2023 Second Half Pre-Close Conference Call

Transcript

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Operator

Hello and welcome to the BAT 2023 Second Half Pre-Close Conference Call. My name is Alex and I'll be coordinating the call today.

If you'd like to ask a question at the end of the presentation you can press * followed by 1 on your telephone keypad. If you'd like to remove your question you may press * followed by 2.

I'll now hand it over to your host Victoria Buxton, Head of Investor Relations. Please go ahead.

Victoria Buxton – Group Head of Investor Relations

Good morning, everybody. I'm Victoria Buxton, Group Head of Investor Relations, and with me this morning is Tadeu Marroco, our Chief Executive and Javed Iqbal, our Interim Finance Director.

Welcome to our full year 2023 Trading and Strategy Update 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 wording regarding forward-looking statements, as well as the notes and disclaimers contained in the trading update. Unless stated otherwise, our comments will focus on constant currency adjusted measures, and all our share data is year-to-date average to September 2023, versus full year 2022 average.

I would also like to remind you, that there will be an opportunity to ask questions later in the call. And with that, I will now hand you over to Tadeu.

Tadeu Marroco – Chief Executive

Thank you, Victoria. Good morning, everyone and welcome.

I am pleased to reiterate our full year 2023 EPS guidance driven by our broad based performance across categories and markets.

Today in addition to our pre-close trading update, I would like to begin by sharing some key highlights of the comprehensive strategic review we have now completed.

I am clear that our early commitment to a multi-category strategy is right. I am also clear that we must continue to make active choices to sharpen our strategic execution through delivery on fewer, bigger operational priorities.

To accelerate the next phase of our transformation journey, we are now committing to 'Building a Smokeless World'. We will deploy our global multi-category portfolio to actively encourage smokers to 'Switch to Better' nicotine products, realising the multi-stakeholder benefits of 'A Better Tomorrow™'.

This commitment is demonstrated by our new ambition to become a predominantly smokeless business, with 50% of our revenue from non-combustibles by 2035. With only 10% of the world's 1 billion smokers currently using New Category products[1], the long-term opportunity for growth as we deliver on our transformation is vast.

Consistent with our vision to 'Build a Smokeless World', and in combination with the current macro-economic headwinds impacting the U.S. combustibles industry, in 2023 we will take an accounting, non-cash, adjusting impairment charge of around 25 billion pounds. This accounting adjustment mainly relates to some of our acquired U.S. combustibles brands, as we now assess their carrying value and useful economic lives over an estimated period of 30 years. Accordingly, we will commence amortisation of the remaining value of our U.S. combustibles brands from January 2024. This non-cash amortisation charge will be treated as an adjusting item and does not impact future capital allocation decisions. Work is ongoing as part of our normal year end process, and we will disclose further details at our Full Year results in February.

Building on our progress in 2023, I am clear that now is the right time to further invest to accelerate our transformation. We are making active investment choices to strengthen our U.S. business, accelerate innovation momentum in Heated Products globally, and enhance capabilities that support our strategic delivery.

These investments will impact in 2024, and alongside continued macro-economic pressures in the U.S., we now expect low-single digit growth in revenue and adjusted profit from operations, on an organic[2] basis at constant rates.

Looking forward, we expect accretive New Category growth and stable combustible revenue to continue to drive total nicotine industry revenue growth. This underpins our medium-term guidance, where we expect a progressive improvement to 3 to 5% revenue, and mid-single digit adjusted profit from operations growth, on an organic[1] basis at constant rates by 2026.

We will continue to reward shareholders through our strong cash returns, including our progressive dividend, and, once the middle of our leverage range is reached, we will evaluate all opportunities to return excess cash to our shareholders.

Turning now to current trading…

Benefitting from our global footprint and multi-category portfolio, we expect to deliver:

- 3 to 5 percent organic[2] revenue growth, and
- Mid-single digit adjusted diluted EPS growth

Our earnings guidance includes the divestment of our business in Russia and Belarus in September.

In New Categories, we continue to drive strong volume and revenue growth, led by Vuse and Velo. However due to the continued weakness of U.S. combustibles, we now expect to deliver group organic[1] revenue growth at the low end of our 3 to 5% guidance range.

I am particularly pleased by our continued strong performances in AME and APMEA, which together we expect will deliver close to double digit revenue and adjusted profit from operations growth.

The continued strength of these two regions, driven by both combustibles and New Categories, gives me confidence that once we have restrengthened our U.S. business, our global multi-category strategy will deliver long term sustainable profitable growth.

Turning now to one of the key priorities I set out in the summer. To drive profitability[3] in New Categories.

After significant upfront investment, since 2020 we have reduced New Category losses by 1.1 billion pounds. As a result, we now expect our New Category contribution to be broadly breakeven in 2023, and to continue to be profitable[3] moving forward.

Vapour and Modern Oral are already delivering profitable[3] growth. This continues to give me confidence that we will profitably transition our portfolio from combustibles to New Categories.

In vapour, Vuse continues to extend our value share leadership[4] reaching close to 37% value share in key markets[5], up 100 basis points. Vuse continues to deliver strong revenue growth, driven by an increased number of consumers, robust pricing and the benefit of growing cross-category poly-usage[6].

We see the fundamentals of the vapour category as a reduced risk[*†] alternative for adult smokers as strongly positive. More adult smokers are switching to vapour than any other New Category, with Vapour and Heated Products equally effective at encouraging smokers to switch. In addition, positive demographics support the long-term sustainability of the category.

In the U.S. our PMTAs[7] for Vuse Alto's two Tobacco flavour products remain under FDA[8] review. These applications further built on the foundational science of our successful tobacco flavour submissions for Vuse Solo, Ciro and Vibe, which received marketing authorisations in 2021 and 2022. We are confident that a successful outcome of the Vuse Alto PMTAs remaining under review with FDA will be received in the coming months, consistent with the Agency's most recently communicated time frame.

