengthen our position, expanding our portfolio from 4 to 28 nicotine strengths and flavours. It also enables us to participate in the segment above 6mg nicotine, which represents 6% of the category.

The Modern Oral category in the US has benefited mostly from geographic expansion by all the key market participants and currently represents around 1% of the US nicotine market.

The newly branded Dryft products have now been launched online and into distribution in Circle K stores in the US. We expect to expand the distribution of the Dryft products from 20,000 to around 100,000 outlets by the end of the first half of 2021.

We are building capacity and expect to be unconstrained around mid-2021.

In ENA we are consolidating our clear leadership position with share growth in all key markets. We are achieving conversation rates from tried to regular usage of over 50% and have higher average daily pouch consumption than the category average.

In summary, we are entering 2021 with good momentum across all three new categories, with some exciting new launches planned.

In Vapour we are launching a Bluetooth enabled version of Vuse, providing electronic age verification. The product will be launched in Canada as a pilot market in the first half of 2021.

Our Vuse Alto PMTA submission in September also included age verification technology.

Also, in early 2021, in line with our ambition to explore and to broaden our portfolio beyond nicotine we are planning a city test of a CBD vaping product in the UK.

And in Modern Oral, to better meet consumer needs we are leading with the launch of the first mini pouches with a recyclable can in Sweden, Norway, Slovakia, and Switzerland. We plan to expand to at least ten markets by Q1 2021. We also aim to make all our Modern Oral cans outside the US recyclable in the first half of 2021.

We will continue to lead in innovation in our multi-category approach.

Moving to driving value from Combustibles. Our excellent performance is underpinned by resilient industry volumes, particularly in developed markets, with BAT outperforming the industry.

Continued strong price mix drove global value share and it is up 20 basis points and our strategy brands value share up 40 basis points.

The US business continues to perform strongly with an excellent performance from Vuse and good pricing Combustibles. Complete value share is up 40 bps and premium share is up 50 bps, year to date. This is driven by Natural American Spirit and Newport.

We are growing share in the branded value segment and to date we have seen no accelerated downtrading.

Moving to the balance sheet, we maintain our strong liquidity profile following recent successful debt issuances. We remain committed to our targets to reduce adjusted net debt to adjusted EBITDA to around three times by the end of 2021. And maintain our 65% dividend pay-out ratio. This will be achieved through continued strong operational cash conversion, in excess of 90% of adjusted profits from operations.

Turning now to ESG, which is central to our strategy. I am pleased to report that we have recently received further external recognition, building on our BBB MSCI rating and the recent improvement on our Sustainalytics score from 28.2 to 27.8.

BAT has again been named in the Dow Jones Sustainability Index for the 19th consecutive year and is the only tobacco company to be included in the DJSI world index.

BAT has been included in the Financial Times Diversity Leaders list for a second consecutive year, with our score increasing from 7.08 to 7.23.

We have also been included in the A List, by the Carbon Disclosure Project, CDP, for climate change action for the second year in a row.

Finally, tomorrow we are launching a sustainability focused report on human rights, the first by any company in the tobacco industry.

In conclusion the business is performing strongly during these challenging circumstances. And we are on track to deliver on our guidance. We are investing, delivering and transforming the business, thanks to our continued focus on our three strategic priorities.

We are growing share in New Categories, driven by innovation, and increasing investments, supported by continued value growth in Combustible and the benefits of Project Quantum. It has enabled us to both deliver on our financial commitments and become a faster, simpler, more agile business.

In summary, we are delivering on our three strategic priorities. We now have around 30 million consumers in non-combustible, we are investing an additional £450m in New Categories and continue to deleverage the company. We are committed to our - a better tomorrow purpose.

Thank you. I will now open the call to questions.

Operator

Thank you. If you would like to ask a question, please press *1 on your telephone keypad. Please ensure that your line is unmuted locally. You will then be advised when to go ahead with your question.

The first question comes from the line of Jon Leinster, calling from Societe Generale. Please go ahead.

