2021 Preliminary Results

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Jack Bowles, Chief Executive

Good morning everyone, I'm Jack Bowles, the Chief Executive of BAT and I am here with, Tadeu Marroco, the Group Finance and Transformation Director. We are very happy to be with you this morning to present our 2021 Results.

I hope everyone listening this morning and your families and friends are well.

In 2021 we delivered a pivotal year, a key milestone towards our 2025 targets, and a clear acceleration in our transformation journey to Build A Better Tomorrow.

This morning I will share the key highlights of our progress, and then Tadeu will provide more details on our performance and outlook.

A year ago, we said 2021 would be a pivotal year and we were at a critical turning point in BAT's transformation journey. We committed to accelerating New Category revenue growth, reducing New Category losses for the first time, and de-leveraging to around 3 times net debt to EBITDA.

And I'm delighted to say that we have delivered on all three areas. We accelerated constant currency New Category revenue growth to over 50%. We reduced New Category losses for the first time, with circa £100m improvement in profitability. And with continued strong cash conversion, we reduced leverage to below 3 times.

As we said, this has given us the financial flexibility to be more active in our capital allocation to deliver sustainable long-term value for shareholders. As a first step in our new capital allocation framework, whilst maintaining a growing dividend, we have announced a £2bn share buyback for 2022. Tadeu will talk more about this later.

With strong progress in New Categories, we successfully accelerated our transformation in 2021. And we are well on track to deliver on our 2025 targets. Our purpose, to reduce the health impact of our business is central to our strategy and we are actively encouraging smokers to switch from cigarettes to our reduced risk New Category products.

Demonstrating this, we delivered a record increase in consumers of our non-combustible products in 2021. We grew this consumer base by 4.8 million, to reach 18.3 million with strong growth across all three New Categories. This shows the power of our multi-category strategy - to encourage the largest number of smokers to switch to our broad range of reduced risk products.

With this strong momentum we are confident of achieving our target of 50 million consumers of non-combustible products by 2030. Over the last 3 years we have built 3 powerful New Category global drive brands.

Vuse is the number one global vaping brand, with a value share of 34%. I am particularly pleased that in the US, Vuse delivered strong revenue and share growth - and in the second half of 2021 became profitable at the category contribution level for the first time.

Glo has achieved 18% volume share of THP in its key markets. Growth has accelerated, driven by the success of Hyper - which is delivering a step change in product satisfaction and a significant improvement in consumer conversion.

With Velo, while we still have work to do in the US, our superior international products further extended our volume share leadership in ENA.

I am delighted with the performance of our New Category brands, with each of them growing revenue by more than 40% in 2021. This demonstrates the importance of a global multi-category strategy - with strong brands, great products, in the right markets.

Our New Category drive brands are supported by a clear ESG focus, which is both important to our consumers and is actively contributing to our Group sustainability targets. For example we have already reduced plastic in our Vuse packaging saving 250 tonnes globally. And we have commenced take-back schemes on New Category devices and vapour cartridges. This is fully in-line with consumers' evolving expectations of global brands and reflects our work to embed ESG across our business.

Turning now to the financials. We delivered robust results in 2021, while navigating the continuing challenges of COVID. Our reported results reflect a translational currency headwind of over 7% on EPS, partly offset by a reduction in adjusting items in 2021.

To better understand the key drivers of our performance, we will focus on constant currency adjusted results unless otherwise stated. Revenue was up nearly 7 percentage points, driven by excellent New Category revenue growth, and a strong performance from Combustibles.

EPS growth of 6.6%, which was at the top end of our mid-single figure guidance range, having absorbed the net impact of a number of one-off factors.

I would like to take this opportunity to thank all our people and our partners, for their continued focus and commitment in delivering this performance through this difficult COVID period.

Having delivered on our pivotal year, we are now entering the next phase of our journey, Faster Transformation. This means first, New Category contribution to group revenue will continue to grow and is expected to more than double from £2bn to £5bn by 2025 - as we continue to encourage more smokers to switch to our reduced risk products.

Second, as we leverage our increasing scale and reduce losses, New Category contribution to Group profit growth is expected to accelerate.

And third, with our new, more active capital allocation framework, we are committed to delivering enhanced long-term value for shareholders.

With these foundations, we are Building A Better Tomorrow. We are making strong progress towards our New Category targets of £5bn revenue and profitability by 2025.

In addition, we see significant opportunities Beyond Nicotine. With our investment in Organigram, and through our corporate ventures unit, BTomorrow Ventures, we are building an ecosystem of capabilities, as consumers increasingly seek products offering wellbeing and stimulation.

We will continue to deliver robust financial results and return to our medium-term outlook for revenue growth of 3 to 5%, and high-single figure EPS growth.

With our continued focus on cash, we expect to generate around £40bn of cumulative free cash flow over the next 5 years - representing more than half of our current market capitalisation.

Tadeu will now provide more detail on this strong momentum in our business.

