

2022 First Half Pre-Close Conference Call Transcript

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Mike Nightingale, Head of Investor Relations

Good morning everyone, I'm Mike Nightingale Head of Investor Relations and with me this morning is Tadeu Marroco, our Finance and Transformation Director. Welcome to our 2022 first half Pre-Close conference call. I hope you are all well and I would like to thank you for taking the time to join us this morning.

Before we begin, I need to draw your attention to the cautionary statement regarding Forward-Looking Statements, as well as the notes and disclaimer contained in the trading update.

I will now hand you over to Tadeu who will say a few words on current trading, before opening it up to questions. Unless stated otherwise, our comments will focus on constant currency adjusted measures, and all share data is year-to-date average, to April 2022.

Tadeu Marroco, Finance and Transformation Director

Thank you, Mike.

Good morning everyone and welcome.

We are delighted to report this morning that BAT's transformation continues at pace.

Our New Category business is becoming an increasing contributor to Group performance and is driving our faster transformation. This has been supported by robust pricing in combustibles and the continued benefits of our cost saving programme Quantum.

I would like to take this opportunity to express our deep concern and sadness for everyone affected by the devastating conflict in Ukraine. Our priority remains the safety and wellbeing of our people in Ukraine and across the wider region.

As previously announced, given the continuing conflict, we are working towards transferring our Russian business in full compliance with international and local laws.

In addition, this conflict is increasing global uncertainty and disruption, further exacerbating inflationary pressures on supply chains, impacting consumer consumption and resulting in increased finance costs.

While we are not immune to these pressures, we are confident in delivering on our current financial targets, irrespective of the timing of the transfer of our Russian business. This is thanks to our well-established multi-category strategy, our strong portfolio of global brands and our resilient, highly cash generative business.

In New Categories, we increased our adult non-combustible consumer¹ base by 1.1m, to reach 19.4m in Q1, and continue to grow. Our New Category products are now available in 59 countries globally, with a total of 84 category market combinations, driving strong revenue and volume growth, and market share gains in our key markets.

We continue to expand and invest in our New Category business, with over £1bn invested in the first half alone. Our Marketing Spend Effectiveness tool is allowing ever-greater focus and targeting of our marketing spend, resulting in lower incremental spend increases in the current year.

Benefitting from the strength of our three global drive brands across all categories, we have been able to increase prices, reduce discounting and leverage scale to drive COGS reduction, while lowering recommended trade margins across our key markets.

As a result, we expect a marked improvement in New Category contribution in 2022.

We are confident in delivering on our targets of £5bn New Category revenue, and profitability by 2025, and 50m adult consumers of our non-combustible products by 2030.

We continue to drive value through our combustibles business...and through Quantum, we are making good progress towards achieving at least £1.5bn of annualised cost savings by the end of 2022.

With this continued good performance, we are confident in delivering on our full year guidance.

We also expect another year of strong operating cash generation, and to exceed our 90% operating cash conversion target. In line with our more active capital allocation framework, and in addition to our growing dividend, we are on track to return £2bn to shareholders through our share buyback programme in 2022. This demonstrates our commitment to delivering enhanced long-term value for shareholders.

Turning now to our performance in detail.

We continue to build on our global category leadership position² in vapour, with Vuse achieving 34.4% value share in the Top 5 vapour markets, up 1.1 percentage points. In April, Vuse achieved the number one value share position³ in the US, the number one vapour market. Vuse reached 35.9% share up 3.4 percentage points and is now the market leader in 34 states.

As a good lead indicator of sustainable future growth, Vuse has maintained its device share leadership in closed systems in all Top five vapour markets.

BAT has been leading the pace of vapour innovation with eight successful launches in the past eight years. In May, we launched Vuse ePod2+ in Canada, our first connected device.

And in the UK we launched Vuse Go, our new disposable offering, with nine flavours, and we have further roll out plans in the second half.

Vuse's own e-commerce continues to grow strongly driving conversion, loyalty and profitability. Total subscriber numbers are up 60% year to date, and now represent 34% of our total e-commerce revenue. Encouragingly, data indicates that subscribers have over 7x the lifetime value versus an average 3rd party retail customer.

