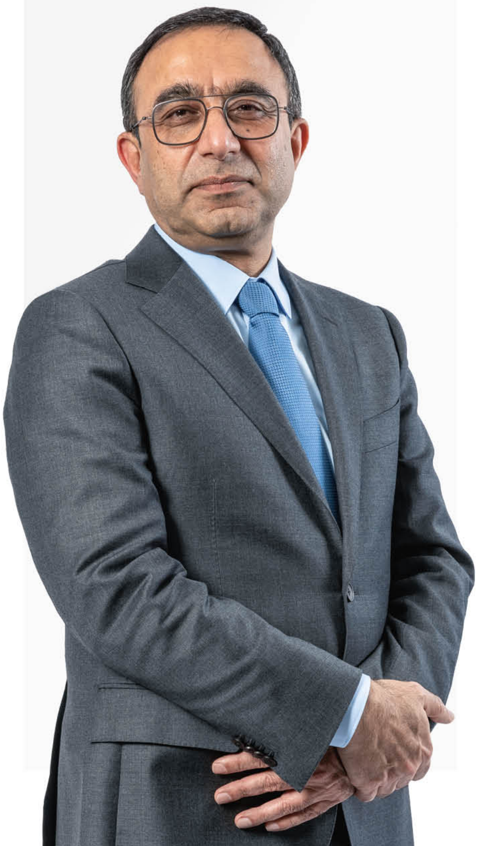
Overview

Interim Finance Director's Overview

Despite the U.S. impairment negatively impacting our reported results, the Group's operational financial performance demonstrates the resilience of the business. We are highly cash generative and remain committed to our capital allocation framework.

Javed Iqbal
Interim Finance Director



2023 has been a challenging year as we navigated a number of issues in our performance.

Our New Categories business is already profitable (at the category contribution level), two years earlier than our original plan, while our global footprint allows us to deliver on our financial priorities despite a challenging U.S. environment.

@I am particularly pleased that our disciplined approach to capital allocation and debt management has brought us closer to the middle of our leverage range (at 2.6x adjusted net debt to adjusted EBITDA). @We remain highly cash generative, allowing us to balance investment in the future while rewarding shareholders with a further increase in dividends (up 2.0% to 235.5p, being 25 years of annual dividend increases).

The sale of our businesses in Russia and Belarus was completed in September 2023, and due to the timing of the transaction partway through the year, this was a headwind on our comparative performance as 2023 does not include a full year's performance from those markets. Combined with a lower underlying performance in Russia as we reduced investment and focus, the comparative impact on revenue was £456 million.

During 2023, we have observed an acceleration of the decline rates in cigarette volume in the U.S., after a period of instability in market trends driven by the COVID-19 pandemic. In response to these increased decline rates, we have revised our forecast performance for the U.S. market, reflecting the ongoing difficult macro-economic environment, uncertainty regarding the impact of the potential menthol ban and continued drag on our legal Vapour business by the illicit single-use products. Accordingly, we have recognised a non-cash impairment charge of £27.3 billion, of which £4.3 billion is in respect of goodwill.

The balance of £23.0 billion mainly relates to the acquired U.S. combustibles brands of Newport, Camel, Natural American Spirit and Pall Mall which are now considered to have a useful economic life not exceeding 30 years, rather than into perpetuity, aligned with our strategy to Build a Smokeless World.

We will, therefore, be commencing amortisation of the U.S. cigarette brands (previously recognised for accounting purposes as indefinite-lived) from 1 January 2024. This non-cash charge of £1.4 billion per annum will be treated as an adjusting item.

@New Categories Driving Group Revenue Growth@

Total Group revenue declined 1.3% to £27,283 million in 2023 (having grown 7.7% in 2022 to £27,655 million).

However, excluding foreign exchange movements (which were a headwind of 2.9% in 2023 and a tailwind of 5.4% in 2022) on a constant currency basis, revenue was up 1.6% in 2023 and 2.3% in 2022.

This was driven by:

- New Categories revenue, up 17.8% in 2023 and 37.0% in 2022; and
- continued combustibles pricing, with Group price/mix of 7.5% in 2023 (4.6% in 2022);

and partly offset by:

- the impact of the sale of the Russian and Belarusian businesses; and
- lower combustibles volume (down 8.3% in 2023) largely due to the difficult trading in the U.S. where volume was 11.3% lower.

Profit from operations declined 250% to be a loss of £15,751 million, compared to a profit of £10,523 million in 2022, an increase of 2.8%.

The decline in 2023 was due to the impairment charges referred to earlier in respect of the U.S. (goodwill and brands). 2022 was negatively impacted by a number of other adjusting charges which did not repeat or were substantially lower in 2023. These include the previously disclosed charges in respect of:

- The sale of the Russian (and Belarusian) business (2023: £353 million, 2022: £612 million);
- Restructuring and integration programmes, including Quantum, being a release in 2023 of £2 million from the previously recognised provision, which was a charge of £771 million in 2022;
- The agreement with the United States Department of Justice (DOJ) and the United States Department of the Treasury's Office of Foreign Assets Control (OFAC) to resolve historical breaches of sanctions (2023: £75 million, 2022: £450 million); and
- A charge in 2022 of £79 million related to the conclusion of the investigation into alleged violations of the Nigerian Competition and Consumer Protection Act and National Tobacco Control Act.