Tadeu Marroco, Finance and Transformation Director
Thank you, Jack. I am very pleased with our results in 2021. We delivered strong progress against all of our key financial focus areas. We further increased investment in New Categories by almost £500m, while at the same time reducing New Category losses by close to £100m.

Quantum is fuelling our transformation and in total we have delivered around £1.3bn of savings and expect to deliver at least £1.5bn of savings by the end of this year.

Cash generation is a key focus for the Group, and we delivered another year of operating cash conversion in excess of 100%. And as Jack has said, this has given us the financial flexibility to be more active in our capital allocation to deliver sustainable long-term value for shareholders.

As a first step, we have announced a dividend increase and a £2bn share buyback for 2022.

Turning now to the results. Revenue growth was strong at 6.9%, comfortably beating our guidance of above 5%.

The impact of excise changes in Australia and the sale of our business in Iran partway through the year, were partially offset by the impact of trade inventory movements in the US.

Excellent New Category revenue growth of 51% was driven by strong growth across all three categories. Non-Combustibles contributed nearly half of total Group revenue growth at 3 percentage points - a significant step up from their 1% contribution in 2020.

Combustible's volume benefited from the performance of Emerging Markets with their partial recovery from the impact of COVID in the prior year.

And with value share up 10 basis points, we continued to drive value from Combustibles. Combustible price mix of 4.3% reflected strong pricing, partially offset by significant geographic mix from the Emerging Market recovery.

The FX headwinds on Group and New Category revenue were around 7% and 8% respectively.

We are delighted to announce Vuse global value share leadership in Vapour in July 2021. We continued to build on this momentum in the second half, with Vuse achieving a full year value share of 34% in our top 5 markets, up 7.8 percentage points.

In addition, Vuse remains the device share leader across all our Top 5 markets - a good indicator of future growth. With Vuse's growing brand strength, we raised prices in all key markets in 2021, driving second half revenue growth above volume growth for the first time.

We also made good progress across all three key levers of profitability improvement, trade margin, cost of goods, and marketing spend effectiveness, driving a strong improvement in Vapour profitability.

In the US, Vuse performed particularly well and has closed that 27 percentage point value share gap in just 2 years - and is now on the verge of leadership. Growth has been powered by continued brand equity improvement, increased consumer relevant assortments, including single and quad packs, which drove higher trial and conversion - and now represent over 60% of volume, and a focus on excellence in our in-store execution.

In addition, state by state execution planning has helped us to deliver hyper local Vuse marketing expressions. At the same time, as Jack has said, we reduced year-on-year losses, resulting in Vuse achieving profitability in the second half of 2021. This is a fantastic performance by our US team and is an important milestone on our pathway to profitability at a Group level by 2025.

In October, Vuse Solo received the first of its kind PMTA authorisation, confirming that the marketing of original flavour Vuse Solo products is appropriate for the protection of public health. This approval gives us further confidence in our other PMTA applications, which share the same foundational science.

In addition to our success in Vapour, we have also gained significant share in THP - powered by the continued success of glo Hyper. In 2021 glo's share of the Japanese total nicotine market grew in every quarter to reach an average of 7.4% in Q4.

In ENA, Hyper continues to drive strong share momentum with glo gaining volume share of total cigarette and THP in key markets.

In Russia, our THP growth has been enabled by the investments we made in late 2020, partnered with outstanding brand equity building, which blends the best of glo with local Russian flavour.

Our share of the THP category in the T9 key markets, was up 480 basis points to 18% for 2021, with Hyper now accounting for over 70% of glo's volume.

And in ENA, glo volume growth is outpacing category growth by a factor of more than 5 times, driving our category volume share up 930 basis points to 16.6%.

As Hyper rapidly generates scale, we are reducing production and consumer acquisition costs - supported by our marketing spend effectiveness digital tools.

In Modern Oral, global volume growth was up over 70%. In the US, while we recognise we have more to do the category represents only around 1% of total nicotine industry revenue due to the availability of established alternatives including vapour and traditional oral and significant discounting.

In ENA we consolidated our clear leadership in both established oral markets in Scandinavia and more broadly across Europe with further share gains.

In our largest market, Sweden, Lyft lab, our Modern Oral innovation hub is a great example of where we have co-created with consumers to better meet their specific taste preferences. The highly digitally focused activation has reached more than 12 million adult consumers.

In Combustibles, we continue to drive value growth. Overall we delivered Combustible's revenue growth of 4% - with continued strong cigarette pricing of 8% partially offset by geographic mix.

This was driven by the performance of Emerging Markets and their partial recovery from the impact of COVID in the prior year, particularly in Bangladesh, Pakistan, and Vietnam. As a result, Combustible volume was flat.

We are continuing to leverage our scale in Combustibles to drive our transformation. Last year one billion of our cigarette packs worldwide carried communication to encourage adult smokers to switch to our New Category products. This year we plan to double this to 2 billion packs.