We are delighted to have received Vapour marketing authorisations for Vuse Ciro and Vibe in original flavour from the US FDA⁴ last month. Together with our Vuse Solo authorisation from last year, this gives BAT the broadest portfolio of Market Authorisations provided to any company in the US. Additionally, it provides further confidence in our Alto PMTA, which shares the same foundational science. Subject to the ongoing FDA discretion, all Vuse products currently available in the US may continue to be marketed.

In THP the continued strong performance of glo Hyper in Europe drove category volume share in the Top 9 markets up 1.5 percentage points to reach 19.6%. Excluding Russia and Ukraine, our share of the Top 7 markets, representing around 70% of total THP volume, reached 18.7% up 1.2 percentage points.

The THP category is continuing to grow in line with historical trends, with growth in Europe significantly higher than APME. glo continues to drive strong consumer acquisition, revenue and volume growth. Our consumer conversion rate is now comparable to the industry.

In Japan, glo's share of the tobacco market reached a high of 7.4% up 60 basis points, as smokers continue to switch to THP. In a highly competitive market, our THP category volume share was 20.6% down 60 basis points.

Glo continued to grow category volume share across all key European markets, with aggregate category share in the Top 7 markets reaching 20.1% up 3.5 percentage points. Excluding Russia and Ukraine, our aggregate share of category reached 17.7% up 5.1 percentage points.

The success of Hyper is driving consistent improvements in glo's brand power. This has enabled us to increase pricing in a number of key markets in Europe, and in the first half, we expect to deliver THP revenue growth ahead of volume growth for the first time.

Glo is continuing its geo-expansion. It is now present in 26 markets and in the second half, we have strong investment plans including additional launches, supported by strong marketing activation initiatives.

Turning to Modern Oral. In Europe, we continue to be market leaders in 15 Modern Oral markets. Aggregate share in our Top 5 markets excluding the US was broadly stable at 69.3%.

In Norway and Switzerland, we continued to strengthen our volume share leadership position in the Modern Oral category from a high base. Our share of total oral in Sweden continued to grow, reaching 9.7%, up 160 basis points.

We continue to drive innovation across the category, Mini pouches are now available in 15 markets, and Max ranges available in 11, driving strong overall growth. We expect to launch Velo in further markets in the second half.

In the US, Modern Oral remains only 1.5% of total nicotine value share. Current low moisture product formulations continue to result in low levels of average daily consumption and high poly-usage⁵. This is leading to a highly competitive pricing environment. Velo's share was 6.9% down 4.8 percentage points, with our main focus remaining on Vuse in vapour.

We continue to drive value through our combustibles business, with value share up 10 basis points

Full Year global tobacco industry volume is now expected to be down around 3% versus our previous guidance of down around 2.5%. This is due to the impact of continuing global macro-economic uncertainty resulting from the ongoing conflict in Ukraine.

With a well-balanced portfolio of brands across all key price tiers, and the benefits of our digital Revenue Growth Management tool, we believe we are well placed to navigate the increasing inflationary pressures this is causing.

While our combustible performance remains robust, the first half volume is expected to reflect the impact of the sale of our business in Iran in August last year, as well as the very strong prior year comparator in the US.

First half pricing remains strong, partly offset by continued geographic mix, driven mainly by the impact of the US. While we are seeing the re-emergence of illicit trade following the end of lock down restrictions in certain markets, to date we have seen no evidence of accelerated downtrading in our portfolio.

In the US, industry volume decline is returning to historical norms, with the first half additionally reflecting the impact of the prior year comparator. US value share continues to be strong, up 40 basis points, driven by our premium brands Newport and Natural American Spirit.

In addition, in the first half, the unwinding of prior year US inventory movements is now expected to be partly offset by the phasing of inventories ahead of the US implementation of our Group-wide SAP platform in July.

In the second half, this inventory phasing around our SAP roll out is expected to fully unwind.

This means full year results will reflect the unwinding of the prior year US inventory movements.

In conclusion on our financial performance, while we are not immune to the current global macro-economic pressures, with:

- Our strong New Category performance
- A robust underlying performance in combustibles
- And at least £1.5bn of savings from Quantum by the end of 2022

We are confident in delivering our guidance of:

- 2-4% constant currency revenue growth, and
- mid-single-figure adjusted diluted EPS growth

Applying current foreign exchange spot rates⁶ of 1.26, we expect a translational tailwind of around plus 2% on adjusted diluted EPS for the half year, and around plus 5% on adjusted diluted EPS for the full year.

