2023 First Half Pre-Close Conference Call
Q&A Transcript

June 6, 2023

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Telephone Operator

Hello and welcome to the First Half 2023 Pre-Close Conference Call.

Please note this call is being recorded and for the duration of the call your lines will be on listen only. However, you will have the opportunity to ask questions at the end of the call. This can be done by pressing *1 on your telephone keypad to register your question.

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

I will now hand you over to your host, Victoria Buxton, Head of Investor Relations to begin today's conference. Thank you.

Victoria Buxton – Group Head of Investor Relations

Good morning, everyone, I'm Victoria Buxton, Head of Investor Relations and with me this morning is Tadeu Marroco, our Chief Executive.

Welcome to our 2023 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. Unless stated otherwise, our comments will focus on constant currency adjusted measures, and all share data is year-to-date average, to April 2023 versus full year 2022 average.

I will now hand you over to Tadeu who will make some introductory comments, before opening it up to questions.

Tadeu Marroco – Chief Executive

Thank you, Victoria.

Good morning everyone and welcome.

Let me begin by addressing a frequently asked question: will there be a change in our strategy? The answer is no. I am absolutely clear that our strategy is right, and that we will execute on it successfully. I have been at the centre of its formulation and implementation since 2019 and I am confident that it will transform our business… <u>and</u> in doing so, deliver long-term multi-stakeholder value.

Our commitment to building A Better Tomorrow by reducing the health impact of our business through our multi-category portfolio of reduced-risk products*† remains. Smokers must have access to better choices. This is now a reality for many smokers who have already switched to our reduced-risk products*†. It also represents a commitment to consumers who continue to smoke and are yet to make that transition.

So, what is different now that I am Chief Executive? While I am proud of our progress to date, rapidly building a £3bn New Category revenue business with profitability expected in 2024, in a fast-changing global environment, we must continue to evolve into an increasingly agile and progressive BAT.

We will achieve this through sharper execution and greater emphasis on fewer, bigger priorities, guided by our market archetype model, which identifies different stages of New Category maturity, ensuring our priorities deliver on our strategy and are well articulated with clear business outcomes defined.

As a truly global business, we understand that markets vary significantly by both category maturity, driven by consumer tastes and preferences and, importantly, by different regulatory environments. In addition to taking a more strategically guided approach to resource allocation, we will continue to increase our engagement with governments, regulators and other key stakeholders on topics including access to New Categories for smokers and regulatory enforcement.

I have made it clear to my senior management team and the organisation that we must operate to the highest ethical standards, and this topic must remain a priority for both our employees and business partners.

Building and developing collaborative and inclusive teams has always been at the heart of my leadership approach. My commitment as the new Chief Executive will be to nurture that passion in BAT for our people, our consumers and our brands.

Turning now to trading, where I am pleased with our performance in a number of key areas. We have increased non-combustible consumer numbers[1] by a further 900 thousand to reach 23.4 million in Q1, with continued good revenue growth and a further reduction in losses, meaning we are on track to deliver our £5bn revenue ambition in 2025, and profitability in 2024. Building on our strong momentum, we have committed to further incremental investment in New Categories this year, with the phasing of our investment plans weighted to the second half of the year.

In vapour, Vuse continues to extend our value share leadership[2] to reach close to 40% share in key Vapour markets[3], driven by further strengthening of our leadership position in closed systems year-to-date in the U.S.

Our PMTA[4] for Vuse Alto remains under FDA[5] review. This application further built on the foundational science of our successful submissions for Vuse Solo, Ciro and Vibe and we are confident that a successful outcome will be received by the end of 2023, in line with FDA's most recent projected time frame.

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

Vuse Go is now available in 40 markets and our rapid geographic expansion continues. As part of our ambition to broaden accessibility of our reduced risk products[*†], we have recently launched Vuse Go in Emerging Markets, including Colombia and Peru, with encouraging early results.

In THP, glo has had an underwhelming start to the year with glo category volume share being down 1.1 percentage points in key THP markets[6].

Continued category volume share momentum in some key European markets has been offset by highly competitive environments in Japan and Italy. Recent momentum is more encouraging, with our new glo Hyper Air platform launched in four key European THP markets – a step forward in what promises to be an exciting pipeline ahead.