We are challenging the Marketing Denial Orders received for Vuse menthol variants, including most recently for Vuse Alto. We have received stays of enforcement for FDA's denial orders. This means that these Vuse menthol products can continue to be marketed and sold while the judicial review process continues.

We believe appropriately regulated, flavoured vaping products — including menthol — are critical in supporting the migration of adult smokers from combustible cigarettes. Indeed, while FDA did not request long-term consumer switching data as part of the

PMTA applications for Vuse, interim results of a 24-month longitudinal study for Vuse show that the proportion of Vuse users completely switching from combustibles was higher among those using menthol-flavoured products than those using tobacco-flavoured products.

Globally, the modern disposables segment is driving incremental vapour category growth. We continue to approach this fast-growing segment in a responsible way in regulated markets, consistently implementing our global Under-age Access Prevention Guidelines and Take-Back schemes for responsible disposal.

Vuse Go is now available in 59 markets and our recent launches in Emerging Markets, including Colombia and Peru, are delivering positive results. We expect our vapour footprint to continue to grow, as regulatory developments in new markets increasingly allow smokers to access authorised, reduced-risk products[*†], which enables our entry.

In Modern Oral, Velo continues to deliver strong volume-led revenue growth and increasing profitability[3].

Modern Oral is a fast-growing category, driving our volume share of Total Oral in key markets[9] up 110 basis points, reaching 8.5%. The category is also developing quickly outside the traditional oral areas of Scandinavia and the U.S., with newer markets now representing a quarter of industry volume.

While our global volume share of Modern Oral is down 210 basis points, driven by the large U.S. market, we are encouraged by the strong results from our recent Velo pilot in New York, including a more premium brand expression and design. In addition, we remain confident of securing the PMTA for our Europe-leading Velo 2.0 platform to support our longer-term competitiveness in the U.S.

Elsewhere, Velo continues to perform strongly, maintaining its clear category leadership in Europe, with 67% volume share in our top 4 markets[10]. And we are taking further steps towards broadening accessibility of our reduced-risk products[*†] through unlocking Emerging Market opportunities.

Velo continues to deliver strong growth in Pakistan driven by increased consumer numbers and with average daily consumption now close to 5 pouches per day. In addition, we have accelerated our national roll-out in Kenya after a successful pilot test.

In heated products, glo's performance in 2023 has been disappointing. Slower industry volume growth, increased poly-usage[6] particularly into the vapour category, together with heightened competitive activity in Japan and Italy, has impacted our performance. As a result, our organic[2] volume and revenue growth has slowed in the second half, and our volume share is down 100 basis points in key markets[11] to 18.2%.

Although glo maintains its strong No.2 volume share position globally and continues to perform well in a number of AME markets including Poland and the Czech Republic, since becoming Chief Executive, I have been clear that we need to do more to strengthen our innovation pipeline, to drive momentum in longer-term performance.

While still early days, I am excited by the accelerated cadence of our innovation pipeline in both consumables and devices. Glo Hyper Air is performing in line with expectations. In addition, we have recently launched veo™, a range of non-tobacco consumables, in 10 markets in Europe, gaining first mover advantage in this new space, with encouraging early results. I look forward to sharing more details on our innovation pipeline next year.

Now, turning to combustibles, where our global volume share is flat year to date, with value share down 40 basis points, reflecting the impact our commercial actions in the U.S., partly offset by stronger performances in AME and APMEA.

In the U.S., combustibles industry volume continues to be impacted by the volatile macro-economic environment, with premium segment share showing recent signs of pressure after a more stable first-half.

Although our volume share is down 10 basis points year to date versus full year 2022, I am encouraged that our commercial plans are delivering early signs of volume share recovery, with a 50 basis point improvement between January and October, driven by Newport, Natural American Spirit and Lucky Strike.

While returning our U.S. Combustibles business to consistent value growth will take time, we are confident that the actions we are taking will strengthen our portfolio over the longer-term.

In California, the impact of the flavour ban continues to evolve, with consumers accessing flavoured products through illicit channels. We can clearly see the lack of effective enforcement on the ground, with overall nicotine consumption broadly stable year to date.

Due to our menthol skew, 45% of our combustible portfolio had to be delisted at the end of last year. We activated commercial plans, and adjusting for a 13% pre-ban rate of decline, our underlying retention rate in combustibles has been over 80%, and over 90% including the impact of elevated menthol volumes in neighbouring states.

Outside the U.S., our combustibles business has continued to perform well.

In AME, our volume share gains and pricing have driven strong revenue and profit growth.

In APMEA, the impact of excise led volume declines in Pakistan has been more than offset by our pricing across the region, and we expect 2023 to be another year of strong revenue and profit delivery.

This demonstrates the benefit of our global footprint, well-balanced portfolio and our ability to deliver in challenging environments.

BAT is a highly cash generative business and we expect to deliver close to 100% operating cashflow conversion in 2023.

We are making progress towards reaching the middle of our guided 2 to 3 times adjusted net debt12 / adjusted EBITDA13 leverage range and expect to be close to 2.7 times by year end. As we set out at half year, we continue to seek and evaluate all opportunities to enhance balance sheet flexibility, including disposals and the exit of non-strategic markets.

We remain committed to a progressive dividend and, once the middle of our leverage range is reached, we will evaluate all opportunities to return excess cash to our shareholders.

Now, turning to our Strategic Update…

Building on our strong progress to date, and to continue to deliver long-term sustainable growth and returns, we are now focused on sharper strategic execution through delivery on fewer, bigger operational priorities. In addition, we are building a more collaborative and inclusive culture, as we drive a more agile and modern BAT.