So, while we recognise that there will be challenges ahead and that there is more work to do, our execution capabilities continue to evolve, and we are rapidly transforming the business.

We are now in our Faster Transformation phase and making strong progress towards our Purpose to build A Better Tomorrow. Driven by the strong growth of our New Category business we are continuing to reduce the health impact of our business, whilst also delivering on our wider ESG targets.

Key highlights in the first half include:

- We now have 18 certified carbon neutral manufacturing and commercial facilities⁷, including a further two added

in the first half, as we continue our work towards achieving carbon neutral operations by 2030

- Our landmark one-year glo clinical study is complete with full-results expected to be published shortly. 180-day clinical study results have already showed that completely switching to glo from cigarettes resulted in positive changes to all measured indicators of potential harm, with the majority of indicators similar to quitting⁸

In summary, with our well-established multi-category strategy, strong portfolio of global brands and our resilient, highly cash generative business, we are now in our period of faster transformation as we build A Better Tomorrow™.”

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

Q&A

Telephone Operator

If you'd like to ask a question, please press *1 on your telephone keypad. Please ensure your line is unmuted locally as you will be advised when to ask your question.

And the first comes from the line of Richard Felton from Goldman Sachs. Please go ahead.

Richard Felton, Goldman Sachs

Good morning, Tadeu, Mike. Two questions from me, please. So, my first question is on Vuse Go, which I'm seeing a lot around London, so it's like the launch is going quite well, but my question is, firstly, in the cities or regions where it has first been launched, can you say roughly how big these go, has become, as a proportion of your overall Vapour business?

And then, secondly, thinking about Vuse Go or disposables in Vapour more broadly, how should we think of those impacting the gross margin of your Vapour business? Will it be accretive to gross margins or dilutive over time?

Then my second question on Combustibles in the US. So, both BAT and the industry are taking a lot more pricing over the last three or four years, certainly than has been the case historically, which I will assume means that affordable is in a slightly different place today than it was a few years ago, or when we had the last recession in the US for instance. Given that step up in pricing and also all the headwinds that the consumer is currently facing, have you seen any shift in elasticity compared to historical levels?

Tadeu Marroco, Finance and Transformation Director

Okay. Thank you, Richard, for your questions. Look, Vuse Go, we have just launched it, so it's early days to make a reference in terms of how much this is the volume compared with our portfolio. But one thing that I can tell you is that the modern disposable is getting a lot of traction in a number of markets.

If you exclude the UK, in the top vapour markets, it's already about 20% of the over market, and the UK is double that. So, it's not a surprise that you see a lot of devices on disposable. And the fact that we have just launched our product, we are very positive in terms of the progress that we can make because we are the ones that had a well-established brand by this point in time.

So, as you'll know, we're the leader in Vapour in the UK and we are very confident that, in this new segment that is opening up in a number of markets, particularly in the UK, we will be able to make a good inroad there.

In terms of the margins, we expect to have similar margins that we currently have with our cartridge products, and we are viewing the products close to our margins, so we have the margin in our mind. We are not expecting any potential derail of that. So, in these new products, we are very conscious about the margins that we want to achieve. Also in terms of the ESG element, so we'll be putting recyclable initiatives on that, and surely continue our responsible marketing, avoiding any type of sales for youth.

So, these are the key elements that we always have in mind when we are launching these products, first, in the UK. And, like I said in my opening, we are also rolling out for other markets in the second half of the year.

In terms of the US, you have to consider that we are seeing some softness of volumes in the first half of the year, but, if you take the last three years, and you make an average of that, you saw, in 2020, we had even increasing volumes in the US, 2021 was a more, you know, normal expectation, this year, it was a bit less. But, at the end of the day, the average is not that much dissimilar to historical trends.

The affordability is having a particular impact at this point in time because of the high levels of inflation but, on the other hand, we also have a market where you have full employment, and we have a wage inflation as well. So, that's why we're not giving any guidance at this point in time. We'll have to see how it performs. We expect, in the second half, that the comparators will be more benign for us. This year, this first half, it's a bit more complicated because the comparator was very strong last year.

In terms of elasticity, we're not seeing that much difference from the 0.4 that we also said, and we believe that we are well-positioned, given the strength of our portfolio, the digital tools that we have in place. There's no big three, if anything, it's growing in a pace that is even slower than the historical ones. Normally, you see the big three growing by 0.8, 0.9 on a given year. What we have seen so far this year doesn't suggest this level of pace.