Turning now to the regions. In ENA, New Category revenue grew by 80%, with all three categories recording more than 40% growth. Glo revenue more than doubled, driven by glo Hyper's success, and THP is now the largest of our three categories in the region. High investments associated with the roll out of Hyper, impacted regional profits.

In Vapour, revenue growth was ahead of volume growth in the year, driven by higher pricing on Vuse.

Combustible revenue grew 1%, as volume decline was more than offset by price mix - which reflected the impact of excise increases in Russia.

In APME, glo revenue grew by 13%, driven by volume share gains, with a strong acceleration in revenue in the second half.

In Combustibles, higher volume and pricing was more than offset by geographic mix, the Australasia impact, and the sale of our business in Iran.

In AMSSA, continued strong growth of Vuse in Canada and the recovery of vapour in South Africa following the sales ban in 2020, drove New Category revenue up over 100%.

Combustible volume was flat, with revenue up 4% driven by strong pricing. Cigarette and THP value share declined 70 basis points driven by growth in the value segment due to lower illicit trade in Canada, and some downtrading in Mexico.

In the US we continued our strong momentum. New Category revenue was up over 50%, led by continued significant value share gains from Vuse. Revenue was up 9%, driven by the excellent New Category growth, and a continued strong performance in combustibles. Combustible volume was down 5% partly benefitting from trade inventory movements, which are expected to unwind in 2022. These movements were mainly linked to the timing of price increases in 2021 and uncertainty about a potential excise increase.

Our underlying volume decline, adjusted for the number of selling days and inventory movements, was around 7%. Combustible revenue growth was 8.1% at constant currency, driven by strong pricing - with four BAT price increases during the year and also benefitted from around £200m additional revenue due to the trade inventory movements. These results reflect the strength of our US brand portfolio.

Value share increased by 60 basis points, driven by our premium brands Newport and Natural American Spirit. We relaunched the iconic brand Lucky Strike in December 2020, successfully broadening our portfolio in the lower priced segment, and achieving around 1% national volume share in 2021.

Moving onto operating margin. Price mix and operational efficiencies contributed 40 basis points to operating margin. A strong operational improvement was partially offset by geographic mix, and the net impact of an estimated £260m negative profit impact in Australasia and the benefit of the US trade inventory movements.

The Group absorbed a 1.7% transactional FX impact on profit, which was a headwind of 60 basis points to margin. We continued to increase New Category investment, with close to an additional £500m invested in 2021, while at the same time reducing New Category losses for the first time by nearly 10%. As a result, the margin headwind from New Categories was materially reduced.

This reduction in New Category losses was driven by, improved trade margins, with a 31% improvement in Vapour. Over £220m productivity savings, through increased automation and reduced cost of goods sold, and a significant improvement in our cost of consumer acquisition across all three brands, leveraging our marketing spend effectiveness tools.

With Vuse now profitable in the US, driven by progress on all three levers, we have reached an important milestone. For the 2022 financial reporting period, we will disclose New Category contribution to Group profit to provide investors with increased visibility and clarity on our pathway to New Category profitability by 2025.

Through Quantum we are continuing to drive further simplification of the business. We have cut the number of business units by 40%, reduced management layers with a 22% reduction in senior management headcount, and we have redesigned our operating model to empower our people and increase our speed to market.

As part of our continued focus on simplification and efficiency, the US will join our global TaO operating model and SAP platform during 2022. In total through Quantum we have delivered around £1.3bn in savings, fuelling our investment in our transformation and we now expect to deliver savings of at least £1.5bn by the end of 2022.

Turning now to EPS, we delivered constant currency adjusted diluted EPS growth of 6.6%. This was at the top end of our mid-single figure guidance range, reflecting a robust operating performance that enabled us to absorb the net impact of the one-off factors I have already talked about.

Earnings growth also benefitted from lower net finance costs, a partial recovery in associate income, and a slightly lower underlying tax rate.

For 2022, we expect net finance costs to be around £1.5bn. And based on current tax rates globally we expect a similar tax rate of around 25%.

Finally, extrapolating current spot rates, we expect currency translation to be broadly neutral on full year adjusted EPS growth.

Operating cash conversion was strong at 104%, reflecting our focus on cash delivery, and also benefitting from the absence of a stock build in Australia following the change in excise structure.

We reduced leverage to just below 3 times and have a strong balance sheet, with a very manageable maturity profile, with 90% of our debt fixed, an average maturity of 10 years and close currency matching, and maximum annual debt maturities no higher than £4bn.

We expect gross capex for 2022 to be broadly in-line with adjusted depreciation and amortisation at around £750m. Over the next 5 years, we are on track to generate around £40bn of free cash flow before dividends.

With strong profitability, cash conversion in excess of 90%, and leverage within our 2 to 3 times net debt to EBITDA corridor we now have the flexibility to be more active in our capital allocation to deliver long term value for shareholders. This will include, continuing to grow the dividend, and maintaining leverage within our target corridor of 2 to 3 times adjusted Net Debt to adjusted EBITDA. Whilst also considering potential bolt-on M&A opportunities, and share buybacks to enhance shareholder returns.