To steer us towards these two objectives, we have refined our strategic direction and ambition. This will drive our priorities and future choices.

First, we will drive a step-change in our innovation capabilities and speed to market.

We have all the right foundations in place. We committed to a multi-category strategy from the outset, recognising that consumer tastes and preferences are not homogenous. In less than a decade, we have built a portfolio of three powerful brands, Vuse, glo and Velo, delivering more than 3 billion pounds of revenue.

And after significant early-stage investment, I am particularly pleased that we now expect our New Categories to be broadly breakeven in 2023, and be profitable[2] from 2024 onwards.

Building on our deep cross category consumer insights, we will deliver an enhanced innovation pipeline, by further investing in our people, our science, our IP and our capabilities, driving an innovation focused culture.

We will continue to leverage our centres of excellence in Southampton, Trieste and Shenzhen, in order to access wider internal and external strategic partnerships, focused on developing consumer-relevant premium propositions.

Second, we are making active choices to accelerate our transformation.

We will leverage our market archetypes to guide how and where we deploy our products and allocate resources, to deliver long-term value creation.

In the U.S. we have now completed a deep and thorough review of our business. We have begun and will continue to invest in sharpening our portfolio management, strengthening our route-to-market, and further leveraging our broad, digitally enabled, revenue growth management capabilities. We are confident this will drive quality growth over the longer-term and ensure greater resilience through economic cycles.

In Heated Products, we continue to invest to rejuvenate our momentum with an enhanced innovation cadence in both devices and consumables. The launch of our new non-tobacco consumables range, veo™ since September is an early sign that this focus, to deliver first to market consumer-relevant innovations, is yielding results.

We are also taking action to strengthen our organisational capabilities. We are committed to playing a more proactive role in sharing our science and insights to support the development of New Category regulation and our contribution to tobacco harm reduction globally.

This is incredibly important for both the future development of New Categories and also to ensure the proper functioning of existing New Category markets.

The recent proliferation of illicit disposable vapour products in the U.S. is a clear example of the importance of effective regulation and enforcement. We estimate that these products now represent over 60% of the U.S. vapour market, with over 90% of the segment estimated to be in non-menthol flavours, where we are unable to participate.

In recognition of the critical role regulation is playing for the future of New Categories, as part of the Management Board changes announced in June, we created the new Corporate and Regulatory Affairs function.

The success of our transformation will also be accelerated by a more collaborative and inclusive culture, which is at the heart of my leadership agenda. I am delighted to welcome Cora Koppe-Stahrenberg to the new role of Chief People Officer. Cora brings a valuable external lens from a diverse range of transforming industries and she will be focused on driving a winning culture and a more agile and modern BAT.

And finally, we are increasing investment in 2024 to secure our long-term sustainable growth.

While we expect continued headwinds to impact our U.S. business next year, we will build on our broad-based performance in 2023, by making the active investment choices I have just outlined.

We are confident that these are the right near-term investments to secure long-term quality growth and accelerate our transformation.

I look forward to sharing more detail on our refined strategic direction, including the KPIs against which we can be measured at our full year results in February.

Thank you for listening, and I will now open up the call to your questions.

Q&A

Operator

Thank you. As a reminder, if you would like to ask a question, you can press * followed by 1 on your telephone keypad.

Our first question comes from Jacob de Klerk of Redburn Atlantic. The line is now open, please go ahead.

Jacob de Klerk – Analyst, Redburn Atlantic

Morning, guys. Thanks for taking my questions. Just a couple. Just going back to your smokefree target you said for 2035, will the contribution be evenly split in three categories or continue to be lopsided to vapour?

And then just secondly, how do you expect to maintain profitability in the NGP category if you're stepping up investment into 2024 specifically behind the THP category?

Tadeu Marroco – Chief Executive

Yes, thank you for the questions, Jacob. Well, look, what we are seeing now currently is the phenomenon of poly-uses is an indication that the smokefree will be adopted through the different categories.

There is clearly, in terms of number of consumptions, more users of Vapour currently. If you take out of the estimated 100 million consumers of these non-combustible projects, you have 60% plus of those core users using vaping, but we are also conscious that a lot of them are poly-using amongst those categories.

So, I don't think that we can highlight one specific category, and that's played in line with our strategy since the outset to be a multi-category company, because we always believe, because consumers are different, the regulatory environment is different, that we would need to activate the three categories at once. I think that we'll be very well prepared for this future that we have already materialised to happen at this point in time.

In terms of NGP, what we are saying is that we expect profitability to come from 2024. So, we will be using some of the profits reinvesting back in the New Categories, mainly on the Heated Products category specifically, but, net net, it will still be a positive outlook in terms of profitability in New Categories for 2024.

Jacob de Klerk – Analyst, Redburn Atlantic

Brilliant. And can I just squeeze on one last one, sorry? There was no mention of the sum of your £5bn revenue target in 2025 for NGPs. Is this target still maintained or will the exit in Russia impact this?

Tadeu Marroco – Chief Executive

Yes, no, for sure, that Russia, it's a headwind if you want, but we have the ambition to get to the £5bn by 2025. The major headwind that we'll be facing is really not the divestment of Russia but is the continual increase of these illegal products of modern disposal in the US. The US is a big part of our revenue that we have achieved so far, and this just makes it more difficult, let's put it that way.

For sure, on the other side of the coin, if we start seeing enforcement, as you would expect in the US from the FDA, this could be a very strong white space that we'll be ready to approach, but the target, the ambition is there.

Jacob de Klerk – Analyst, Redburn Atlantic

Thank you very much.

Operator

Thank you. Our next question comes from Owen Bennett of Jefferies. Your line is now open, please go ahead.