These charges were partly offset by a net credit of £167 million (2022: £460 million) in Brazil as the Group revised the calculation of VAT and excise on social contributions in prior periods following updated guidance and the conclusion of litigation.

Our operating margin was consequently 95.8 ppts lower at -57.7% in 2023 (2022: down 170 bps to 38.1%).

We aim to continue to reward shareholders and our financial performance allows us to further increase our dividend by 2.0% - marking 25 years of annual dividend increases.

Strong, sustainable, cash flow generation underpins confidence in the future.

@We remain committed to our medium-term targets of 3-5% revenue growth (excluding currency), mid-single figure adjusted profit from operations growth (excluding currency) and growth in dividends.@

Profit from operations was down -250% (2022: up 2.8%), impacted by the impairment charges largely in respect of the U.S. goodwill and brands.

Strong cash generation has enabled us to return £5.1 billion of cash to shareholders in 2023, while still deleveraging @to 2.6x adjusted net debt to adjusted EBITDA@.

Excluding these significant adjusting items, and a translational foreign exchange headwind of 2.6%, on an adjusted constant currency basis (which we believe reflects the operational performance of the Group) profit from operations grew by 3.1% (2022: up 4.3%), due to the continued reduction in losses @of £398 million@ from New Categories, which are now profitable at a category contribution level- two years ahead of our original plan.

Adjusted operating margin (at current rates) increased 80 bps to 45.7% (2022: up 150 bps to 44.9%) driven by the reduction in New Categories losses in both years, combined with the impact of the disposal of the Group's businesses in Russia and Belarus, as the margins of those businesses were lower than the Group average.

EPS Impacted by U.S. Impairment, Offsetting Resilient Operating Performance

On a reported basis, basic EPS was down 320% at -646.6p (2022: down 1.2% at 293.3p) with diluted EPS 322% lower at -646.6p (2022: down 1.3% to 291.9p), as 2023 was impacted by the impairment charges recognised in respect of the U.S.

Excluding both the adjusting items (discussed on pages 52 and 53) and the effect of foreign exchange on the Group's results, adjusted diluted earnings per share, at constant rates, increased by 4.0% to 386.4p, building on the 5.8% growth in 2022. The performance in 2023 was also impacted by the timing of the sale of the Group's businesses in Russia and Belarus during the year, a negative headwind on the performance of 1.2%.

Active Capital Allocation Framework Ensures Deleverage, Investment and Investor Returns

We remain committed to our active capital allocation framework, which we expect will deliver long-term value to our shareholders, driven by our cash flow generation and deleverage plans.

These include:

– Continuing to grow the dividend;

– Maintaining our target leverage corridor @of 2-3x adjusted net debt to adjusted EBITDA@;

– Potential bolt-on M&A opportunities; and

– Share buy-backs to enhance shareholder returns.

The Group remains highly cash generative, realising £10.7 billion (2022: £10.4 billion) of net cash generated from operating activities. @This translates to £3.3 billion (2022: £3.1 billion) of free cash flow after dividends.@

This allowed for a net repayment of borrowings in the year, with total borrowings (including lease liabilities) down from £43,139 million in 2022 to £39,730 million in 2023.

Consequently, our leverage ratio has improved towards the middle of our range@, with an adjusted net debt to adjusted EBITDA ratio decreasing from 2.9 times to 2.6 times@.

Our liquidity profile remains strong, with average debt maturity close to 10.5 years and maximum debt maturities in any one calendar year of around £4 billion@. Our medium-term rating target remains Baa1/BBB+@, with a current rating of Baa2 (positive outlook), BBB+ (negative outlook), BBB (positive outlook) from Moody's, S&P and Fitch*, respectively.

In August 2023, the Group completed a tender offer to repurchase sterling-equivalent £3,133 million of bonds, including £43 million of accrued interest, reducing future refinancing risk. The Group has debt maturities of around £3.2 billion annually in the next two years. Due to higher interest rates, net finance costs are expected to increase as debts are refinanced.

25 Years of Consistent Dividend Growth

We are extremely proud of our long history of dividend growth.

2023 marks the 25th consecutive year of sterling dividend increases, with a further increase of 2.0% to 235.52p (with a dividend payout ratio of 62.7%).

Facing the Future with Increasing Confidence

Our business is well placed for the future.

With a diversified geographic and product portfolio, and a track record of delivering robust and consistent cash generation, we believe the Group is well positioned to continue to invest for future growth while navigating the near-term macro-economic uncertainties and challenges.

Notes:

* A credit rating is not a recommendation to buy, sell or hold securities. A credit rating may be subject to withdrawal or revision at any time. Each rating should be evaluated separately of any other rating.

@ Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.