We expect that glo's performance will improve as we progress through the year, driven by activating commercial plans in Japan and Italy, and further market roll-outs of glo Hyper Air planned in the second half.

In Modern Oral, Velo has maintained its clear volume share leadership in 15 European markets, supported by our pipeline of innovative new products. While our global Modern Oral segment share was down 1.8 percentage points, mainly driven by the U.S. where we await the outcome of our PMTA for a new Velo product, our volume share of the total oral category was up 70 basis points in key Modern Oral markets[7].

In addition, we continue to unlock Emerging Market opportunities, with strong growth in Pakistan, and a national roll-out in Kenya following a successful pilot in key cities last year.

I am very clear that consistently driving value from our combustible brands is critical to generating value to fund further New Category growth and deliver substantial cash returns to shareholders.

Our combustible brands outside the U.S. have been performing well as we address portfolio gaps and optimise pricing, driving group volume share up 10 basis points. However, group cigarette value share is down 40 basis points mainly due to the implementation of commercial plans in the U.S.

We are starting to see early signs of stabilisation in the U.S. industry premium segment and have built sequential volume share since the start of the year. Returning combustibles to consistent value creation is critical to our multi-category strategy in the U.S. We are taking action, although it will take some time to carefully and thoroughly implement our plans.

Due to the first half impact of SAP-related inventory phasing in the prior year, we expect our full year volume performance in U.S. combustibles to be second-half weighted.

In California, the longer-term impact of the flavour ban currently remains difficult to assess. Menthol products are reportedly still being sold illicitly due to lack of enforcement, and we have also seen elevated flavoured volume in surrounding states. We have anti-smuggling protocols in place and are doing our part by engaging with our stakeholders including the State Attorney General's Office to crack down on illicit sales.

Our FDA authorised products introduced at the start of the year are performing well, as adult consumers of flavoured tobacco products switch to legal non-flavoured alternatives. We continue to strongly believe that there are more effective ways to reduce tobacco harm, by encouraging more smokers to switch to scientifically substantiated reduced risk products*†.

Our active capital allocation framework considers the macro environment, potential future litigation and regulatory outcomes, and continued investment in our transformation, and I am pleased that we have now reached agreements with the DOJ and OFAC.

In Canada, the CCAA mediation process is still ongoing, and we expect this to conclude over the medium-term.

Given this, and the more challenging and dynamic macro environment, it is vitally important that we take a pragmatic approach to our balance sheet. At the same time, we understand the importance of cash returns to shareholders, and remain committed to our 65% dividend pay-out ratio over the long-term.

I am pleased that, driven by continued strong cash generation, we are making good progress towards reducing our leverage closer to the middle of our 2-3x adjusted net debt[8] / adjusted EBITDA[9] range by the end of 2023. This will provide greater business resilience and support future financial agility. And I am clear that once the middle of the range is reached, we will sustainably return excess cash to shareholders.

To conclude, I am honoured to have been appointed Chief Executive. Throughout my 30-year career with BAT, developing teams that deliver strong performance through inclusivity and collaboration has always been part of my leadership approach.

I am fully committed to enabling an increasingly agile and modern BAT. One that is driven by our strategy, guided by our purpose, and enabled by a focus on flawless execution. This will drive our transformation and deliver long-term multi-stakeholder value. I have great confidence that this can be achieved.

We continue to maintain our full year 2023 guidance of 3-5% organic[10] constant currency revenue growth, with our performance expected to be second half weighted, and mid-single figure constant currency adjusted EPS growth impacted by the timing of the transfer of our businesses in Russia and Belarus which we expect to close in 2023.

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

Q&A

Telephone Operator

Ladies and gentlemen, as a reminder if you would like to ask a question or make a contribution on today's call, please press *1 now on your telephone keypad. To withdraw your question please press *2.

The first question comes from the line of Rashad Kawan, calling from Morgan Stanley. Please go ahead.