Owen Bennett - Analyst, Jefferies

Good morning, guys. I hope all is well. I had a couple of questions, please. The first one on the incremental investment, would you be able to say how much of that incremental investment will be on Heated Tobacco? And then can you outline where, on Heated, that investment will be going? Is it likely to be on additional discounting or will it be below the line on things like in terms of education and building these consumer relationships?

Tadeu Marroco – Chief Executive

Okay. Owen, the incremental investments, we are highlighting three areas, and they're not very different from what I have been saying. In reality, you've heard consistently from me that, since I took over as the CEO, there is clearly a need to reset the US business.

So, a lot of these investments will be us continuing to build the commercial plans that are needed in the US to transform the US into a more consistently long-term business for the Group. And not just on making the portfolio more resilient in terms of regulation and economic cycles, but also investing in trade markets covered and investing in the digital capabilities in the US and some other areas that will strengthen the business.

So, a lot of these investments will carry on the US and the Heated Products is the one that I have singled out since the beginning because we have a strong performance in New Categories overall and mainly, specifically, in the Vapour and the Modern Oral, we are very pleased with the promise that we have been able to make in those two categories, but, clearly, Heated Products are not there.

So, the investment will pretty much be aligned with leveraging some innovations that we want to bring to the market and how you can make them more accessible for consumers.

We want to strengthen where we play in terms of the portfolio of Heated Products, and the first step has been the introduction of these non-tobacco-flavoured products in some markets in Europe. We will continue to roll out these next year as the ban in flavoured tobacco heating starts to be adopted by more European markets, so this will part of the investment, but also related to the new innovations.

For sure, we also want to step up our investments around IPs because this is one area that has been constraining us in the past, and that's why I was referring to our centres of innovations in places like Shenzhen and the investments that we are making in terms of leveraging internally and external partnerships to reflect into more compelling products that we could launch in the market.

Owen Bennett - Analyst, Jefferies

Well, thank you, sir. And then the next question is just on the 2024 guidance. What are you assuming for US Vape in terms of are you assuming any meaningful action on disposables? And then are you also assuming your tobacco PMTA gets approved, and you perhaps would see some acceleration on the back of that? Thank you.

Tadeu Marroco – Chief Executive

Okay. Yeah, the 2024, the first point I would like to highlight is that we expect the two regions outside the US to continue to deliver strongly, and we also expect the New Categories, like I answered that question before, to make inroads not just in terms of revenue but, more importantly, in terms of profitability as well. So, this is all going in the direction that you would expect to go.

There is no doubt that some of the commercial plans that we have already started addressing in 2023, you have already seen the reflection of that in terms of our share performance from January to now, which I disclosed in this statement, has an impact in terms of carryover for 2024.

And, on top of that, we are answering your question not assuming any meaningful enforcement from the FDA because, unfortunately, we haven't even seen these up to this point in time. Clearly, the FDA, we expect them, first of all, to conclude the process of the PMTAs in Vapour. So, in concluding that, they will be able, let's put it that way, to start publishing a complete list of legal products, and they haven't done this so far which creates a lot of uncertainties in terms of enforcement because, when you visit key accounts, for example, in the US, they're still doubtful if their products will be approved or not because they are still pending some definition of the FDA.

So, the first thing is the FDA needs to be a bit clearer in terms of what's illegal or what's allowed to be in the market, which they haven't done, but we also believe that they need to really dramatically increase inspections of retailers, distributers, wholesalers, hold lawbreakers accountable, which we are not seeing yet, employing its most powerful enforcement tools that they have, and eventually drive effective enforcement with coordination with other government law enforcement agencies.

So, we are not seeing any of that at this point in time and, hence, our assumption for this plan which is, you know, underpinning the 2024, is that we are not seeing any meaningful FDA enforcement. For sure, if we are wrong on that and all of a sudden, we start seeing them be much more active and, hence, open up space in that market, we will be benefiting from that.

And, in terms of the PMTA, we are very confident that they will be approving our tobacco flavours. It seems that they have taken a right blank approach in terms of menthol, denying all products, they haven't approved any products of menthol, which is very frustrating to say the minimum because this goes against even their belief in terms of risk continuing and migrating consumers out of cigarettes, they just make this more difficult.

We hope that, with the expedited process of PMTA with some technology to prevent use by youths, they can reassess that and bring the flavours back. But as are very confident that our tobacco flavoured products will be approved in the coming months.

Owen Bennett - Analyst, Jefferies

Okay. And then just on that, I'm assuming, kind of, you're referring to Bluetooth technology, as I understand, you were hoping to get a new PMTA in by year end. Is that still the case?

Tadeu Marroco – Chief Executive

Well, our expectation is that, like I said in the statement, they have just basically ignored all the studies relating to our process specifically, all the studies that we have proven that the menthol flavours in vapour are much more effective in converting smokers out of cigarettes towards vapour. They basically ignored that, and they issued the Denial Order, which we are appealing, just as you heard, and will continue to be in the market as a consequence of this appeal.

So, in the meantime, they have issued a more expedited PMTA process to allow the manufacturers to submit devices that has intrinsic technology through Bluetooth to enable to assess age, and, with that, prevent the access of youths to these products.

We believe, and there is no certainty on that, it's basically a belief that, with that, they will be more keen to approve the flavours, at least the menthol one, because it's a – I strongly believe that they also see the benefit of smokers moving away from cigarettes to Vapour via flavours.

So, in our case, our Bluetooth device will be early next year, be filed as a PMTA, and, based on what we heard from the FDA, this process will be expedited compared with the normal ones.

Owen Bennett - Analyst, Jefferies

Okay. Thank you, sir. I appreciate it.

Operator

Thank you. Our next question comes from Rey Wium of SBG Securities. The line is now open, please go ahead.

