

Quality Growth

Our Modern Oral Products

In recent years, a new category of Modern Oral products[†] has emerged.

These come in the form of tobacco-free nicotine pouches that are placed under the lip so that nicotine can be effectively absorbed.

34

Number of markets where the Group's Modern Oral Products are sold

Modern Oral Top 5 markets **
the U.S., Sweden, Norway, Denmark and Switzerland.



Highlights

Continued strong global volume growth (up 33.6%), with consumer numbers up 0.7 million to 3.3 million.

Category volume share in key Top 5 markets was 28.0%, down 240 bps, driven by a decline in the highly competitive U.S. market.

Continued strong growth in Pakistan and Kenya, supporting future Emerging Market ambitions.

Volume share leadership in Modern Oral in AME at 67.0%, with continued market leadership (through Velo) in 14 European markets.

AME revenue up 41.5%, with volume up 36.5%.

Overview

The Modern Oral category has a clear runway for growth in markets with established oral nicotine consumption. Markets like the U.S. and the Nordics are examples of this as consumers already have the experience of Traditional Oral products.

However, the key challenge in unlocking the category's potential in new markets relates to how the oral nicotine product is used, which is different to how nicotine has previously been consumed, namely through inhalation.

Building a portfolio of strong brands and products/ranges to accelerate consumer adoption is fundamental to establishing a leading, global Modern Oral business.

The Scientific Evidence^{*}

Modern Oral nicotine pouches build upon the extensive scientific evidence available for snus, including long-term studies^{1,2} which demonstrate that snus use is associated with less risk of many diseases compared with cigarette smoking.

Modern Oral products, however, are designed to offer adult consumers an improved, reduced-risk[†] alternative, with many Modern Oral products manufactured as tobacco-free.

Laboratory chemical studies for our Modern Oral products show they produce substantially lower levels of toxicants than cigarette smoke³ and lower levels than snus⁴ – a traditional oral tobacco product which is already regarded as a reduced-risk[†] alternative to smoking.

Toxicology tests assessing the biological effects of our Modern Oral products on laboratory cells also show they have reduced effects relative to cigarettes and snus⁵.

Published in 2022, results from our innovative cross-sectional clinical study showed that exclusive Velo users had substantially lower exposure to tobacco toxicants, and significantly better results for indicators linked to smoking-related diseases, compared with smokers. In 2023, in a study where daily smokers were provided with Velo, the majority of participants significantly reduced their daily cigarette use.

On the basis of our evidence and informed by the wealth of independent evidence regarding snus, switching completely to Modern Oral products can be expected to reduce the risk of smoking related disease when compared to continued smoking.[†]



Oral nicotine pouches, used as recommended, as a replacement for smoking, would be associated with a reduction in overall risk of adverse health effects.

UK Government

Committee on Toxicity 2023

Notes:

1. Ramström L, Borland R, Wikmans T. Patterns of Smoking and Snus Use in Sweden: Implications for Public Health. *Int J Environ Res Public Health*. 2016 Nov 9;13(11):1110. doi: 10.3390/ijerph13111110. PMID: 27834883; PMCID: PMC5129320.
2. Sohlberg, T., Wennberg, P. Snus cessation patterns - a long-term follow-up of snus users in Sweden. *Harm Reduct J* 17, 62 (2020). <https://doi.org/10.1186/s12954-020-00405-z>
3. Gaca, Marianna, et al. "Bridging: accelerating regulatory acceptance of reduced-risk tobacco and nicotine products." *Nicotine and Tobacco Research* 24.9 (2022): 1371-1378.
4. Azzopardi, David, Chuan Liu, and James Murphy. "Chemical characterization of tobacco-free 'modern' oral nicotine pouches and their position on the toxicant and risk continuums." *Drug and chemical toxicology* 45.5 (2022): 2246-2254.
5. East, N., et al. "A screening approach for the evaluation of tobacco-free 'modern oral' nicotine products using Real Time Cell Analysis." *Toxicology Reports* 8 (2021): 481-488, and Bishop, E., et al. "An approach for the extract generation and toxicological assessment of tobacco-free 'modern' oral nicotine pouches." *Food and chemical toxicology* 145 (2020): 111713.

** Key Modern Oral markets are defined as the Top 5 markets by industry revenue, being the U.S., Sweden, Norway, Denmark and Switzerland and accounting for c.85% (2022: c.80%) of total industry revenue.

Our Products

Our Modern Oral products are white in colour and contain high-purity nicotine, water and other high-quality food-grade ingredients, including plant-based fibres, flavouring and sweeteners.

Originating in Scandinavia, Velo is now a leading global brand of nicotine pouches. These typically appeal to a broader audience than Traditional Oral tobacco because of their attractive price positioning. With comparatively lower excise rates (versus Traditional Oral and combustibles), Modern Oral generally has higher margins than Traditional Oral.