Rashad Kawan, Morgan Stanley

Hey, good morning Tadeu, thanks for taking my questions today. Just a couple from me. The first on the US, I think the price increases you've been taking in cigarettes there have been – you know seemed to lag the industry a little bit. Should we read into that that that's a function of the revenue management actions you've put in place last year around targeted promotions and all? And, you know, any update as to how these actions are playing out and whether you're starting to see it yield some benefit in terms of volumes. I know you talked about the premium segment kind of seeing some signs of stabilisation but any more colour there would be helpful?

And then the second question around the CEO change, can you give some insight into the Board's decision there? And as you look into your tenure as CEO, and I recognise it's early and I know you mentioned you don't expect a strategic shift, but what would you say are your top priorities, kind of near and long term? Thank you.

Tadeu Marroco, Chief Executive

Look, thank you for the questions. On the US let me give you a kind of overview on the US market first. The volume of cigarettes has been impacted clearly by the post COVID normalisation. What I mean by that is the absence of fiscal, federal, and state stimulus. And this has been exacerbated by the fact that we have a lot of macro pressures, which have resulted in a high single digit market decline and some downtrading that we saw mainly last year.

So more importantly the price elasticity is still holding nicely at 0.35 to 0.4, and so we also saw – like we commented in the trading update, some levels of stabilisation, some early signs of stabilisation in the premium segment. So the price we took has taken all those things into consideration. In the US you cannot forget that the US is the most affordable market in cigarettes, second to Japan. And the elasticity like I said, they are still similar to the pre COVID period.

So, you're absolutely right, we are taking into consideration the revenue growth management and we are taking much more smart and targeted pricing. And we are committed to do some commercial adjustments in our portfolio as well to cope with this new environment. So we have spoken in the past about price laddering, that we are doing as we speak. And we are absolutely leveraging on the strong distribution force that we have in the market.

So, I'm sure that we will – we are seeing already some early signs of share recovery is we compare the January position to where we are now. But this will probably take some more time - in order to get to the position where we want to be.

So, all in all I think that the message is that we don't see any reason why the volume decline in the US cannot come back to the normal demographic declines of 4 to 5% in any given year. We are in the market which is very profitable and with still very benign levels of elasticity. Reynolds has a fantastic portfolio that needs some adjustment as we speak to cope with the macro pressures that we are facing.

And we cannot forget that the US is more and more a multicategory market. So we have Vapour that accounts for almost 10% of the – in the pool there in the US and we are doing extremely well in Vapour. The levels of incidence in Vapour is 15%, so compared with 19% of cigarettes, we are doing extremely well.

And the progress that we are making in Vuse, not just on the share side, but also on the profit side, as well as with the help of the restructuring and the cost savings agenda that we have through Quantum, will help us to mitigate the pressures that we'll be facing on Combustibles. So that's the US.

So, in terms of the Board's decision, look, yes, there was no single event behind that decision. The Board unanimously thought that – they considered I would say the faster changing environment, we have a very different economic cycle, we have heightened competitive activity, regulation and the Board took a view that it was a time to have a change in leadership and the leadership skills. And that is exactly what they have done. In a short period of time to avoid disrupting the business.

So, like I said in my opening, I'm quite you know clear about the fact that we have the right strategy. So I want basically to – it will be a question more on how we deliver the strategy as opposed to what. And the how will be much more – I'm an evidenced based person by nature, let's put it that way, so I think that the how will be a much more sharpened way to do resource allocation in the Group. It will be leveraging on the latest change that we have done in terms of marketing archetypes; it will be precise in terms of where we invest and the best return we can get from our investment.

And we also want to have a more inclusive and collaborative leadership and culture across the Group. And I think that these will be two very powerful ingredients to take this company forwards.

Rashad Kawan, Morgan Stanley

Thank you very much.

Telephone Operator

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

Gaurav Jain, Barclays

Hi good morning Tadeu.

Tadeu Marroco, Chief Executive

Hi Gaurav.

Gaurav Jain, Barclays

Two questions from me. So, the first one is that you know you're saying BAT's strategy is right, but if I look at the stock performance over any period of time, year to date, one year, three-year, five-year, ten-year, we are seeing the worst performing tobacco stock. So, what do you think BAT hasn't gotten right?