Rey Wium – Analyst, SBG Securities

Thank you. Hi, Tadeu. Just a question regarding the 2024 guidance which has now been reduced to revenue and operating profits to low-single-digit. I'm a bit surprised on the revenue side that that's also been lowered, so the only sort of thing I can, sort of, you know, determine from this is that maybe you plan to be probably more aggressive on pricing or maybe, you know, reduce the price increases that you had in the US. Is that a fair assumption?

Tadeu Marroco – Chief Executive

Yeah, it's difficult for me to make comments on the pricing, but there is, as part of the commercial plans in the US, because we said that, we will be strengthening our portfolio of brands, and laddering, for example, is part of the process.

We are reviewing also all the covers that we have in the difficult channels in the US, but, more importantly, don't forget that, in the plan for '24, we are not really seeing a major shift in terms of macroeconomic downward pressures in the US market. I'm not giving guidance to the US markets, but, this year, the industry will be finishing close to a decline of high-single-digits.

For sure, it's not just the macroeconomics that is driving that. These illicit modern disposals though is having more and more impact on Combustibles as well. But, answering the previous questions from Owen, we are not expecting any major change in terms of enforcement from the FDA in terms of our assumptions.

And there are the assumptions that the macroeconomic environment will not get substantially better in '24 either, and, like I said before, the commercial plans that we have started this year has an implication in terms of carry over for next year.

So, everything else in terms of performance in the other two regions, we're expecting them to continue to be very strong, and so our overall New Categories business, but the US will take some time. And it's no different from what I have consistently said since the beginning, that to adjust the US and, plus, with the macroeconomics that we are now seeing, that will take time, or more time to recover, it will have an implication in the short term for the Group results.

Rey Wium – Analyst, SBG Securities

Good. And then just a quick question – I see you referred to looking at measures to increase the balance sheet flexibility, which includes disposals. Now, obviously, this brings us back to the issue around your investment in ITC. I don't know if you just want to elaborate a little bit more why it is so important for you to hang on to this investment, or is there not an opportunity for you to still have meaningful influence and just reduce part of the investment and still, you know, keeping like a 20% stake in the business?

Tadeu Marroco – Chief Executive

Yeah.

Rey Wium – Analyst, SBG Securities

Because, I mean, that can easily, you know, reduce your debt by £5bn.

Tadeu Marroco – Chief Executive

Yeah. Yes, based on the ITC in January, for sure, ITC is a company that continues to perform extremely well. It's accretive for BAT in terms of performance, it has had a very strong share price performance over the last couple of years. If anything, it is still undervalued compared with most of the FMCG companies in India, and FMC, today, is more than 50% of revenues of ITC, so there are plenty of opportunities for share price to continue to grow there in ITC. So, we see a longer runway for future share price outperformance in value creation in ITC.

Now, for sure, we don't need to have more than 25% shareholding in ITC to have a strategic influence, including veto rights. Today, we have more than that. But you cannot underestimate the complexity related to making divestments in ITC. There are two major pain points, let's put it that one – one is the foreign direct investment rules in tobacco specifically which precludes international companies from investing in the Indian tobacco sector, which means the universe of buyers is limited. But, more importantly, there are specific RBIs, the RBI is the central bank in India, approvals that are required in respect of any action-taking in relation to our stake, and this adds a significant level of additional bureaucracy.

So, I'm not saying we will be sticking to the shares, but what I'm saying is that it's not as easy and as it could transpire from outside. So, the points that you make, we see this, for sure, that there is an ITC Board approval for the merger of this hotel business may provide us with some greater capital allocation flexibility going forwards. But your point, specifically, is something that will be always being reassessed by the Board regularly in terms of capital allocation opportunities, and we're going to navigate throughout the difficulties that we have in that space, but disappointed that the Board considers, as usual, as you would expect, let's put it that way.

Rey Wium – Analyst, SBG Securities

Okay. Thank you very much.

Operator

Thank you. Our next question comes from James Edwardes Jones of RBC. Your line is now open, please go ahead.

James Edwardes Jones – Analyst, RBC

Thank you. Morning. The £25bn write-down, what does that indicate about your view of growth and profitability in the US? And I guess, related to that, has there been any change in price elasticity in the US?

Tadeu Marroco – Chief Executive

Okay. Yes, the price elasticity continues to be very benign, it's still around 0.35%, 0.4% (?) and we haven't seen any change on that.

The accounting is basically catching up with reality of the US markets as this is reflected in the natural evolution of the increased interaction of the US smokers with New Categories, this is happening elsewhere and not just in the US.

Also, the fact that we have already reviewed our strategy to be much more assertive in terms of our ambition to transform the Company, accelerate a transformation by 2035, without this in mind, it's very difficult to defend the existence of finding its value for some of these combustible brands in the US that equates to almost £80bn in our balance sheet.

So, what we have decided to do is to basically move the accounting treatment of some of these US combustible brands from indefinite life to a finite life, meaning that they will be a valued over approximately 30 years instead of in perpetuity.

So, when you do that, you have to make an adjustment, and that's exactly the adjustment we are doing, like I said, it will be adjusted in the results of the Group, it will be a non-cash item. It will have no impact on average, it will have no impact in terms of capital allocation decisions, and then we commence amortisation over the next 30 years. In that period of time, for sure, there is no way to justify the presence of the brands.

I'm not saying that the Combustibles, the cigarettes won't appear in 30 years in the US, I really don't believe that, but you cannot justify the value of those brands equating to a number as equivalent to what we have today in the balance sheet. So, at a certain stage, you'll have to do this anyway and we decided to do this right now.

James Edwardes Jones – Analyst, RBC

Thank you.

Operator

Thank you. Our next question comes from Gaurav Jain of Barclays. Your line is now open, please go ahead.