Our Velo product range spans across both mint and fruit flavours and are sold in various nicotine strengths, from 4mg to 17mg of nicotine per pouch.

We are also delivering a step change in Modern Oral manufacturing. Truly living our ethos, our Modern Oral factory in Pécs, Hungary, put together a bold plan to implement food industry standards for Modern Oral manufacturing.

With a cross-functional team across quality, production, engineering and EHS teams delivering technical changes and process improvements, Pécs became the first site in BAT's history to obtain the ISO 22000 certification for food safety management systems.

We have also built and recently commissioned a new facility in Trieste, Italy that will further enhance our capabilities and provide additional capacity (in Modern Oral and HP).

In line with the Group's sustainability ambitions, Velo plastic cans are being upgraded to use single polymer plastics, with the use of bio-based materials also being trialled to achieve International Sustainability and Carbon Certification.

Performance Summary

2023 maintained the momentum from 2022 with growth in volume and value. Volume was up 33.6% to 5.4 billion pouches, having grown 21.7% to 4.0 billion pouches in 2022.

Revenue increased 35% to £539 million (2022: up 45% to £398 million). Excluding the impact of foreign exchange, this was an increase of 39% in 2023 and 46% in 2022, as price/mix was up 5.4%, after the increase of 23.9% in 2022.

Volume share of the Modern Oral category in our Top 5 markets was 28.0%, down 240 bps compared to 2022, driven by the U.S. where we continue to await the outcome of our PMTA submission for our successful European product, Velo 2.0.

In the U.S., our volume share of Modern Oral declined by 200 bps with volume down 1.3% to 297 million pouches (2022: down 50% to 301 million pouches). We expanded our geographic coverage in the U.S. and continued to innovate, including the launch of our fusion and sensations ranges, tailored to meet the needs of local consumer tastes and preferences.

Revenue declined in 2023 to £25 million, as the Group reinvested in trade activation plans leading to a decline in net pricing (including trade incentives) of 30.5%. The Group had reduced such activity in 2022 with a resultant increase in revenue to £36 million in that year.

The U.S. market remains highly competitive, with current low moisture product formulations continuing to result in low levels of adult consumer numbers and high polyusage.

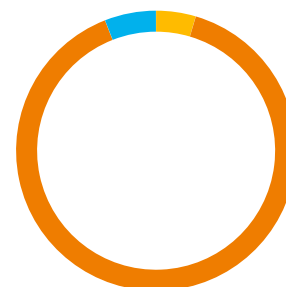
We are encouraged by the strong results from our recent Velo pilot in New York, including a more premium brand expression and design, with a national roll-out to commence in 2024.

In our key markets outside the U.S., we maintained clear Modern Oral category volume share leadership, despite a decline of 170 bps to 67.0%

In AME, we maintained volume share leadership in 14 markets. Revenue increased by 41.5% (2022: up 29.9%) or 44.6% (2022: up 31.6%) at constant rates of exchange. Price/mix was positive in both years, at +8.1% in 2023 and +1.1% in 2022. The higher revenue was driven by volume growth (up 36.5% in 2023 and 30.5% in 2022) due to continued consumer acquisition.

As the Modern Oral category continues to grow and becomes more established in Europe, we continue to see strong growth in adult consumer numbers. In Sweden, Velo is the largest (by volume share) of any snus or Modern Oral nicotine pouch brand**.

Proportion of Modern Oral revenue by region in 2023 (£m)



	2023 £m	2022 £m
U.S.	25	36
AME	482	341
APMEA	32	21
Total	539	398

We have been engaging with governments and other regulatory agencies and we are encouraged by the recently announced government regulatory proposals in Hungary, Finland, Lithuania, Iceland and Serbia. These markets join an evolving group of countries (including Sweden, Denmark, Estonia, Slovakia and the Czech Republic) that have issued bespoke regulation for the Modern Oral Category, that is aligned to our Tobacco Harm Reduction strategy.

For example, in APMEA our volume grew 36.2% and our revenue grew 50.3% (being 70.8% at constant rates), mainly driven by strong volume performances in Pakistan and Kenya. In Pakistan, through stronger consumer acquisition, we have achieved our highest active consumer base (as a % of population) in Modern Oral globally. In Kenya, our accelerated national roll-out in January 2023 has driven a near fourfold increase in adult consumer numbers.

Together, our learnings from these two markets give us confidence in our ability to unlock the Emerging Markets opportunity for Modern Oral going forward.

We continue to seek opportunities and develop the category in other markets as we believe that Modern Oral is an exciting longer term opportunity to commercialise reduced risk products[†].

Notes:

* 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.

** Source: Kantar New Category Tracker.