Tadeu Marroco, Chief Executive

Well Gaurav, look I am not here to manage the share price per se, I think that the best way to address the share price weakness that you are referring to is really focusing and persevering in what we are doing, because we are making big inroads.

The strategy of BAT at the very early stage was more complex than others, we decided to tackle three categories as opposed to go one by one. This proved to be a much more lengthy and costly strategy to start to pay back, but it was right. And because we were convinced since day one that the consumers would be different, the regulatory environment would be different, the taste of cigarette would be different. And what we are seeing today in the market is more and more poly-users across all these categories.

And today we have a very strong position in terms of leadership in plays like Vapour, which is still the best way to convert smokers out of cigarettes, towards these less risky products. We are seeing the emergence of modern disposable as accretive to the closed systems.

And we saw Modern Oral that was at the beginning a very niche product gain more and more traction. You saw Sweden now being very close to a smoke free market with 5% of incidence because they started promoting basically Snus many years ago. So, it's massive the impact that this can have on society. And THP, although we were late and absolutely, we were late to the largest competitor there, we are in a position that moving forward we are very confident that we have a good strong set of pipelines to make inroads on that.

And if anything, the margins of all these products are even better sometimes than cigarettes. So, I definitely believe that we are in the right place. We have a position in terms of a geographic position in the markets where a global company would expect to be. So, the US for example is not just important because of the role of the Combustibles in providing the funds to funding all of this transformation, but also it would be important towards our strategy of all these reduced risk products launched and even Beyond Nicotine in the future.

So, I definitely believe that we have the right strategy. And as we go along and we prove the points, I would expect the share price to recovery accordingly.

Gaurav Jain, Barclays

So, thank you and my follow up question is on the heated tobacco market where you are saying that you were a late entrant. But you have been in the market for five years and the market share has been consistently around 20%. So, can you create a business which has like a 40% margin in heated tobacco at this 20% market share? And as 40% is your cigarette margin, so I'm just trying to understand where does it break even and when can we see incremental profitability?

Tadeu Marroco, Chief Executive

Gaurav, THP the performance now that we are seeing in the first quarter is also a consequence of the heightened competitive activity in markets and big markets like Japan and Italy where incidences of THP is very pronounced compared with others.

But one point that is very particular of BAT in Europe which is the market that is growing faster in terms of THP is the fact that our cigarette portfolio in Europe is skewed towards the value for money alone, which means that every time that we migrate smokers from cigarette consumption towards our glo consumables actually this is margin accretive. So, take the example of Poland for example where margins are almost five times higher in THP than they are in Combustibles when you compare our own portfolio of cigarettes, and we migrate to our products in THP.

So, it is definitely the right direction, but there are many considerations around THP that we have been addressing over these last few years. Like I said I would like to focus more on that and be able to be more competitive. But I think that we have built some capabilities in the Group now that will allow us to move forward on that particular category in the future.

Gaurav Jain, Barclays

My last question is you know the impact of the menthol ban in California, was much more negative than we thought, we are having a huge amount of flavour ban in the next few months, and you have 70% share of flavours in Glo. So first of all what are the time lines right now with this flavour ban and how will you approach that?

Tadeu Marroco, Chief Executive

Yeah, the menthol ban in California specifically, look we were – 45% of our portfolio in California was – has to be delisted as a consequence of the menthol ban in that state. And we had been seeing a decline, around 25% - but you know if you consider the fact that we were already declining before that ban was introduced, as in every other state in the US because of all the macro pressures that I spoke about. In terms of the real decline that was attributed to the menthol ban, we consider that we were – we have a retention of around 87% of our volumes because the no menthol SKUs that we have introduced have been very successful and that has been the case month after month.

So, the other element which I allude to is that we saw some menthol – higher sales in the border. So, if you take the West sale area of the US for example, our levels of retention from 88 (?), goes all the way up to the likes of 95, because you have to take this into consideration, the levels of enforcement in California are really not great.

So, I think that we have proven in the US, in California that we have solutions to deal with the potential menthol ban nationwide. We are going to know more about these numbers that I am quoting to you as we move along because the situation, like I said, in the trading update is still a bit volatile because of all these problems with the enforcement and so on.