The Board will prioritise these capital allocation opportunities, while taking into account macro and fiscal factors, and potential regulatory and litigation outcomes. As a first step, we have announced a dividend increase of 1% and a £2bn share buyback for 2022.

Looking forwards, 2022 results are expected to be driven by strong New Category growth and a further reduction in losses. We expect a continued good underlying performance in Combustibles, while, lapping a very strong performance in the US, absorbing the unwinding of the US trade inventory movements, and reflecting a highly competitive pricing environment in Australia.

As a result we expect revenue growth of 3 to 5% and EPS growth reaching high-single figures, with incremental benefit from the share buyback, and growth weighted to the second half.

And with that, I will now hand you back to Jack.

Jack Bowles, Chief Executive
Thank you Tadeu.

So now we are at the time of the Q&A

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Q&A Conference Call

Operator
Thank you so much, Jack. And, if you would like to ask a question on today's call, please press *1 on your telephone keypad. You will then be introduced, and you ask your question. Again, it is *1 on your telephone keypads to ask a question.

The first question is coming from the line of Jon Leinster from Société Générale. You're now unmuted and may now go ahead.

Jonathan Leinster, Société Générale
Thank you very much. Good morning, gentlemen.

Jack Bowles, Chief Executive
Good morning.

Jonathan Leinster, Société Générale
On the NGP, I mean, clearly, the cost base in 2021 was around £3bn, given that you're expecting revenues to be £5bn by 2025, does that imply a significant increase in operating leverage and that the costs for the whole NGP operations are not going to grow significantly between now and 2025? How do you get to profitability?

Tadeu Marroco, Finance and Transformation Director
Well, first of all, we need to consider that these are very consolidated figures. When you see the broader Group numbers, it's a combination of markets where we have been very mature for some time. For example, Vapour in the US, we have been investing in that market for longer. So, we referred to in the presentation that, in the second half, we just got to a positive category contribution from vapour, which was a fantastic result from the US team, but at the same time, we have other markets where we are just starting the geographic expansion.

If you see many markets in ENA, for example, THP has been rolled out very recently through Hyper. So, it's difficult to make a kind of, you know, consolidated view. You have to go in a more isolated case, but the fact is that our levers of profitability are working properly. The trade margins, like I mentioned before, have reduced significantly, many on the Vapour side.

We are taking pricing. Pricing will be an element of us reaching profitability. And we are now being able to, like you said, get some operational leverage because our fixed cost has been vested and a lot of extra marginal consumers are coming to the platform in many different markets.

So, we are very confident with the progress that we have made, and you will see more of that in the years to come, and we are very comfortable to reach the profitability by 2025.

Jack Bowles, Chief Executive
You have seen that, in '21, we started to reduce the losses despite - or with an investment of £500m in New Categories, so we have the levers that are working well, and we're continuing to expand. We'll get there. No problem.

Jonathan Leinster, Société Générale
Just to follow up on that, I mean, in the past, you've mentioned that automating the supply chain on the vaping side would represent a considerable saving. Is there any evidence of that, sort of, coming through or is that still work in progress?

Tadeu Marroco, Finance and Transformation Director
No, there is clearly evidence. This is clearly coming through. We have been seeing the reduction in the liquids that we produce because we are replacing

manual lines with automation as a consequence of us being able to gain scale. And these investments have a very, very fast payback, to be honest, and we are benefiting from that, and is clearly one of the elements. That's why I highlight that in terms of our levers to improve profitability. Automation is clearly one of these elements there.

Jonathan Leinster, Société Générale
Thank you. And then, quickly, the share repurchase of £2bn seems to imply that roughly, looking forward, you're targeting, sort of, maintaining net debt to EBITDA at about 3 times, or at least on my figures. Although you say 2 to 3 times, should we assume that, going forward, buybacks are more important than, sort of, further debt reduction or deleveraging from that perspective? Should we assume that sort of, the high end of your target range of 2 to 3 times is where you're, you know, comfortable?

Jack Bowles, Chief Executive
Yeah. We have said that we will do the right balance between the different elements that we spoke about in our model, and we'll take the opportunities as we go.

We are very happy now to be at 2.99 times in terms of net debt to EBITDA, and we have a corridor of 2 to 3. So we have space to navigate in the different parameters of that new approach in terms of capital allocation.

Tadeu Marroco, Finance and Transformation Director
Yeah, and just to compliment that, we have proved now that we were able to de-lever between 0.3 to 0.4 times every year on a constant FX base. For sure, we cannot control FX.

And, just in 2021 alone, our free cashflow was, on a constant FX basis, £3bn on top of the dividends that were paid. So, we are very strong position. That's why we are making the point about £40bn free cashflow for the next 5 years. So, we have a very cash generative company.