Jon Leinster, Analyst, Societe Generale

Good morning gentlemen.

Tadeu Marroco, Finance Director

Hi Jon.

Jon Leinster, Analyst, Societe Generale

Hi, a few questions if I may?

The first question is on Glo in Japan. I think at the interim results you said that your exit rate in June was sort of 5.9% and then you say here it's good you hit a sort of high in October of 5.9%, with Hyper having risen from 1.3 to 2.3%. I mean does that imply that hyper is just cannibalising existing Glo and you know - why has the total share of Glo not really risen in a segment that has clearly risen within the total market? That would be my first question.

Tadeu Marroco, Finance Director

Okay, Jon, look, the point - the reading in the middle of the year was one ad hoc reading, a weekly reading that we quoted at that time of 5.9. And this one now in October is a more robust reading throughout the end of the month. We are clearly growing as a family. There is some cannibalisation, but our total category market share is growing as well in Japan. We are now slightly above the 20% mark and we were below that by the middle of the year.

So there is clearly a growth expansion on the whole Glo family and Glo Hyper is outperforming within that.

Jon Leinster, Analyst, Societe Generale

Okay. And secondly, I think you mentioned that you don't expect to be capacity constrained in US Modern Oral by the middle of 2021. Can you give us some idea of what that capacity would be?

Tadeu Marroco, Finance Director

Well we have already a very well-established capacity in our current SKUs and as part of the Dryft acquisition we are also inheriting third party supply capacity for the current Dryft volumes. And we are bringing in a machine from outside also to reinforce our capacity in the US.

So what do we mean to be unconstrained is basically a combination of all those three, eventually move some capacity from the current one to the Dryft format. But also being able to reach at least 60 million by the middle of next year, which we believe that will be a good capacity to fulfil our plans and grow above that in the subsequent period.

Jon Leinster, Analyst, Societe Generale

Thanks. And lastly if I may, obviously South Africa was rather bizarrely shut for a long time, but now it's reopened has the market moved back to the legal market, or is there still significant problems with illicit trade?

Tadeu Marroco, Finance Director

So the South Africa market, we have to consider that before the crisis the government was doing massive inroads in illicit. In 2019 for the first time in many, many years we saw a reduction on the illicit trade, given the enforcement of the new government that has been assuming power at that time. And clearly for the first time BAT in many, many years was growing volume, was growing turnover, was growing share, growing profit. And all of a sudden this came to a halt at the end of Q1 this year.

So the illicit at that time had been dropped back to the likes of 52%. And then you have, you know, this extended period of time without being able to sell any cigarettes, the illicit is dominating the market, new networks were established as a consequence of that. And now the level of illicit is higher than it was before, as you could expect because it takes some time for these networks to be disassembled again and the government to refocus on what they have done before.

So as we speak today, we saw an increase in the illicit trade from the likes of 52% before to close to 60%. And the government now needs to go back and do what they have done before the pandemic. Which is a clear demonstration that when we have the willingness there are ways to tackle that and we will be supporting for sure.

Jon Leinster, Analyst, Societe Generale

Okay, well thank you very much.

Operator

The next question comes from the line of Gaurav Jain, calling from Barclays. Please go ahead.

Gaurav Jain, Analyst, Barclays

Good morning, thank you for taking my questions.

Tadeu Marroco, Finance Director

Good morning.

Gaurav Jain, Analyst, Barclays

I have two questions. Number one, can you share your initial thoughts on FY'21 volume outlook, especially in the US?

Tadeu Marroco, Finance Director

Well, Gaurav, 2021, you know that today it is still very volatile for us to make a prediction. Now we have a new government in the US. There are now discussions about fiscal stimulus, the COVID crisis is nowhere near the end. We have a bright light at the end of the tunnel but there's still long months to go - in terms of the vaccine, but it's still long months to go until the vaccine will be rolled out. And it's very difficult to, at this point in time, to have a firm prediction about the volumes.