But the national regulation from the FDA we are still waiting to see the final order, the proposal that will come to the market. We are not sure if they will keep the timing that they were originally expecting to do, maybe towards the second half of the year, more towards the end of the second half. We are not clear about that.

But as you know there is a long process to go on that particular regulation, because it needs to be science based, it needs to consider all the unintended consequences. There is a lot of material that was submitted for the FDA, addressing all these points that they had to go through. And when they finally issue the resolution, the industry needs to assess that and see if it's – you know and make their own view in terms of resolution. So, we believe that this is something that will not be concluded until at least you know the next three or four years.

Gaurav Jain, Barclays

Okay, sure, thank you so much.

Telephone Operator

The next question comes from the line of Richard Felton coming from Goldman Sachs. Please go ahead.

Richard Felton, Goldman Sachs

Good morning, two questions from me please. The first one, just coming back to US industry volume declines. I mean the data has been a little bit weaker than I think most industry participants would have expected in the last 12 months and even when we try and look through the unusual comp base the rate of volume declines are a bit worse than historical rates.

So, my question is can you share any colour on what's actually happening at the consumer level? You know is this is a case of smokers smoking fewer cigarettes per day, is there an acceleration in smokers leaving the category? Any colour or thoughts on the underlying dynamics that are actually driving the industry declines would be incredibly helpful.

And my second question is just a point of clarification on your prepared remarks. When you think about capital allocation and share buybacks, do you want to be at the 2.5x so the mid-point of your target leverage range before you consider any share buyback programmes? Thank you.

Tadeu Marroco, Chief Executive

Okay, look on the US every daily consumption has an impact coming from affordability. Now at the end of the day we are living in a period of time, like I said before, of withdrawal of stimulus that was very important over the last I would say 18 months, on the federal and the state levels. And also, this combined with a massive impact on the cost of living that started in the middle of 2022 with very high levels of oil price, we note that gas price in the US has a negative correlation to cigarettes. And then these things reversed over time. But it was there already in the beginning when we started seeing this trend materialising and then carried on from a number of other areas of the consumer – I would say portfolio that they submit to. Now of courses energy bills and so on and so forth. So there is a lot of pressure on the consumer side.

The commercial plans that we are trying to put in place is exactly to address this scenario. And when we talk about laddering for example, we were not well prepared, we saw some of the other brands – so when you saw for example downtrading, we did not necessarily have all the answers to that. So we are putting those things in place. And also, we are making use of our revenue growth management to be much more targeted in terms of promotions, pricing and so on.

So I think that is – like I said, it's clearly a period of time that will revert over time as soon as the macroeconomics start, you know, improving. And we are not seeing any fundamental structural change in terms of migration or in terms of anything different from what you would expect in a recessionary environment that suggests that we cannot see the volumes returning back to the levels of 4 to 5% decline over time. So that is on the US.

In terms of capital allocation just to remind you of the decision that we took to stop the buyback is basically coming from the fact that as soon as we have announced the buyback in the previous year, early in the previous year we were put on a negative outlook from one of the credit rating agencies. So this happened at that time.

And on top of that we saw a massive increase in interest rates, unprecedented to be honest, the interest rates moving from the likes of 0.5, all the way to 5, 6, 7 and worse than that, we didn't know exactly where this would stabilise because the levels of inflation were still very high. And now we start to have a kind of feel about what the Fed, what the Bank of England are doing in terms of interest rates. But at that time, we had no idea about that.

We also had to cope with the latest negotiation with the DOJ, that has now come to – it has already concluded and fined. And we had the business in Russia that we have announced the transfer. And independent of the transfer, the cash is completely trapped there.

So, at the end of the day, we had to cope with all that and without this environment we thought that the best approach would be to stop the buyback and accelerate the de-leveraging of the company towards the middle of the range to create some buffer for us. So, when we decide to restart the buyback doing it in a sustainable way.

And clearly the buyback is part of the capital allocation decisions of the Group moving forwards. It will be more of a question of how much rather than if it's there. And the middle of the range is a reference point for us and every year we will be considering all these elements that I just spoke about. Some of that has developed already throughout 2023 and as I said in the note, we are happy with the progress we are making on de-leverage. So, this looks like we will be in a much stronger position in the years to come.