And, like Jack said, we will be weighting the pay outs year by year. And I've not been guiding on the top of the range or the low of the range. We need to keep in the corridor and make the right calls to improve shareholder returns over time.

Jonathan Leinster, Société Générale
Thanks. And, lastly, can I just ask a quick question? Yesterday, one of your competitors reported, or stated, that there'd been a trend infringement patent ruling against you in Germany. Does that impact glo Hyper's launch or expansion or continuing sales in Germany?

Jack Bowles, Chief Executive

No, it does not, but the more broader question is there are a lot of cases, as it is normal in, I would say, an emerging category in the last four to five years really. There are a lot of patent challenges across the world. You win some, you lose some. They mostly look at backwards looking and technology is evolving fast and, no, there is no problem in Germany.

Jonathan Leinster, Société Générale
Great. Thank you very much.

Operator
Thank you for your questions, Jon. And the next question is coming from the line of Gaurav Jain from Barclays. You're now unmuted and may now ask your question.

Gaurav Jain, Barclays
Good morning. Thank you, Jack. Thank you, Tadeu. So, I have three questions. One is on the, you know, dividend philosophy going forward. So, this year, you have increased dividend by 1% and you haven't written the statement that, you know, the dividend pay-out will be 65% of EPS, so should we assume that the dividend will still grow going forward but it will be below EPS growth, and so some more free cashflow will be returned to shareholders in the form of share repurchases? And, clearly, we have seen, you know, that the stock has been very strong in anticipation of share repurchases, so clearly markets value share repurchases more than dividends. So, how are you thinking about dividend growth going forward over the next few years?

Jack Bowles, Chief Executive
Yeah. So, dividend first. Dividend will continue to grow. Tadeu?

Tadeu Marroco, Finance and Transformation Director
Yeah. Look, we have a 20-years plus track record of dividend growth, even during the crisis of COVID, and we were one of the companies out there keeping the growth in dividends. We believe that this is aligned with the majority of the BAT shareholders, and we want to keep the dividends growing in sterling terms.

So, at the end of the day, these would be more relevant for us than the 65%. As we speak today, the ratio is even above the 65%. It's likely above the 66%. But moving forward, we will make considerations around dividend, around buyback, with the clear assumption that the dividend continues to grow, not necessarily at the 65% pay-out like you referred to, and then how we can enhance shareholder return as a combination of the dividend of the buyback and also the investments that we have to make to accelerate the transformation of the Group eventually if we find it interesting in terms of M&A bolt-ons. And these, we think, the range of 2 to 3.

That's the active capital allocation framework that we have highlighted today, which is quite aligned with a company that is transforming fast as BAT.

Jack Bowles, Chief Executive
You know, what's very important to me is that is, in the last three years, we developed the company, and we went from a low position in New Categories where, boldly, we put together and followed, you know, a multi category consumer centric approach in terms of New Categories. And that was a lot of investment for three years, creating the capabilities, hiring the people, simplifying the company, making sure that our Combustible business revenue and value supports that.

We had that pivotal year in 2021 where you saw that the results, I mean, are extremely strong. We're very proud of that. Now, we have a bit more space and less of a straitjacket where we can make more calls moving forward, and that's more the fact of having more opportunities - that is extremely important to Tadeu and myself - and we will continue to grow the company faster in the transformation. And that's the key. That's the key to our business moving forward.

Gaurav Jain, Barclays
That's very, very helpful. My second question is on the US market. For US, cigarette volumes last year and, you know, you are saying that e-cigarette volumes grew 20% last year, and we had a difficult comp. We also had price increases which more than historical averages and cigarettes have turned out to be only down, you know, minus 6%. How are you looking at FY22 volumes? Like, will they be worsening from here because of e-cigarette growth and oil price increases, or you could have another year of minus 5% kind of volume decline the US?

Jack Bowles, Chief Executive
Yeah. I'm not going to give some guidance in terms of the size of the US market. I mean, that's much too soon in the year to do this kind of exercise. All I can tell you is that the market was strong last year. We grew value share. The premium segment was extremely strong. There was no massive acceleration in terms of downtrading.

I think that the US market is strong. We have a very strong portfolio over there. And we had the launch of Lucky Strike there as one of the best launches in many years in the US market, and we go for value in the US market, as you know. We go for value. And we'll continue to do that.

So, you will have temper that a bit related to everything that is happening, the price of oil and other things in the US, but the springboard is very strong.

Gaurav Jain, Barclays
Sure. And my last question is on, you know, potential future launches on glo. So, your competitor is clearly out there, and they are talking about it bullishly about their device out there, and we haven't seen an update on Hyper now, I

would say, in almost two years. So, when could we expect the next device launch out of glo?

Jack Bowles, Chief Executive
Well, that's a very good question and a bit too early in the process, but let me tell you the following, you know. Since two years, or since a year-and-a-half rather, we have launched glo Hyper in a lot of geographies. The rollout has been extremely successful, and we have been able to grow positions everywhere. So, we have a very good product.