Gaurav Jain – Analyst, Barclays

Hi. Good morning, Tadeu. Three questions from me. So, one is on the guidance for FY24 and, you know, I think others have also asked this question in a different way, but what you are telling us is that NGP is going to breakeven this year and will be profitable in FY24 and that the total company organic EBIT growth is mostly through this. I think most of us are assuming that international, cigarette EBITDA will be growing, you know, mid-single-digit to high-single-digit based or whatever we are seeing in terms of volume trends across the space and what other companies have communicated. So, this will imply that the US has whittled down mid to high-single-digit. Is that the maths which is happening?

Tadeu Marroco – Chief Executive

Yeah, in 2024, it's a recognition of, first of all, the US business, like I always said, we will take more time to fully recover and this is basically compounded by the fact that we have these macroeconomics and the situation with illicit in modern disposables carry on for longer and the fact that we carry on with our initiatives and investments to strengthen our business there in terms of portfolio resilience, in terms of capability and so on. That's the first point.

And this is mainly related to that, but also the fact that we want to keep investing mainly on the heat and the heated products. We expect this, to answer your question, to have a positive profitability in terms of New Categories in 2024, but what I'm saying here is that part of this profit will be reinvested mainly in strengthening our Heated product positions.

So, you saw that in the last two years, we have just basically reduced our loss by £1bn in the New Categories, so it's a very strong pace in the annual base. So, we will continue to increase profits but not with that magnitude moving forward because we will reinvest some of that through strengthen our categories. So, that's what we are trying to say here.

Gaurav Jain – Analyst, Barclays

Sure. And, so, if I look on that, so, very clearly, tell us the overall NGP, you know, EBIT. Is it possible to give us some indication on the profit contribution of the different categories, Modern Oral, E-cigarettes and Heated Tobacco? Some other companies have, sort of, given the max loss that they will bear on NGPs and Heated Tobacco, so is there a way for you to help us, you know, understand? Like is there a max loss on Heated Tobacco that you will be willing to bear and that's the way to model it?

Tadeu Marroco, Chief Executive

We are not giving the disclosure per category; I don't think this call will the appropriate time for us to go deeper into this. We're going to have more time in the next year to give more visibility on that. But one thing, and even in this statement you can capture for there, we are already in a positive territory, we are, in '23, in a positive territory in terms of profitability in Vaping and Modern Oral, we mean that we had a loss on the Heated Products. And overall, the other two categories more than offset the loss on Heated Products.

And what we expect moving forward is more compelling offers for Heated Products, or competitive offers, we can start also to turn these around and start firing on all three cylinders in the New Categories and make it a driver for accretion for the Group moving forwards.

So, you're going to have different engines in BAT in the medium term. We will have the two regions outside the US, which are already, if anything, delivering extremely exceptional results and it's not just in Combustibles, it's also doing quite well in New Categories, mainly the European region, and we will have the New Categories overall continuing to be accretive for the Group.

And, at certain points, once the macroeconomics improve in the US, hopefully the FDA starts doing their job that they were supposed to do in terms of enforcement of these illegal modern disposable products and us being able to do the adjustments that we want to do that we think that most of it will be done in 2024, you're going to have a much-improved result for the Group. That's why we are giving a three-year's guidance this time as opposed to just one year, so you can contextualise the 2024 as an investment year that is necessary to secure the long-term sustainable growth of the Group.

Gaurav Jain – Analyst, Barclays

Sure. And one last question on OrganiGram and the investment that happened. So, how should we think of that, you know, in the context of what's happening, you know, today the stock is down a lot, dividend yield is almost touching 11%, so clearly investors want to see capital returned to them and, you know, the dividends were higher than what anybody thought, so how should think of investments like OrganiGram in that context?

Tadeu Marroco – Chief Executive

Investments in OrganiGram? Well, the OrganiGram, it's not really a relevant capital deployment at this point. What we want to do is to create a foundation in the cannabis space without, you know, having to deploy massive capital, like other companies have done, in order to be prepared in case the regulatory environment changes to be able to have a stronger foothold on that segment.

And, OrganiGram, in our belief, is the best company out there in terms of management, in terms of capabilities. They are pretty much focused on this smokeless side of cannabis, which is also aligned with the Group's strategy, and this is pretty much kind of setting the grounds and the foundations more than anything.

Gaurav Jain – Analyst, Barclays

Sure. Thank you so much.

Operator

Thank you. Our next question comes from Jonathan Leinster of Société Générale. Your line is now open, please go ahead.

Jonathan Leinster – Analyst, Société Générale

Hi. Good morning, gentlemen. A couple of questions if I may. First of all, you say you've launched the non-tobacco heated tobacco consumables in ten countries. I mean, given that would seem to be a fairly way around the sort of, ban on flavours, has there been any reaction from the EU regulators on this?

Tadeu Marroco – Chief Executive

Well, look, these are early days in terms of reaction from them, and I think that some of them, they are surprised to see the product because there is no, I would say, clear classification of this product at this point in time, and I think that the debate will be more on the excise discussion than anything. But it's clearly an opportunity to keep consumers migrating out of cigarettes towards these products, because, like Vapour, it's not different. We know that flavours play a big part on that.

Jonathan Leinster – Analyst, Société Générale

Okay. The second question, obviously you disposed of the operations in Russia in September, have you seen any proceeds from that and are your expectations for eventual proceeds the same as they were in September?

Tadeu Marroco – Chief Executive

Yeah, look, you know that, based on our disclosure, that this has been a very, let's say there's been a big hit that we have to take in order to materialise these investments. We had some proceeds because we had the sale of it, and this is flowing through as we were expecting, but overall, you cannot lose perspective. It's far away from the real value of the business given the circumstance that the deal was done and couldn't be done more differently than that. But I think that was a good compromise because, at the end of the day, we preserve the jobs of almost 2,700 people in the Russian business, which was our intention since day one, and we did it in compliance with all the rules, international rules and local rules.