And we are not seeing, like I mentioned before, any type of downtrading of our brands, Newport and Natural American Spirit in particular, performed extremely well, and we are very well positioned in the US market independent of the pricing step we are taking.

Richard Felton, Goldman Sachs

Thanks very helpful. Thank you, Tadeu.

Tadeu Marroco, Finance and Transformation Director

Okay.

Telephone Operator

The next question comes from the line of Rashad Kawan from Morgan Stanley. Please go ahead.

Rashad Kawan, Morgan Stanley

Hey, guys. Good morning and thanks for this. Just one from me. Just wanted to get your thoughts on the implications to BAT from the Philip Morris/Swedish Match deal? I mean, does that change the way you approach the US NGP market at all? I mean, how much flexibility do you have to push, keep that burn in the US market, as an example, if IQOS is pushed aggressively there and starts taking traction as a category? Thank you.

Tadeu Marroco, Finance and Transformation Director

Rashad, look, to be honest, I don't see any implications for BAT in terms of our strategy. First of all, it's interesting to see that everyone now is seeing what we have already seen many years ago, that the direction is the multi category. We were the first ones to start saying that, and not saying but executing that.

So, as a consequence of this, we are very well positioned already in Modern Oral, and we are well positioned in Vapour, and that THP, in particular in the US, like you said, first of all, I think we have mentioned it before, we don't believe that that's a category that has a lot of potential because we see the differentiation between the top levels are tiny, considering combustibles is really high compared with THP. And we saw this in markets like Canada, which has a similar level of tar and nicotine and combustibles in the industry after trying, for many years, with very heavy investment in THP got nowhere in terms of presence in that market.

And we will be more as an insurance, making sure that we have a PMTA for glo Hyper, that, by the way, has already been filed in the FDA, and if necessary, we will activate that. But we still believe this is pretty much a vapour-established market, like we saw in France, like we saw in the UK. And, when you have a very well-established market with very high levels of tar and nicotine, the potential of THP's much reduced, and that's the deal from the multi category, the fact that we are addressing different consumer needs in different geographies with different levels of offers in terms of our nicotine enjoyment. Okay?

Rashad Kawan, Morgan Stanley

Very clear. Thank you.

Telephone Operator

The next question comes from the line of Pallav Mittal from Barclays. Please go ahead.

Pallav Mittal, Barclays

Hi. Good morning.

Tadeu Marroco, Finance and Transformation Director

Hi, Pallav.

Pallav Mittal, Barclays

It is announced in the PMTA to relaunch some Vuse products in the US, so have you witnessed any change in the consumer more acceptance of the product post approval?

Tadeu Marroco, Finance and Transformation Director

No, in reality, the consumers are not even aware that the products get approved. That's an important point. Their approval just gives you the right to keep your products in the market. So, once you get their approval, the market authorisation, you cannot publicise that, you cannot publicise that for consumers. So, it's completely indifferent.

So, that's why we are not very precious about the timing of approval, for example, of the Vuse Alto. We were one of the last to submit our PMTA. They're probably seeing other products before us, but this wouldn't be a problem because the consumers are unaware of what the FDA did in terms of approval or not.

We feel very confident and that's the important bit, the important bit. We feel very confident about the approval of Vuse Alto because the science foundation of the product is exactly the same that we used in the other SKUs of the family, and they all got approved and we made sure that we took the learnings before from the others to give a robust dossier for our Vuse Alto. So, we are confident that we will get approved. But independent of the time of that, we can keep the product in the mind, and consumers will not perceive the difference once they finally get approved.

Pallav Mittal, Barclays

Sure. Considering the ban on importation of IQOS in the US while the IDC case is going on, what are your plans on in the US now?

Tadeu Marroco, Finance and Transformation Director

Well, our plans, like said in the previous one, we don't believe that the category will be as strong as Vapour. Our plan continues to focus on vaping. We spoke about Modern Oral before. Modern Oral is the category that is still lagging a lot of product features on that.

The products that you see in the US are the ones that had to be in the market before August 2016. As a consequence, the level of moisture is very low compared with the ones that you see outside the US, and it's not really satisfying enough. And that's the consequence of that, it's the level of poly-use is very high, like 95% of the users of Modern Oral are poly users, and the level of consumption is 2 to 3 pouches a day, whilst if you go to Scandinavian, it's between 6 to 7, and the level of sole use is much higher.