Now, we've not been sleeping in terms of R&D to say the least, and we have a lot of things that are, you know, getting ready for launch in the foreseeable future, but it's too soon to speak about that. Too soon to speak about that, but we are very happy with the performance that we have at the moment, and we are still doing geo-expansion of the current one.

You know, I'm a farmer. You do one, then you bring the second one, then you continue to accelerate. We're growing by, you know, close to 5 million additional consumers every year, and that is on the record of last year, and it means that we have the right portfolio for the consumers, and, we have because we are multi-category, a lot of insights on consumers on the three categories. So, we know a lot about consumers that are going to New Categories, not only one but three.

Gaurav Jain, Barclays
That's very helpful, Jack. Thanks a lot.

Tadeu Marroco, Finance and Transformation Director
Thank you.

Operator
Thank you for your question.

Jack Bowles, Chief Executive
Thank you very much.

Operator
And the next question is coming from the line of Nik Oliver from UBS. You're now unmuted and may now go ahead.

Nik Oliver, UBS
Good morning, Jack and Tadeu.

Jack Bowles, Chief Executive
Morning.

Nik Oliver, UBS
Two questions from me as well, please. Firstly, just on the EPS guidance, obviously, very nice to see a return to the high single-digit constant FX

algorithm, but I guess, you know, that was the historic BAT model and now we've got the buyback as well. So, just any words on just, you know, why it's not higher? Is that just investments in New Categories or maybe some of the unwind of the US trade inventories that you mentioned?

Jack Bowles, Chief Executive
Yeah. Tadeu?

Tadeu Marroco, Finance and Transformation Director
Shall I take the EPS one? On the EPS, we are coming out of two years of mid single digit at the back of COVID, and we want to remind everyone about the high single digit figure that we used to have in the past. And, at the end of the day, it's just slightly different, the company then that we had in the past from today - Reynolds was part of our associates, now it's part of our subsidiaries - and we believe that the return to high single-digit would be a natural step for a company that now has turned into the investment mode in New Categories and moving now to a path to profitability which, in essence, will translate into a kind of profitable driver and profitable enhancement for us for the years to come, which is very, very positive.

But we have to remind everyone that our numbers include FX transactional, different from others that give guidance in EPS, excluding transactional FX; we incorporate these in our numbers. And, with the fact that Reynolds now is part of the subsidiaries, means that the EPS mostly needs to come from our operational performance from the Group.

And, in 2022 in particular, we made reference to some of the headwinds that we faced during my presentation, and that's the reason why we were referring to us being able to start reaching the high single-digits in 2022, that will be boosted by the share buyback in accordance with how we can executive throughout the year.

And second question on the US, you mentioned, obviously, the very strong pricing in the US. You know, eight price increases in two years, that your peer has done seven. Any words on how you're thinking about pricing going forward? Thank you.

Jack Bowles, Chief Executive
So, step by step.

Tadeu Marroco, Finance and Transformation Director
And the US price? I don't think that we can make any comments on that.

Jack Bowles, Chief Executive
Yeah, US price. We're not going to make any comments related to that. Price elasticity is still strong in the US. There are a lot of moving parts at the moment in terms of price of gas, employment and inflation and everything. I mean, we will take it step by step.

Nik Oliver, UBS
Great. Thanks so much. And maybe just one quick follow-up on the US. Obviously, you mentioned, you know, Lucky Strike, how that's taken 1% of share. I mean, when you think about, sort of, segmentation in the US, is it really premium growing strongly and value, and then maybe the mid-section, is struggling? Is that how we should think about volumes in the US?

Jack Bowles, Chief Executive Officer
What you have at the moment in the US is a strong premium market and we're doing very well in that strong premium market. You have a high level of pricing, but it's 50 different states with 50 different levels of pricing in the different states. So, that's an aggregated number, which is less representational of one given market somewhere, but it gives you the possibility to do a lot of pricing because you can do geo-pricing much more effectively in the US.

And the other thing is that you see that, in the lower part of the market, you have some competitive brands that are doing well - Lucky Strike has taken a very good position – and the non-big three players are taking some pricing. So, I think that it's a geo-expansion approach plus the fact of having the right portfolio that makes the difference.

Nik Oliver, UBS
Cool. Perfect. Thanks, guys. Really clear, as always. Thank you.

Jack Bowles, Chief Executive Officer
Thank you very much.

Operator
Thank you for your question. And, as another reminder, it is *1 on your telephone keypad to make a question on today's call.

The next question in the queue is coming from the line of Owen Bennett from Jefferies. Owen, you're now unmuted and may now go ahead.

Owen Bennett, Jefferies
Morning, gents.

Jack Bowles, Chief Executive
Good morning.