The fact is that 2020, we saw - as you saw in our statement, a very solid US market, there's a number of factors impacting in a favourable way the US market. But it's very early to call. We expect to do a more firm view on the US market by our year end results in February.

Gaurav Jain, Analyst, Barclays

Thank you. My next question is - you know your two long term objectives, one is high single digit EPS growth and the second is New Categories of £5bn by 2025, that would imply that annual New Categories driven new growth would be like £700m per annum, versus the £200m, £300m growth that we have seen in the last two or three years. Does it require a significant step up in the growth rate and investment in that?

And I guess the question I'm trying to ask is that are these two goals incompatible with each other?

Tadeu Marroco, Finance Director

No I don't think that they are, and we clearly have prepared the company to allow us to continue to generate the savings that we need, that's why we launched Project Quantum. We also have a very strong Combustible business, as you know. And both these factors will be generating the funds necessary to fulfil the growth on New Categories.

You have to take into consideration that 2020 is a very particular year. We had for example a number of headwinds in 2020 New Categories that materialised. The COVID impact on supply chain in the first quarter as a consequence of the shutdown in China like we spoke about in the half year results. The closure of shops in ENA and Japan, ENA happened again in the second lockdown in Europe in marketing activation disruption. We

had the Modern Oral ban in Russia at the end of 2019, the beginning of this year that we had to lap. And we had also the impact of Glo Sens that we talked about.

So there were a number of factors, the Vapour industry is still recovering from the value price in the US. And also the new legislation of the FDA at the beginning of the year.

So I think that we cannot read much through the numbers in absolute terms in 2020 in terms of end goal. But the most important thing is to understand and to recognise the momentum that we have in all those categories.

As we quoted before, we are growing share in every single one of those categories. In Vapour we are really leading four out of the five top markets and making big inroads in the US. In Modern Oral it's just solidifying our leadership outside the US in the US now with Dryft we have a much more competitive offer to consumers. And in THP we are getting close to 20% volume growth, despite the headwind of Glo Sens.

So I think that this gives us the reassurance that we'll be able to achieve our £5bn target by 2025. And at the same time continue to deliver on our financials as well as soon as the pandemic is over.

Gaurav Jain, Analyst, Barclays

Thank you. And my last question is just on share repurchases, like your indication that it's maybe like 2 or 3% cost of debt and your equity free cash flow yield is north of 10% leverage, once we adjust for that associates, it's not really 3.2x because the leverage is much lower. So why not start buying back the stock then?

Tadeu Marroco, Finance Director

Well, look this - the capital allocation is a subject that we'll be reviewing on a constant basis. We believe that the best thing we can do for the next year is to strengthen our balance sheet. We have done a very good exercise recently in terms of liability management that changed the shape - the profile of the debt moving forwards, quite nicely like we point out in the announcement.

We believe that the best was to remunerate our shareholders at this point in time is to keep the dividend as it is. It's part of the DNA of the company. And we also want to continue investing in our M&A - New Categories business through eventually some M&As, like we just did with Dryft in the US.

So by the time we get to the end of 2021 and we have reached the around three times leverage we'll be reviewing again the capital allocation. And if the circumstances persist at it is today because I agree with you about the undervalue of the company, we'll be reconsidering all those points again by then. Okay?

Gaurav Jain, Analyst, Barclays

Thanks a lot.

Operator

The next question comes from the line of Alicia Forry calling from Investec. Please go ahead.

Alicia Forry, Analyst, Investec

Hi. Good morning, Tadeu. My first question is on the guidance. The global volumes look to have been about 2% better than you were previously expecting, and that's with a skew to [audio jump] from a higher price mix developed market, so I'm surprised that the top line guidance was not raised by more than the roughly 1% you've indicated. So, I appreciate you've touched on a few factors holding back revenue growth this year, but could you perhaps be a bit more specific on which factors have primarily held back that top line?

Tadeu Marroco, Finance Director

Yes. Yeah, sure, Alicia.