So, we believe that a vapour category will still continue to be a very well-established category once we start getting approval from that day - to more modern products in Modern Oral, better quality, similar to the ones outside the US, we'll probably see some more traction in that category.

And THP, we don't believe that we will as success, whereas you see, in other parts of the world, because of the characteristics of the US markets, like I just mentioned before. It's a very high level of nicotine and tar in cigarettes. It's a market where the excise is 100%. You have difficulty in terms of commercialising, in terms of advertising, and we don't see, really, a massive potential in that.

Saying that, like I mentioned before, we have applied for our PMTA with glo Hyper, and we are in the process of getting it approved because we believe that having always - the MARTP - on THP in the US would be benign when you engage with regulators outside the US. That's our major driver to that. And, if needed, we can activate in the due time.

Pallav Mittal, Barclays

Sure. Thank you.

Telephone Operator

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

Rey Wium, SBG Securities

Hi, Tadeu and Mike. Just, first of all, I just want a clarification around the Russian business. Will you continue to account for it until you have successfully concluded the sale, or will it only be in from, like, the first two months of the year?

And then just a follow up on Russia, I mean, it is such a large market. How do you, longer term, think of, basically, re-entering the market or, you know, what plans are there, because there is just, from my perceptive, by just exiting it and,

you know, let all your business there go and, you know, basically, open it up for competitors? So, I was just wondering if you could give just a bit of a steer of how you think, longer term, of the Russian business?

Tadeu Marroco, Finance and Transformation Director

Okay. Thank you, Rey, for your question. Look, Rey, just to answer your question on the reporting, why the exact time of the sale remains unclear. We, under IFRS, we must continue to record our Russia operations in our reported numbers.

Now, like we communicated back in March, we are working as fast as we can towards exiting our Russian business, but it's an extremely complex process to fully separate the business from the Group.

As some of you probably know, we have spent five years, for example, I've just given one example, integrating our ERP systems and creating these unique platforms that we call Project T... across all the Group. And so the Russian business is no different than others, so it's completely tied up for the mothership, so to untangle all that, takes a long and very complex task to be done. And then you go to the discussion around patents, around trademarks, and all that, so you can imagine the level of complexity in cutting that.

In addition to the negotiations happening, we want to make sure that we remain compliant with all regulations and international sanctions, and they are changing continually, which, again, translates into some adjustments to the term sheets.

So, in terms of the future, it's difficult to predict now. I think that we will be just speculating at this point in time if we will be able to go back and to come back to the market. We have to see how it goes.

But the important thing is that we are working to get it done. The point that I made about our guidance is that, irrespective

of the timing of the Russian disposal, we are confident in delivering the revenue, the EPS guidance that we gave in the RNS today, and that is what matters, and let's see what happens as we move along because, like I said, it's a very complex process.

Rey Wium, SBG Securities

Now, it's just a quick follow up, just in terms of the updates around the vapour business sounds quite positive. I was just wondering about the profitability in the US. You know, you talked about, obviously, trade margins reducing, I think you mentioned last year, the second half, Vuse turned profitable in the US, so is there a chance of, you know, getting to full profitability in the full year?

Tadeu Marroco, Finance and Transformation Director

Well, look, we will be, sort of, providing category contribution on a consolidated base from half year results, so you will start seeing the progress we are doing in terms of reduction of losses. And what I can tell you, so, we are not providing disclosure by category, by markets, but what I can tell you is that the US has been one of the biggest drivers for us to reduce losses.

We are very pleased with the performance. You're absolutely right, from the second half last year, we turned it into a positive contributor. What we have done in the US is exactly the model that we apply elsewhere. You know that we have started with very high levels of discounts in device to get our products in the hands of consumers because we always believe that our products are better than competitors, and this translates into more and more consumables being sold.

And we are in the phase now that we are able to increase the price, not just on the consumables, but also on the device. And we do that using these digital tools that we have developed for combustibles, because then we can play with different packages. For example, we have of one cartridge, two cartridges, four cartridges. So, we understand elasticity in

different geographies and different channels, and we are using all opportunities to get as much value as possible.