Owen Bennett, Jefferies
I hope all is well. Morning, guys. I just had a quick question on glo in the US. So, IQOS, obviously, delayed from being back on the US market for a while, at least now, so I'm just, kind of, of view of would it not be better for you to get your PMTA in on glo sooner rather than later so maybe you can on the market not long after IQOS is potentially being introduced? So, just wanted to get the latest with the glo PMTA in the US. You know, are you maybe even waiting to do a PMTA on Hyper versus the original glo? Is that the strategy then?

Jack Bowles, Chief Executive

Yeah. As you know, I mean, the PMTA process is a very long process, so we're taking all the steps that we need to take related to that in order to be in the market when we will need to be in the market.

Yet, always remember, there's a lot of offers to the consumers already in the US market, and the results of e-cigarettes and the results of Traditional Oral and the result of Modern Oral gives a lot of opportunities for the consumers to use non-combustible products in the US. So, it will take a long time. The process with the PMTA is very long, so we'll play the long game, and there is no problem related to that.

First, we focused on e-cigarettes because that was the closest product to the needs of the consumers. We've done that well. Remember three years ago, a lot of people said we would never have a place in there, now we're leading there, worldwide and very close to being there in the US. We're taking pricing, we're taking position and, in terms of oral with Traditional Oral, that is around 10% of the market in the US, we have a very strong position also.

Modern Oral is, you know, a very small category at 1% with a lot of, as Tadeu said, price key admissions that need better products in the future and that will need PMTAs again, so that's pushing it down the road a few years before its absolutely there. So, step by step, and, yes, we are pursuing that very closely.

Owen Bennett, Jefferies
Okay. Just a quick follow-up there.

Jack Bowles, Chief Executive
Sure.

Owen Bennett, Jefferies
So, on the Vape side, so, you moved to profitability in the second half, if we do see PMTAs in the near term, could we expect then, behind the Vape category from you guys, to really materially pick up again or would you expect kind of, spend levels where they are to just persist?

Jack Bowles, Chief Executive
I think that what we have at the moment is a very efficient approach in terms of investment and in terms of marketing in the US for e-cigarettes. So, there would be no need for further acceleration.

What we have at the moment is an overall ecosystem that is working very well and working in our favour. We are the only ones who have, what, 250,000 reps in the US that are supporting vapour, and that gives us a very strong position.

We still have to do some geo-expansion. As you know, we are very close to being the leader at point one, but we yet we're the leaders in only 26 states, so I still have a lot of states to go and to do geo-expansion. So, I'm very much confident in the fact that we'll continue to grow in the US in the vapour business and will start to make money.

Owen Bennett, Jefferies
Cool. Thanks, guys. Very helpful.

Jack Bowles, Chief Executive
Thank you.

Operator
Thank you for your question, and the next question is coming from the line of Rashad Kawan from Morgan Stanley. Rashad, you're now unmuted and may go ahead.

Jack Bowles, Chief Executive
Good morning.

Rashad Kawan, Morgan Stanley
Hi. Good morning, gentlemen. Thank you for taking my questions. Just a couple from me. So, the first one, if I can follow up on the US cigarette market, are you seeing signs of accelerated downtrading in '22 as inflation and rising, kind of, gas prices remain elevated? I'm just trying to get a sense on whether you're seeing or expect to see any major changes to consumption trends this year.

And then my second question is around Velo in the US. So, how are you thinking about that, kind of, on the medium term? I guess, if you take a step back, have you views on the US Modern Oral market changed and do you expect kind of, some level of normalisation to promotional activities in '22?

Jack Bowles, Chief Executive
So, in terms of the US, again, it's more related to, you know, what happens in 2022, but, I mean, the market has been very strong in the US in 2021, and you have something that has happened towards the last part of the year, in Q4, is a reduction in discounting because you have the absolute pricing and then you have the discounting that gives more space to the consumer. And this discounting has been lower than what they are normally at this part of the year, so that's why you see a bit of inflection that reflects into a bit of a pick-up at the low end of the market.

What's very important as an indicator is the strength of the premium and the strength of the premium is there, so I would not be too concerned with that.

The second question is related to Modern Oral. Yeah, Modern Oral, you know, you have already, as I say always, there's a lot of offers in the market already in terms of reduced risk products, especially with e-cigarettes and traditional oral. Modern Oral is only 1% of the market.

As we said last year, it's mostly a geo-expansion in the course of 2021, so it starts to stall a little bit, and then what you have are big companies that are investing heavily in discounting and offers of products to the consumer - buy one get one free kind of, you know. So, that's quite extreme at the moment, so the value is not here.

The second thing that we know is very much occasional usage because the satisfaction of the product - remember, they have to be in the market a long time - the satisfaction of these products are very low, yeah, and you have to do PMTAs, so it takes a few years more so that you have product satisfaction to the right level.

So, that very occasional usage of these products costs you a bomb in terms of consumer conversion, a bomb, and the products are not yet there to the right level for the consumers. So, that category will take some time before PMTAs come in and bring additional new products.