Richard Felton, Goldman Sachs

Great, thanks very much Tadeu.

Tadeu Marroco, Chief Executive

Okay, thank you.

Telephone Operator

The next question comes from Kartikey Kaushik, calling from Aegon Asset Management. Please go ahead.

Kartikey Kaushik, Aegon Asset Management

Hi, thanks for taking my questions. So, your long completing target is BBB+ and I think the share buyback reduction announcement will definitely be hitting that score. But if I look at your broader metrics, they seem to be in line with BBB+ for both S&P and Moodys. So, have you had any discussions with the agencies as to what exactly is the trigger they are looking for to move and then to change the outlook and for Moodys to upgrade you by a notch?

Tadeu Marroco, Chief Executive

Yeah, the way the rates – the credit rating agencies calculate the leverage is not necessarily the ones that we do. So, for example they have to strip out all of

Canada out of the numbers because the Canada cash is already trapped for some time. They did the same with Russia. As soon as we announced the transfer of the business, or they saw what was happening in the market they again, they adjusted. So, the ratio – although we have improved in our own ratio from 3 to 2.9, last year in the S&P ratio for example it was going backwards. This was one of the reasons why they put us on a negative outlook in the first place.

The review this outlook every two years. So, they have done that early last year, which means that they were supposed to be doing the same review at the end of this year. And the Fitch rating put us actually more recently on a positive outlook. And we expect to make progress that will satisfy the way they also calculate their ratio by the end of the year.

Kartikey Kaushik, Aegon Asset Management

Okay, so let me ask you this. So, if you do achieve the 2.5x target by the end of the year, do you think S&P will move to a stable outlook based on that number?

Tadeu Marroco, Chief Executive

Well, I cannot talk on behalf of S&P; you know because they see the efforts that we are making in terms of de-leveraging the company. We expect that under their own way to calculate the ratio we will also make progress this year. And it is up to them to make a final call in terms of the outlook. But more important is us creating this buffer in order to allow us to – once we decide to restart the buyback in the future, we do it in a sustainable way like I said. That for me is the most important thing.

Kartikey Kaushik, Aegon Asset Management

I see thanks. Just one last one from my side, did you say the retention rate in light of the California ban is 87%?

Tadeu Marroco, Chief Executive

Retention yes that's what I said yes. If you take California alone, if you take the broader West sales area, which including the neighbouring states our level of retention is around 95%.

Kartikey Kaushik, Aegon Asset Management

Understood, thank you.

Telephone Operator

The next question is from Rey Wium calling from SBG Securities. Please go ahead.

Rey Wium, SBG Securities

Hello Tadeu and Victoria, thanks for the time. I just want to have a bit of a clarification just on your overall global volume outlook. I see there's a bit of a deterioration from minus 2 to minus 3% and I just want to – if you can just clarify what has led to that softer guidance? So that's my first question.

Tadeu Marroco, Chief Executive

Yes, well this is basically Pakistan and Pakistan had a massive excise increase happening earlier in the year and that translated to a big jump in terms of illicit trade, that today accounts for almost half of the market. And we are very exposed to Pakistan as you know. And the volumes are also very, very big. So that is basically – and when you round the numbers you end up with 3% as opposed to 2% that we had before.

Rey Wium, SBG Securities

So, is it fair to assume that – I mean you've indicated your cigarette volume share, I guess that globally is up 10 basis points, that you know give or take your overall volumes for the year should probably be not too far off from that sort of 3% decline? Am I reading that right?

Tadeu Marroco, Chief Executive

Well yes, for sure we are talking always organic here because we don't know the timing of the Russia transfer. And parking this aside your comments are broadly right. So sometimes we are a bit more exposed in one market or another, but it wouldn't be that much different from what we are seeing in the industry wide, in terms – considering this level of volume share performance.

Rey Wium, SBG Securities

Okay. And just in terms of the Vapour trends, the AGM update sort of indicated the share of 39.4% you're now talking 38.8% so it looks like there has been a deceleration or a slowdown in the share growth. So, I don't know if you can maybe just elaborate you know which markets have been a bit of a problem?