Look, like we articulated a bit in the half year, there are three major drags for BAT this year. The first one is the global travel retailer, although the volumes is not that much material, there is a massive value intrinsic to those volumes and the business, if anything, was completely decimated.

The second one is South Africa is a big market for us because we are leaders, and we couldn't sell stick of cigarettes since the end of April until the second half of August. So, it was a big blow in terms of revenue and weakness that we saw mainly in emerging markets.

There was a lot of disruption, mainly that happened in the first half of the year, the likes of Mexico, the likes of Pakistan and Sri Lanka, markets where stick sales are predominate. And this was a big drag. That was difficult to recover.

We had some upsides, like you refer to. The developed markets clearly outperformed in this crisis and outperforms in US in particular as well. It was very beneficial. But this all nets to this 2.5 impact that we are quoting in terms of turnover. And so that's what lies behind the numbers.

Alicia Forry, Analyst, Investec

Okay. Thank you. My second question is on Modern Oral in the US - obviously a very exciting growth category, and many companies are involved in developing this space. Can you characterise the competitive landscape that you're seeing there, and has there been any change in competitive dynamics there, in particular just regard to price mix?

Tadeu Marroco, Finance Director

Yeah, look, yeah, you said it's a very fast-growing segment, although it's still 1% of the US nicotine pool. And it's important you quote that because, you know, we have put things into perspective.

If you look from the other more developed Traditional Oral markets, the likes of Norway, for example, Modern Oral is now reaching 20%, a bit more of 20% of the market. And, in Sweden, for example, it's something like 8% where it's similar to the US that's closer today, it's 10%.

It's a very competitive category, like you referred to. We have players investing with new products. And, in our case, in particular, we were not able to compete freely across the whole scope of the category because we were limited with the offers that we have in place.

So, the reasons that we are now in Circle K is actually to test our marketing mix to make it as competitive as possible in order to be able to roll out to the rest of the country from the beginning of next year onwards.

I think that we will see how this pans out, and we are very optimistic in terms of the possibility to extend our range of offers from four SKUs to 28, as you can imagine, and be able to compete in a segment of above 6mg that we were not before.

So have to see, and I think that it's a bit early to make a prediction in terms of price mix. I think, at the moment, all players are trying to compete, trying to increase distribution, and more important now is to have the right marketing mix in place.

Alicia Forry, Analyst, Investec

Thank you. And if I could just ask a final one. Can you update on anything that you're seeing in the US market with respect to various local menthol bans? What impact, if any, are you seeing on consumer behaviour in those areas where there have been local menthol bans?

Tadeu Marroco, Finance Director

Well, where they have been, in reality, we haven't seen much impact because, at the end of the day, the consumer ends up circumventing that, and buying in other geographies close-by, so by, or via comms, if possible. So, there are no real implications in terms of sales.

And we still believe that the FDA is the body is the one responsible to make this type of call. And we have been seeing in priorities at least of the FDA, we are not expecting to see either a menthol ban or nicotine control enforcement any time soon.

In reality we are seeing, for example, based on the latest youth research incidents in terms of use of menthol in cigarettes and vaping, that there was a remarkable reduction compared with the previous year, which just takes the pressure off.

And another point that I would like to make around that is that, as time passes by, and you still having examples of menthol bans outside the US, you can use this as a kind of

reference for the future. And we just saw these here, for example, the introduction of a menthol ban in Turkey in January this year, and, as you know, in May, in Europe. And both of these countries, in Turkey, the lack of retention was even higher than 100%. In our case, we gained that market share, but we had a differentiated product in Turkey with the differentiated performance and differentiated filter.

In Europe, we also made a retention above 100% but we were present in the New Category space, and we saw that, out of the cigarettes, we had a retention of 91%, some 2% or 3% decided to quit completed as a category, and the balance of the potential move to New Categories were 7% move to Vapour where, like we just spoke about, we were very strong. As a consequence of that, in terms of nicotine retention, we were more than 100% than we were before the menthol ban.