So, it was a very complex process, as you can imagine, and expect to conclude actually the receipt of some of the proceeds now in December, and it's basically a kind of completely independent company now and has nothing to do anymore with BAT.

Jonathan Leinster – Analyst, Société Générale

Just to clarify, I thought there was some talk of a potential buyback of the business in a couple of years, or is that not part of the deal anymore?

Tadeu Marroco – Chief Executive

The call option? Yeah, the call option, it's restricted for a very short period of time, it's two years, so I don't think that will be really, well, it's anybody's guess, but will be effective. This is a requirement from the Russian authorities. They wouldn't allow you to have a call option with a larger period of time than these two years.

Jonathan Leinster – Analyst, Société Générale

Okay. Just going back to previous questions, if I may, I mean, you mentioned the discussion on the disposal of non-core assets. I mean, although the disposal of ITC and, in itself, might be difficult, is the sort of disposal of the hotel assets presumably much, or, you know, the potential spinoff from ITC much easier because that's clearly got nothing to do with tobacco, or would that remain still quite difficult?

Tadeu Marroco – Chief Executive

Yeah, well, our expectation is that, well, let's put it this way, we have no intention to be in the hotel business but you cannot forget the fact that ITC will hold something like 6% of the share of the hotels, but the problem is not the hotels, it's the tobacco that has the FDI, so there is FDI involved in the hotels, let's put it that way.

Jonathan Leinster – Analyst, Société Générale

Okay. Thank you very much.

Operator

Thank you. Our next question comes from Simon Hales of Citigroup. The line is now open, please go ahead.

Simon Hales, Citigroup

Thank you. Morning, Tadeu. Three quick ones from me, please. I don't know if I can first just follow up on John's question there about the Russian cash proceeds coming in, you said you've received some cash in December. I don't know if you're able to quantify that at this point and also talk about the timeline going forward as to when you hope to receive the remaining, sort of, cash in from that sale. That's the first question.

Tadeu Marroco – Chief Executive

Yeah. We are not giving amount related to that, you know, but what I can say is that expect to conclude all the proceeds now in December, in the next coming weeks, and this has been happening since September.

There were some limitations and agreements in terms of a cap on the month base and this is bringing us to an end now in December. So, by the end of the year, it's all done.

Simon Hales - Analyst, Citigroup

And just to be clear then, in your 2.7x net debt EBTIDA leverage guidance you've issued this morning, that includes your assumption of those proceeds coming in this year?

Tadeu Marroco – Chief Executive

Yeah, it includes the assumption.

Simon Hales - Analyst, Citigroup

And then, secondly, I just wanted to go back to the US. Tadeu, you talked about, obviously, the industry's combustible volumes declining high-single-digits this year. How do you think about the building blocks of that, you know? What do you think has been macro-related? What's poly-usage? What's just the underlying decline rate in the market? I'm just trying to understand the build and how we think about this for not only 2024 but perhaps longer term, what you're now assuming is the rate of decline of US combustibles.

Tadeu Marroco – Chief Executive

Yes. You'll note that the secular decline in the US market has been always around 4% to 5%. For sure, the COVID years was an exception to that. A lot of consumers with a lot of support from tax, federal and state tax, and without having the opportunity to spend anything, so we saw a very, I would say, unexpected trajectory for the positive. That has reversed completely from 2022 onwards. But normally you would expect to see 4% to 5%.

There is a big weight now related to the macroeconomics, but there is also an impact coming from the illicit modern disposable which, we believe, that could well represent something close to 2% of this volume decline that you are seeing.

So, when you ask about what do you see moving forward, like I said before, the elasticity's no different from before, it's still 0.35%, 0.4%, which means that there is still a lot of pricing power in the US, the cigarettes are still very cheap compared with consumer purchasing power.

For sure, the scenario will now improve once the macroeconomics get better, which means interest rates and such coming down, consumer confidence starts to go up, and then it will be anybody's guess when this will start happening – some people are saying that is more towards the second half of 2024. That's why I'm also saying that we expect that most of the year we'll be seeing still a lot of pressure from the consumable point of view, and we start seeing some green shoots more towards the end of '24.

But the bigger question will be in terms of, again, on the enforcement from the FDA on these modern disposables because, if this happens, it will not just help with the Vapour glo system where we are present, the legal part of vapour, let's put it that way, it will open up a big white space because, today, we believe that £6bn out of £10bn Vapour revenue, more than £6bn is coming from these modern disposables.

And this will also have an implication on the consumables trend, how they are trending, the consumables volume, the reduction in consumables for cigarettes, and this is something that we need to see in the next, I would say, few months, as soon as the FDA concludes its process relating to Vapour. If they really make a step change in terms of enforcement, we'll be more clearly to be able to precisely answer your question around what's the estimate moving forwards.

Simon Hales - Analyst, Citigroup

Got it. And then, just finally, I mean, you've said again this morning that you'll evaluate further cash return opportunities once you reach the middle of your leverage range.

Tadeu Marroco – Chief Executive

Yes.

Simon Hales - Analyst, Citigroup

Without getting too caught up in the semantics, I just wonder how you're now defining the middle of the leverage range. Is that 2.5x and below or is that range of, sort of, 2.4x to 2.6x? Just a little bit of colour there, please.

Tadeu Marroco – Chief Executive

Yeah, well, we are seeing 2.5x, that's what we are saying the range. We had to take into consideration that the world has changed dramatically since we established the 3x to 2x range.

Now, the cost of capital has increased substantially, the interest rates have increased, we expect them to have peaked now and start reducing but it's still much higher than before, and also the fact that we still have out there a process in Canada which is the CCAA, that at a certain point, this should conclude itself, so we had to create some space for that.