Tadeu Marroco, Chief Executive

Yeah, look, I wouldn't be much focused on these quarterly numbers of variation. Vapour, we have been doing extremely well, we have – Rey, for sure that is also a consequence of the modern disposable that is growing substantially in some market. If you take for example the UK and Germany, they are more than 70% of the market already. So, it takes some time for us to catch up. We were clearly leaders on the closed system, we have now a good offer in terms of modern disposable, though it takes some time, so it's natural to see some variations.

But more important, out of our five key markets in Vapour we expect to be already profitable in terms of category contribution in four out of the five by the end of the year.

Rey Wium, SBG Securities

Okay and then just finally just a clarification. The guidance on the net debt to EBITDA, you sort of say it should be closer to the mid-point, so towards 2.5. So, I just want to – the range, does it mean below 2.75, or much closer to the 2.5x your target?

Tadeu Marroco, Chief Executive

Well, we are targeting it to be closer I suppose to the 2.5x. That is our intention and I think that we are going to get a very good result by the end of this year as well. So, this is on the clarification on the net debt to EBITDA ratio.

Rey Wium, SBG Securities

Okay, excellent. Thanks for that.

Telephone Operator

Ladies and gentlemen, as a final reminder if you would like to ask a question please press *1 now. The next question comes from the line of Nik Oliver calling from UBS. Please go ahead.

Nik Oliver, UBS

Good morning, thanks for the questions. Just two from me. One on the outlook regarding organic sales of 3 to 5, you mentioned that's H2 weighted. Does that also apply to profits in constant FX terms? Because I guess there are a lot of moving parts in terms of New Category investments, etc.

And then the second one is just regarding the investment in ITC. You know that has been asked quite a lot by investors recently given the relative valuations, but just any comments on how you think about that investment and whether there is any scope to increase value from that investment over time? Thank you.

Tadeu Marroco, Chief Executive

Thank you, Nik. Look, thank you for the question. Just for me to clarify the 3 to 5 is always organic numbers, i.e. excluding Russia. So, we are not taking consideration of Russian impact, because we cannot predict by when Russia will be taken out of the numbers, as soon as we conclude the transfer for the business.

So, we said that given the fact that the US volumes will be impacted in the first half of the year mainly from the SAP implementation roll out that happened last year, so this year it will have an impact in the first half of the year volume wise. That ends up impacting revenue and total Group revenue given the weight of the US.

So, then we said that the weight of the revenue will be more second half weighted this year. Okay, so the 3 to 5 we expect to achieve 3 to 5 in the full year, weighted in the second half, mainly driven by volumes/revenues in the US impacted by the SAP roll out in the first half of last year. So that's the first thing.

The profit side, you're absolutely right, you cannot come to this level of conclusion on the profit side because we are investing more in New Categories in the second half, and we are doing that on the back of these innovations that we are putting in the market. THP for example is a clear example. This glo device is the finest device that is out there in the market.

One of the pain points that we have in our THP offer in glo is exactly the bulkiness of the device, so we are trying to address that with the glo Air. And we will be rolling out in the second half of the year. This should give an example of where this higher levels of investments in New Categories comes in the second half of the year. So, you cannot come to this conclusion in terms of profit.

The EPS number is a reported EPS number. So, the EPS number, what we mean about mid-single digit EPS number has a range between 3.5 and 6.5% EPS. Where we're going to land is pretty much dependent on the Russia transfer of the business in the second half of the year, because we have just gone through the first half basically. So, if it's earlier in the second half of the year the lever of the EPS will be more towards the end of the range. If it's more at the end of the year and then you're going to see the levels of EPS be more in line with the middle of the range. So that's because Russia, as you know, represents something like between 3% of Group revenue and around 2, 2.5% at the profit level, okay.

So that's the – I would like to use your question just to clarify to everyone in the call here to all these points about the guidance.

And your other question on the ITC. Look our stake in ITC is regularly assessed by the Board. But there is one point that we have to take into consideration. There are significant regulatory and bureaucratic hurdles to overcome. For example, we have a foreign direct investment ban in tobacco in terms of regulation, RBI processes, if you were to monetise some of our shareholding in ITC it is not that straightforward as you could imagine. That is the first point.