And we are also able now that we are delivering in 24 states, to have a better negotiation in terms of trade margins. And, on top of that, we have just reviewed our supply chain, and we start moving production out of China to other locations to avoid the import tariff imposed in China that also enhanced profitability on the Vapour business.

So, when you put all this together, it's clear it's an accretive business for us today in the US, and we are very pleased with it.

Rey Wium, SBC Securities

Excellent. Thank you.

Telephone Operator

Before we go to the next question, as a reminder, if you'd like to ask a question, please press *1.

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

Alicia Forry, Investec

Hi. Thank you. Good morning, Tadeu and Mike.

Tadeu Marroco, Finance and Transformation Director

Hi, Alicia.

Alicia Forry, Investec

Thank you. A few questions from me. Just wondered if you could dig in a little bit into, you know, the confidence in reiterating guidance despite a little bit of, you know, increased macro pressures that you cite? You know, is this confidence based, kind of, price increases that you've taken or internal cost savings that you see? Just a bit more colour would be helpful.

And maybe, as, sort of, part of that question, you mentioned illicit returning. I don't think that's a surprise post the crisis,

but are you able to, you know, kind of, detail where that's occurring? And it sounds like it's not affecting your business, but perhaps you could confirm that?

Tadeu Marroco, Finance and Transformation Director

Okay. Yes, so, yeah, we are seeing a better environment price wise, and I'm talking here worldwide, the whole globe, it's not just a particular market. But, worldwide, we are seeing a better price environment than we saw last year, which is a positive for us. So, this will be one element that we'll be using to navigate through the headwinds that we face.

The savings, the fact that we have an already established problem to deal with, what we are doing is just really trying to leverage as much as possible the mobilisation of the company around the cost savings to get it, you know as stretched as we can so that we are very comfortable now to get above £1.5bn savings by the end of 2022. That will help the turbulence of '22.

And these will be, together with the strength of our portfolio, the rollout of the revenue growth management tool I was referring to into the US, to other parts of the world. These will be the key elements that we will be using to navigate through this turbulence. And we are already 88% of pricing that we need for the year, so that's the level of confidence that I was referring to.

For sure, the unknown, you know, that the timing of the transfer of the business in Russia, so you would expect that it takes a longer than a year. We will be more in the upper range of the range. But, overall, we are very confident that we can be able to deliver that.

On the illicit, because we are also doing quite well in the non-combustibles, is another element that I spoke of and is scripted. The non-combustibles, you remember that we, for the first time last year, we reduced our loss by £100m, and we expect now to consolidate this trend moving forward in 2022 because all the initiatives that I was referring to during my

opening. And these will be also an element that will help us to go through this.

Now, for sure, we'll have some headwinds, and, on top of the pressures, we have to, in the US to lap a very strong first half this year. We have stocks that would be unwound through the year that we referred to at the beginning of the year. So, when you put all this together, we are very confident on the targets that we put for ourselves.

We expect a move balanced result between the first half and second half, subject to what happens with Russia, for sure, because the pressures that we'll be facing more on the combustible side will be pretty much balanced out with the improvements we are doing in our categories.

In the second half, we expect the pressure in combustibles to ease a bit because of the comparator, mainly in the US, but on the other hand, we are investing more in the New Categories. Like I said in my opening, we are going for new launchings, we are going for new marketing activations. And so we expect pretty much a more balanced Half One, Half Two in 2022, subject, for sure, of what happens in Russia.

In terms of illicit, we still have some legacies, markets from COVID that are still doing quite well. We have Brazil, for example, where illicit continues to decline, which is very good news. And it's all this trend started with COVID when they closed of borders, the government then started acting, and we haven't seen any excise increase for five years now, even state excise in Brazil, which is very helpful. And we also seeing improvements in places like Malaysia, which, as you know, has very high levels of illicit, and it continues to improve this year.

But we saw some reversal of this trend in places like South Africa, since 2020. We see problems ..., in Saudi, for example. But, like we said, overall, we are expecting a 1% increase in illicit this year. Illicit, today, is adding to something close to 12% of the total market, and we expect this to be pretty much on 13%

when you consider places like the usual suspects, like Pakistan or ..., like I referred to, and some of that offset by the other markets that I was referring to too. Okay?

Alicia Forry, Investec

Okay. Thank you. I think I'll leave it there today. Thanks for that detail.

Tadeu Marroco, Finance and Transformation Director

Thank you.