As you see, in the rest of the world, we're the leaders. Why? Because the products are much better. They are much more adequate to the consumer needs. So, I think that that category's really under tension in terms of pricing and margins at the moment. A lot of price skirmishes is gaining - you know, it's the Far West a little bit out there – and will take two years, three years in order to get the PMTAs on the road. A small segment.

Rashad Kawan, Morgan Stanley
Thank you very much.

Operator
Thank you for your question. And the last question is coming from Richard Felton from Goldman Sachs. Richard, you're now unmuted and may now go ahead.

Jack Bowles, Chief Executive
Morning.

Richard Felton, Goldman Sachs
Thanks. Good morning, guys. My first question is another one on US pricing. I know you're not going to give us detail of your FY'22 pricing plans, but clearly the frequency and the size of your price increases in the US has stepped up quite materially over the last few years, so, I guess, can you help us understand what the strategy has been? Has that been, kind of, you know, opportunistic as the consumer's had a bit more disposal income, or is that a sort of, strategic shift in the way that you've been approaching pricing in the US over the last few years?

Jack Bowles, Chief Executive
Strategic shift, it's not an opportunistic - a strategic shift. We understood much better and sooner the price elasticity and the fact that the US is 50 states, and the tools and the approach was much more national than it was regional, or even state by state, or communities by communities, or city by city. So, that gave a lot of opportunity to do pricing. And, as we can monitor that very well, then we took more pricing.

And remember there are two levels of pricing in the US; one is the published price list, and the second one is the discounting. And there is more than 4bn in discounting in the US to the consumer – forget the trade, to the consumer. So, you can modulate and adapt as you go along, and you can make sure that your rhythm is maintained. So, strong pricing in the last two years in the US.

The environment, we have to see exactly how it works, as I said earlier, and then we'll modulate our pricing relative to that, but I think that there's still some space for pricing in the US for sure.

Tadeu Marroco, Finance and Transformation Director
Just to add to what Jack's saying, it's important to highlight the data analytics that we have put in place in the US over the last two years, the revenue growth management. That gives us visibility that we didn't have in the past, even by postcode or channel, and we can make very targeted movements in terms of pricing and overall trading in particular. And this, combined with a very strong portfolio and very well represented, not just in the premium but also in the mid and the low, we give us all the confidence to take the actions that we have taken in the last two years.

Jack Bowles, Chief Executive
And, by the way, on the same token, because you have size and scale and a very strong brand in e-cigarette, we can do exactly the same now - use the tools that we have in Combustibles and put them on e-cigarettes - because we can exactly do the same approach. That's why we have started in the second half of 2021 to take much more pricing, adapt our offers and grow more granular in terms of e-cigarettes. We're all about value. Okay?

Richard Felton, Goldman Sachs
That's very clear. My follow-up, if that's okay, you seem very confident on the free cashflow generation of £40bn over the next 5 years. So, in that context, why have you decided to do a one year share buyback target rather than committing to a multi-year programme, and is there any reason that we shouldn't that buyback programme to continue in future years?

Jack Bowles, Chief Executive
You know, I mean, I'm a reasonable person, and three years ago we started, and we had very little growth in New Categories. It was nascent category. We had a lot of investments to do. Then, we were starting to accelerate, and then you have COVID that goes in there. And then we continued to grow the dividend. Then we said we were going to do an enormous effort in terms of cash, and that's what we did. In the last three years, we did cash conversion of more than 100%. And then we said we were going to save £1bn, and we did £1.5bn, and now we say more than £1.5bn. We went from mid-single to crawling nicely our way towards high single-digit. Give us a little bit of space. We do £2bn in terms of pounds, which is not far from $3bn in terms of US dollars, of deleverage in one year.

So, we are telling you that, in a short period of time, we were going to do this, and we've put a mechanism in reviewing that on an ongoing basis.

So, give us a little bit of space, give us a little bit of possibility to grow the business, and we'll come back to you at the appropriate timing.

Richard Felton, Goldman Sachs

Excellent. Thank you very much.

Jack Bowles, Chief Executive

Thank you very much. I think that the questions are finished so I am now going back to the end of the presentation.

So, we are very proud to have delivered a pivotal year. That was a very important moment for the company. We accelerated our transformation, delivering over 50% New Category revenue growth. The losses have reduced for the first time, and we have invested £500m. The losses have reduced for the first and will continue to do so.

We have driven net debt to EBITDA below 3 times, and our capital allocation flexibility has increased, as we just said, which is reflected in our share buyback announcement of today.

We are well on track to meet our key ESG targets as we enter the next phase of our journey. That next phase is faster transformation, and this phase will be led by continued, strong New Category growth and improving profitability together with further development of opportunities Beyond Nicotine.

This will not only transform our business and the nature of our relationship with society, but it will also generate strong financial results with medium term outlook of revenue growth of 3% to 5%, high single figure EPS growth and continued strong cashflow.

So, we are transforming BAT to a high growth, multi-category consumer-led CPG with the reduced impact on public health and ESG at its core. I am confident this will create value for all our stakeholders.

Thank you very much for joining us today.

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