The second is that for sure we consider the investment in ITC at this stage more than a financial investment. We consider it a strategic one. And why do we do that? Well first of all because of the size of the Indian market, the largest population in the world today. And more importantly the established oral markets that we have in India. Volume wise, if you consider all the volume of the oral consumption in India it is higher than the consumption of oral elsewhere in the world. Just to give you an idea.

So, we believe that we might have significant opportunities in terms of New Categories, mainly in the oral space, in India over time.

So, for sure ITC is also doing extremely well, it is a very valuable asset. We have been – you know very pleased with the performance in terms of dividends, in terms of the share price. And there is a still a long gap in terms of valuation of ITC compared with other FMCGs in that market, which means that there is a lot of potential for growth in the future.

So, I just want to make all these points clear for everyone on the call as well regarding ITC.

Nik Oliver, UBS

Great, that is super clear, thank you for that Tadeu.

Telephone Operator

There are no further questions, so I will hand it back to your host to complete today's conference.

Tadeu Marroco, Chief Executive

Okay, thank you all for listening and for your questions. I would like to leave you with a final few comments. And first of all, our transformation is well under way. We have reached a point where sharp execution and greater emphasis on fewer, bigger priorities is now required to ensure sustainable outcomes.

I will do this by developing teams that deliver a strong performance, through increasing inclusivity and collaboration. I am confident that together we will continue to transform BAT and deliver long term multi stakeholder value.

A reminder that tomorrow I will be participating in a fireside chat at the Deutsche Bank Global Consumer Conference at 8.15am UK time. Audio from the event will be streamed live on our website.

And with that I look forward to updating you again on our progress at our Half Year Results on the 26th of July. Thank you very much.

-End-

* Based on the weight of evidence and assuming a complete switch from cigarette smoking. These 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] The number of consumers of Non-Combustible products is defined as the estimated number of Legal Age (minimum 18 years, U.S.: 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 adult consumer tracking (utilising studies conducted by third parties including Kantar). The number of consumers is adjusted for those identified (as part of the consumer tracking studies undertaken) as using more than one BAT Brand - referred to as "poly users". Target market for acquisition is existing adult smokers/nicotine users.

The number of consumers of Non-Combustible products 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 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.

[3] **Top 5 Vapour markets:** U.S. - Marlin, Canada - Scan Data, UK – Nielsen IQ, France - Strator, Germany – Nielsen IQ. These five markets cover an estimated c.80% of global closed system revenue.
[4] Premarket Tobacco Product Application

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

[6] **Top 12 THP markets:** Japan - CVS-BC, South Korea - CVS, Italy – Nielsen IQ, Greece – Nielsen IQ, Hungary - NDN, Kazakhstan – Nielsen IQ, Ukraine – Nielsen IQ, Poland – Nielsen IQ, Switzerland – IMS, Romania – Nielsen IQ, Malaysia - IPSOS, Czech Republic – Nielsen IQ. The THP 12 Top markets were adjusted in H1 2023, with more established THP markets Kazakhstan, Romania, Switzerland and Malaysia introduced and Russia removed in advance of the planned exit this year. Accordingly, glo's category volume share for 2022 was rebased on the new T12 definition (excluding Russia) from 19.4% to 19.2%. The T12 THP markets account for c.80% of total industry THP revenue.

[7] **Top 5 Modern Oral markets:** U.S. - Marlin, Sweden – Nielsen IQ, Denmark – Nielsen IQ, Norway – Nielsen IQ, Switzerland - Scan Data (excl. SPAR, Top CC and Alligro). These five markets cover an estimated c.80% of total industry Modern Oral revenue.

[8] 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.

[9] 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.
[10] 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, adjusted profit from operations and adjusted operating margin, 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 expected sale of the Group's businesses in Russia and Belarus, the impact these businesses have 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. We also provide in this release the reconciliations of volume to organic volume, revenue to organic revenue at constant rates of exchange, profit from operations to organic adjusted profit from operations at constant rates of exchange and operating margin to organic adjusted operating margin at constant rates of exchange. 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.

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 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 Tobacco Heating Products (THP), 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.