Telephone Operator

The last question comes from the line of Jared Dinges from JP Morgan. Please go ahead.

Jared Dinges, JP Morgan

Hi, guys. Thanks for the questions. So, in recent years, you know, we've seen industry pricing ahead of inflation in the US in cigarettes and, you know, given this year, you know, you actually have a very inflationary backdrop across other categories, so, essentially, you're seeing cigarettes becoming more affordable. Do you see any opportunity to, kind of, offset any US downtrading through accelerated pricing even further, or do you, kind of, prefer to take this year to make cigarettes relatively more affordable in the US? That's the first one.

Tadeu Marroco, Finance and Transformation Director

Look, Jared, this is a continuous check in for us. We have this very sophisticated model to analysis the level of elasticity in a very granular base. It's not that we take one initiative because you have to consider that pricing's one thing, but the discount is what really matters in the US, and the discount varies a lot.

So, you see the headline prices, but what the consumer ends up paying at the end is what is, you know, offering him after discount. So, the levels of discounts vary a lot, and this is a consequence of us analysing exactly the point that you are raising, the level of affordability, and this varies between different states, for example, or even better different channels.

And so, overall, my point about the comment on the pricing is that we are seeing a better price environment than the previous year, and we are not seeing, in particular in the US, at this point in time, a big difference in terms of elasticity from what we have seen the previous years.

Consumers are still spending similar amounts of money, but, overall, I'm not just talking about cigarettes, but they are a bit more selective in terms of where they spend their money. And we are using all this intelligence and follow up from consumers to understand where we need to apply the right levels of discounts.

We haven't seen the downtrading in our portfolio, like I said, and the reason why we are growing 40 base points in terms of value shares is the fact we have brands like Natural Spirit, which is a fantastic brand - that, by the way, is the only brand in the US that has no discount at all - it still continues to grow, and also our Newport, which is our premium brand in the US. So, the fact that this strong portfolio combined with this level of knowledge from the digital tools, very helpful.

And you have to remember that the industry has this peculiarity that we can leverage the excise and the retail price, meaning that we are more resilient than other consumer goods. So, the characteristics of the excise and how much we pass on to the consumers and how much comes to the manufacture itself, makes this category very attractive and more resilient in an environment of high inflationary pressures.

Jared Dinges, JP Morgan

Got it. That's very helpful. And then may to just switch gears, but also in the US, so you guys have talked about, you know, in the past, the potential shake out, kind of, post-PTMA, I think you quantified the size of that potential opportunity in the past. We continue to see the Disposable category grow and grow, like, I know, you know, which brand winner within that is changing, it's become pretty fragmented, but it is combined

fairly sizable now, and it's almost all flavoured and primarily non-menthol flavoured.

You know, we've seen some PMTA denials come through. I know some of those are going through the court system. They're under review. But maybe you can give us an up on how big you think that opportunity is and will be and when you think, you know, we'll finally see that shake out.

And maybe just to add to that, you know, how many of those consumers that are consuming, kind of, the fruity flavoured vapour products, how many do you think would actually stay within Vapour if it was only menthol and tobacco flavours being offered? Thanks.

Tadeu Marroco, Finance and Transformation Director

Yeah, look, you have to consider - the bigger picture is that the FDA has 400 employees to deal with this massive amount of dossiers of submissions, millions of that. So, they have provided some market authorisation, some market denials. I think that they have something like 500,000 to 1 million of cases still to be analysed. So, they are really late on that. And it's really not a surprise because the amount of SKUs that exist in the market was, you know, very substantial, vis-à-vis the capacity they have to assimilate all that. So, that's the first thing.

The second is we are seeing more and more concentration in the US for closed systems, because all these open systems and liquids are having tremendous difficulty to get approvals through the FDA which, again, is not a surprise. And, as you move along, you expect this to materialise.

One thing, loophole, that existed, that the FDA just recently acted on that, is related to the disposable synthetic nicotine. And why I'm saying the 'loophole' because remember that they banned all flavours of it and menthol and tobacco back in January 2020, but there was no mention to synthetic nicotine

because synthetic nicotine was not subject to the remit of the FDA.

So, these types of products grew to something close to 20% of the total markets over the last couple of years. And the FDA has just enacted, the President actually enacted a mandate that the FDA now have the authorisation to regulate these products as well. So, we expect the FDA to request PMTA for these products as they did for the other products in the markets with tobacco.