And, if you now make an analogy of those circumstances back to the US, you'll see that Newport, which is our largest menthol brand in the US, is the one that has a 7% of the franchise in a differentiated format with 100mm length. That cannot be copied. As you know, the FDA has frozen all specifications of cigarettes since 2007, so we cannot launch in a new SKU in the market. And it has, also, the lowest level of mentholation in the market, and we are present and making big inroads in the New Categories.

So, I think that, in future, if we see a menthol ban coming in the US, we'll be well-prepared, and those factors happening outside the US, is a clear indication for that.

Alicia Forry, Analyst, Investec

Thank you.

Operator

The next question comes from the line of Sanath Sudarsan calling from Morgan Stanley. Please go ahead.

Sanath Sudarsan, Analyst, Morgan Stanley

Hello, and good morning, all. Just a quick question on the level of investment. You've done a very good job recruiting more consumers this year, investments levels keep getting higher. How should we think about what seems to be the right level of overall investment in this category going forward? I'm particularly interested about, you know, you still maintaining the £5bn revenue ambition by 2025, but what should it mean in terms of profit for the shareholders?

And then, secondly, could you just briefly touch upon how your emerging markets are shaping up post all the restrictions? Are you seeing downtrading? Are you seeing brand migration? Are you seeing more opportunities coming away from the illicit market? Could you just give us a more general view on the emerging market consumer, please? Thank you.

Tadeu Marroco, Finance Director

Okay. So, there are a lot of questions, Sanath. Let me try to address them.

Look, we are very pleased with the performance on the non-combustible consumer base. We had 30 million. It's also 30% more than a year ago.

As you'll know, we have the ambition to reach 50 million by 2030. That was, you know, set out in our revised strategy back in the CMD in March, and it's important to recognise that, today, there are more than 80 million of those non-combustible consumers out there, and we have 30 million of that. So there is, already today, a massive contestable space for us to go after.

And this is what gives the confidence that we are able to achieve the £5bn by 2025 because, given the strength of our portfolio in the New Categories, and the contestable space that, already, is there today, and, if anything, with consumers increasing over time, it will give us all the indications that we are able to achieve and start accelerating our growth for next year.

In terms of our profits for shareholders, I do believe that we have invested a lot in the New Categories in the first three years, building the necessary capabilities to be successful - the likes of, you know, IPs, the designs, digital, innovation and so forth.

More recently, we have resourced and allocated this level of investment through more consumer-facing type of investments, and we think that we have the right level. After a year, the consequence now is to see the revenue growing faster. In reality, we expect that we have reached the peak in terms of losses in our P&L in New Categories in 2020, which means that, for 2021 onwards, the New Categories, we expect to be more EPS accretive.

And this, together with our cost agenda that we articulated at mid-year in terms of the Quantum at the full year last year, we expect to generate the two levers necessary for us to continue delivering our financial algorithm while transforming the business.

Now, in terms of your emerging markets, as it is today, it's a big mix. It's a basket case here in terms of mix. It is a mixed case because we have countries like Brazil, for example, performing extremely well - we have seen double-digit growth in Brazil this year as a consequence of interruption of illicit flow from Paraguay.

Remember, a lot of those emerging markets have been impacted by illicit, and illicit, if anything, still grows. It's growing slightly lower this year, but it's still above the previous year. The likes of Pakistan, for example, is growing. The likes of Indonesia now, more recently, because of the excise and so on.

So, we have markets where we can control illicit activity in Brazil, for example, they form extremely well, and where you cannot, like South Africa as an extreme example, still with a lot of work to do in terms of recovering that space that we lost.

So, I think that, at the end of the day, it's a very mixed picture out there. But, overall, we have seen some spots of good performance - we quoted Turkey, we quoted Bangladesh and Brazil, which is trying to offset some others that is a more negative view. Okay?