So, we don't believe that to be in the upper range of the range, for example, is acceptable anymore. That's why we want to bring this to the middle of the range and then, when it gets there, we make some decisions in terms of capital allocation because one thing that is imperative in our mind is that, once we restart the buyback to do it in a consistent basis and not a one and off. So I need to be a position to be comfortable giving all that I just said before in order to be able to restart the buyback. That's why the 2.5x is the reference that we have.

Simon Hales - Analyst, Citigroup

Very clear. Thank you very much.

Tadeu Marroco – Chief Executive

Thank you.

Operator

Thank you. Have no further questions for today, so I'll hand back to Tadeu for any further remarks.

Tadeu Marroco – Chief Executive

Okay. Thank you all of you for listening, for your questions. I would like to leave with a few final comments. We are maintaining our full-year 2023 guidance, reflecting the resilience of our global, multi-category portfolio.

In addition, our expectation that New Category contribution will be broadly breakeven in 2023, gives us confidence in the long-term sustainability of our multi-category strategy.

As we accelerate the next phase of our transformation, we are now committing to building a smokeless world. This is reflected in our ambition for 50% of our revenues should be in non-combustibles by 2035. By achieving this, BAT will deliver value for our stakeholders.

I am clear that now is the right time to continue to invest. While these choices and investments have implications for our 2024 guidance, they will ensure sustainable growth and returns over the long-term. We will continue to reward our shareholders throughout this period and will seek and evaluate all opportunities to enhance balance sheet flexibility.

And with that, I look forward to updating you again at our Full Year Results in February. Thank you very much.

END

* Based on the weight of evidence and assuming a complete switch from cigarette smoking. "Reduced-risk" products are not risk free and are addictive.

† Our vapour product Vuse (including Alto, Solo, Ciro and Vibe), and certain products, including Velo, Grizzly, Kodiak, and Camel Snus, which are sold in the U.S., are subject to FDA regulation and no reduced-risk claims will be made as to these products without agency clearance.

[1] Global consumer numbers for New Categories and Smokers at an Industry Level. Source: Statista 2023, Kantar Incidence & Track Studies.

[2] To supplement the Group's results presented in accordance with International Financial Reporting Standards (IFRS), the Group's Management Board, as the chief operating decision maker, reviews certain of its results, including volume, revenue and, adjusted profit from operations, at constant rates of exchange, prior to the impact of businesses sold or held-for-sale. Although the Group does not believe that these measures are a substitute for IFRS measures, the Group does believe that such results excluding the impact of businesses sold or to be held-for-sale provide additional useful information to investors regarding the underlying performance of the business on a comparable basis and in the case of the sale of the Group's businesses in Russia and Belarus, the impact these businesses had on revenue and profit from operations. Accordingly, the organic financial measures appearing in this document should be read in conjunction with the Group's results as reported under IFRS. In 2021, the Group sold its Iranian business. However, as the Iranian business was not significant to the user's understanding of that year's or subsequent years' financial performance, management did not treat the sale of Iranian business as an organic adjustment.

[3] **Profitability at category contribution level**: Profit from operations before the impact of adjusting items and translational foreign exchange, having allocated costs that are directly attributable to New Categories.

[4] Based on Vuse estimated value share from reduced-risk products in measured retail for Vapour (i.e., total Vapour category value in retail sales) in the Top 5 Vapour markets.

[5] **Top 5 Vapour markets:** U.S. – Marlin, Canada – Scan Data, UK – NielsenIQ, France - Strator, Germany – NielsenIQ. These five markets cover an estimated c.80% of global closed system revenue.

[6] **Poly-usage:** Refers to a transitional period for smokers towards complete switching to potentially risk reduced nicotine products during which period such smokers reduce cigarette consumption and choose to consume one or more New Category nicotine products.

[7] Premarket Tobacco Product Application

[8] The U.S. Food and Drug Administration

[9] **Top 5 Modern Oral markets:** U.S. – Marlin, Sweden – NielsenIQ, Denmark – NielsenIQ, Norway – NielsenIQ, Switzerland – IMS. These five markets cover an estimated c.80% of total industry Modern Oral revenue.

[10] **European leadership refers to Top 4 Modern Oral markets:** Sweden – NielsenIQ, Denmark – NielsenIQ, Norway – NielsenIQ, Switzerland - IMS.

[11] **Top 12 HP markets:** Japan – CVS-BC, South Korea – CVS, Italy – NielsenIQ, Greece – NielsenIQ, Hungary - SZTFH, Kazakhstan – NielsenIQ, Ukraine – NielsenIQ, Poland – NielsenIQ, Switzerland – IMS, Romania – NielsenIQ, Malaysia - IPSOS, Czech Republic – NielsenIQ. The T12 HP markets account for c.80% of total industry HP revenue.

[12] **Adjusted net debt** is not a measure defined by IFRS. Adjusted net debt is total borrowings, including related derivatives, less cash and cash equivalents and current investments held at fair value, excluding the impact of the revaluation of Reynolds American Inc. acquired debt arising as part of the purchase price allocation process.

[13] **Adjusted EBITDA** is not a measure defined by IFRS. Adjusted EBITDA is profit for the year before net finance costs/income, taxation on ordinary activities, depreciation, amortisation, impairment costs, the Group's share of post-tax results of associates and joint ventures, and other adjusting items.

Share growth refers to volume share for HP 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 2022 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 322 and 323.

New Categories comprises Heating Products (HP), Vapour and Modern Oral. Our products as sold in the US, including Vuse, Velo, Grizzly, Kodiak, and Camel Snus, are subject to Food and Drug Administration (FDA) regulation and no reduced-risk claims will be made as to these products without FDA clearance.

Please see the cautionary statement regarding Forward-Looking Statements, as well as the notes and disclaimers contained in the trading update.