So, the question here is how long it will take and the level of enforcement that we will see for this to materialise. But the size of the prize can be as big as 20% of the market, but it's very difficult to predict the timing of that, and, from my point, it's not just a question of time, but it's also a question of enforcement.

In terms of the consumers, we are seeing, still, a very good attraction in terms of menthol and tobacco, and you saw that the category continues growing since January 2021, the fruit flavours has been taken out. Okay?

Jared Dinges, JP Morgan

Got it. That's great. Thanks, Tadeu.

Tadeu Marroco, Finance and Transformation Director

Okay.

Telephone Operator

There are no further questions, so I will hand the call back to your host for some closing remarks.

Tadeu Marroco, Finance and Transformation Director

Okay. So, thank you all for listening and for your questions. I'd like to leave you with a few final comments from my side.

We are very proud of the progress we are making to transform BAT driven by the continued strong momentum across all three

new categories, driving value to our Combustible business and generating cost savings through Quantum.

We are confident in delivering on our 2022 guidance and, with that, I look forward to updating you further on our transformation at our Half Year 2022 Results presentation on 27th July. Thank you very much and stay well.

Telephone Operator

Thank you for joining today's call. You may now disconnect your lines.

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END
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Market share and volume data (unless otherwise stated) YTD April 2022.

T9 THP markets: Japan - CVS-BC, South Korea - CVS, Russia - IMS (BAT+PMI), Italy - Nielsen, Germany - Nielsen, Romania - Nielsen, Ukraine - Nielsen, Poland - Nielsen, Czech - Nielsen.

T5 Vapour markets: US - Marlin, Canada - Scan Data, UK - Nielsen, France - Strator, Germany - Nielsen.

T5 Modern Oral markets: US - Marlin, Sweden - Nielsen, Denmark - Nielsen, Norway - Nielsen, Switzerland - Scan Data excl. SPAR and Top CC.

¹Non-Combustible Consumer Definition: The number of consumers of Non-Combustible products is defined as the estimated number of Legal Age (minimum 18 years, US: 21 years) consumers of the Group's Non-Combustible products. In markets where regular consumer tracking is in place, this estimate is obtained from adult consumer tracking studies conducted by third parties (including Kantar). In markets where regular consumer tracking is not in place, the number of consumers of Non-Combustible products is derived from volume sales of consumables and devices in such markets, using consumption patterns obtained from other similar markets with consumer tracking (utilising studies conducted by third parties including Kantar). Target market for acquisition is existing adult smokers/nicotine users.

The number of Non-Combustible product consumers is used by management to assess the number of consumers regularly using the Group's New Category products as the

increase in Non-Combustible products is a key pillar of the Group's ESG Ambition and is integral to the sustainability of our business.

The Group's management believes that this measure is useful to investors given the Group's ESG ambition and alignment to the sustainability of the business with respect to the Non-Combustibles portfolio.

² Based on Vype/Vuse estimated value share from RRP in measured retail for Vapour (i.e. total Vapour category value in retail sales) in the USA, Canada, France, UK, Germany. These 5 markets cover an estimated c.75% of global closed system revenue.

³ Based on US Marlin Value Share of Total Vapor (Feb. 2022 – Apr. 2022).

⁴ US Food and Drug Administration (FDA)

⁵ Poly-usage refers to an adult consumer using more than one type of New Category product.

⁶ Current exchange rates of USD/GBP 1.26 as at 7th June 2022

⁷ Carbon neutrality relates to Scope 1 & 2 greenhouse gas (GHG) emissions, achieved by a combination of initiatives, including energy efficiency, emissions reduction, renewable energy use, the purchase of renewable energy certificates and offsetting.

⁸ <https://link.springer.com/article/10.1007%2Fs11739-021-02798-6>

Share growth refers to volume share for THP and Modern Oral and value share for Vapour. As used herein, volume share refers to the estimated retail sales volume of the product sold as a proportion of total estimated retail sales volume in that category and value share refers to the estimated retail sales value of the product sold as a proportion of total estimated retail sales value in that category. Please refer to the 2021 Annual Report on Form 20-F for a full description of these measures, together with a description of other Key Performance Indicators (KPIs), on pages 302 and 303.

New Categories comprises Tobacco Heating Products (THP), Vapour and Modern Oral.