Sanath Sudarsan, Analyst, Morgan Stanley

Thank you very much.

Operator

Before we move to our next question, please be reminded, if you would like to ask a question, please press *1 on your telephone keypads.

The next question comes from the line of Rey Wium calling from SBG Securities. Please go ahead.

Rey Wium, Analyst, SBG Securities

All right, Tadeu. I'm just curious, if you maybe can just elaborate a little bit more on South Africa. I mean, if we now take, you know, since you have been allowed back in the market, what is your market share, for instance, relative to what it was in the same months in the prior year? Are you down? Because what I understood is that, you know, the illicit side is still, or it has gained a foothold, and are you struggling, you know, to dismantle that? Is this a correct assumption?

Tadeu Marroco, Finance Director

Yeah, the problem with the South Africa market is not about market share. The problem is the whole market. Now, because the illicit, like I had mentioned before, we had this problem related to the incidents of illicit going from the likes of 52% to very close to 60%.

Our share is pretty much flattish throughout the period when you saw our performance, and we have been growing share, like I mentioned before, since Q1 2020. So, we're entered in a very strong momentum just before the COVID crisis. And we were able to capture that level doubly after the crisis went through.

The problem is the size of the market because of the illicit now, make some inroads because of these networks that were established in those months that there were no legal sales of cigarettes. These need to be dismantled.

But I have to say, the problems with tobacco illicit in South Africa, the government has demonstrated, in the past, that it's possible to be done. So, we are very optimistic that, with the learnings that they had before COVID, they could reassess that, making, again, inroads in tackling the illicit problem in South Africa.

Rey Wium, Analyst, SBG Securities

Good. And I just have a question regarding the overall New Products Category revenue. I know your medium-term target, I think, is 30% to 50% a year. In the first half, I think it

was like 15%. So, based on what you've said about the £50m hit in Japan, and some leading products revenue down, are we going to get a bit of an acceleration into the second half revenue versus the first half, and probably still falling short of that 30% target? I just want to get an idea, a bit of a ramp-up, you know, until we get sort of growth rates, you know, above 30%.

Tadeu Marroco, Finance Director

Yeah, no, we didn't provide guidance for New Categories into revenue growth for this year, 2020. We had a 12% increase in the first half of the year, and we are saying that we accelerated in the second half. And, despite the headwinds coming from Glo Sens, for example, and all the points that I mentioned before, we are expecting to perform better in the second half than we did in the first half. And that is the comment that we want to make at this point in time.

But my point that I raised before, is that we have to be conscious that this was a very particular year, a very difficult year, given all the backdrop that I highlighted before. We were for example in ENA until recently with all our Vapour stores closing again across Europe, the second lockdown. And we have problems from the first half and so on. So, we have to put this into context now.

Rey Wium, Analyst, SBG Securities

Okay. And then, finally, I just want to put you back on the spot about the share buybacks. Did I understand it correctly that you said that once you get to a net debt to EBITDA around about 3x you would probably then put it back on the table to consider? I just want to get of a broad idea at what sort of levels share buybacks could be a feature again.

Tadeu Marroco, Finance Director

Well, I think that we are getting very ahead of the game here.

As I said, capital allocation is constantly being reviewed. We are very clear, for the year to come, that we want to strengthen our balance sheet, hence the leverage that got into the levels that we have said before. And we want to continue investing in New Categories, and continuing doing the dividends of the 65% pay-out, as we have been saying for a while.

So, what I said is that, for sure, by the time we get to this level of the leverage around 3x, you'll get more flexibility, and, hence, you'll have to put all those things back on the table. But this will depend a lot in terms of the valuation of the company at that time as well. So, a number of factors are in play, you know.

Rey Wium, Analyst, SBG Securities

Yeah. Okay. Excellent. Thank you.

Tadeu Marroco, Finance Director

Thank you.

Operator

The next question comes from the line of Alan Erskine calling from Credit Suisse. Please go ahead.

Alan Erksine, Analyst, Credit Suisse

Hi. Good morning, everyone. Just two questions from me.

One on point clarification on the 2.5% impact of COVID-19. So, there are obviously some elements that are easy quantify, like travel retail, etc, some hard to quantify. I mean, I would imagine that, certainly, some of the better performance in the US is because people have more discretionary income to spend, they have more home time. And, similarly, you know, Northern Europe will have benefited from tourists staying at home.

So, I think, Tadeu, you indicated that the 2.5% was a net number, that that was your best guess of what all of those easy to quantify and less easy to quantify impacts were. I just want to clarify that that is the case.

And then my second question is just on kind of what learnings have you had from the failure of Glo Sens? I mean, clearly, you did work going into the launch of that. What disappointed you? What went wrong with that product? Thank you.

Tadeu Marroco, Finance Director

Thank you, Alan.

Yeah, look, your first question, you're absolutely right. It's very hard to disentangle all those different elements. You see the US, for example, a market that is performing quite well this year. And we saw that one of the big impacts that is responsible for that is related to the vaping slowdown and stocking up of cigarettes. We know that.

There were, for example, shipment days that were beneficial this year, oil price, a very low price, and we know about the correlation between oil price and the sales of cigarettes. So, there are a number of effect other than the potential fiscal stimulus and all that. Because you saw the fiscal stimulus withdraw in July, and the volume was still holding on very nicely throughout the second half.

And the same happening in the other markets. For example, we were in Mexico, or Argentina where it was very, very badly hit by COVID and, hence, the sales. We were able to be to come back to the markets in a much more agile way and make inroads in terms of shares that mitigate some of that.

So, this 2.5% is a really, really consolidated figure related to that. So, that's the first question.

The second point, well, look, I think that the Glo Sens was the use of, basically, two different consumables; one is a tobacco, and the other is the liquid pods that were running

out at difficult times, and were clearly complicated for consumers, while the satisfaction was not optimal either.

So, we gave all the support to increase the penetration. That was the key method for us in the first half of the year. But we finally decided to withdraw the product to avoid being distracted to a very successful Glo Hyper launch.

I think we had fundamentally changed our beta testing, our consumer validation methods to prevent such failures in the future. But one point that is important - this is a consequence of trying to be developing and innovating we can be successful, as we demonstrated through Glo Hyper being the first in the market with the induction technology, or not, as was the fact of Glo Sens. The important thing is to learn fast and to improve from the following launches.

Alan Erksine, Analyst, Credit Suisse

Thanks, guys.

Tadeu Marroco, Finance Director

Thank you.

Operator

We have no further questions coming through on the phone lines, so I'd like to hand the call back over to Tadeu Marroco to close the call. Thank you.

Tadeu Marroco, Finance Director

So, thank you, everyone.

So, in summary, just to leave the message with you, all right, the business is performing well in challenging circumstances. We are guiding to the top end of our 1% to 3% revenue range, and we are capitalising on strong momentum in the business to invest a further £450m in our New Categories.

We have been, as you saw, making big, big inroads in terms of our non-combustible products, consumers growing almost 30% to 30 million now. In Vapour, Vuse has increased substantially its value share across the top five markets. In THP, we expect in the top eight markets now to be about 50% of the category. And in Modern Oral, very least, to have some of the leadership of the outside the US, and the Dryft acquisition significantly strengthened our US position.

The business is performing well. We are on track to deliver on our mid-single digit constant currency growth guidance. Let me tell you, we could have delivered high single figures EPS, this year in 2020, however we are clear that continuing to invest behind New Categories is the right thing to do for the business, and we want to leverage on the momentum that we have.



We are investing, we are delivering, we are transforming the business, and we are committed to our purpose to build a better tomorrow.

So, thank you. I look forward to speaking to you all in February at the Prelims, and I wish you and your families a very happy Christmas. Thank you, everyone.

Operator

Thank you for joining today's call. You may not disconnect your lines. Hosts, please stay connected.

END