

Capital Markets Day 2020

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Operator

Hello and welcome to the BAT Capital Markets Day. Throughout the call all participants will be in a listen only mode and afterwards there will be a question and answer session.

Just to remind you this conference call is being recorded.

Today I am pleased to present Jack Bowles. Please go ahead with your meeting.

Jack Bowles, Chief Executive Officer

Welcome everyone and thank you for meeting us today. There is a lot we want to cover today about our business and about our strategic path.

You will of course be wondering about the impact of Coronavirus on BAT and on our industry. As you know we are a major global business, and of course the welfare of our people and stakeholders is a key priority.

As you might expect we are monitoring the situation extremely closely and we are actively managing our business globally.

I would like to emphasise two things, one - our business is one of the most resilient sectors of the global economy. And second, to date, we have seen no material disruption to our business. You will hear more on this area from Tadeu later in the webcast.

That all said it is also important for you to see today some key things about us, our strategic path and our long term future. First, we have consistently delivered against our financial guidelines. We have delivered again in 2019 and at present we are confident we can deliver 2020.

Second, we have a clear strategy for growth, founded on our unique cross-category consumer understanding. And we would like to tell you how this strategy is evolving.

Third, we are building capabilities; we have the resources to continue to fund investment for the future, delevering the balance sheet and deliver against our financial objectives.

And finally, we have a focused, high quality team of people, some of whom you will see speaking today to lead this business in the future.

During the presentations we will go more into details on each of these points. We will demonstrate a number of things; that we are delivering our financial results, that we are committed to our 2020 priorities, that we have a clear strategy to build a better tomorrow, and that we have already started building the capabilities for the future. And we are already creating a bolder, faster and more empowered organisation.

I am sure that you will find these short presentations useful and we look forward to answering the questions at a later stage.

In March last year I set out three clear priorities. In 2019 we have delivered against these priorities, while creating a stronger, simpler and faster business. And our commitment to delivery remains unchanged.

In 2019 we delivered on all our financial commitments to the market, both in Combustible and in New Categories, whilst also making significant additional investment for the future. And importantly we delivered on our high single digit earnings growth commitment.

Furthermore, we remain committed to delivering on our 2020 targets. with revenue growth of 3 to 5% and high single digit EPS growth, alongside strong cash generation, allowing us to continue to deleverage the business and deliver on our commitments.

Finally, although the environment remains volatile we will continue to drive value from our Combustible business whilst driving a step change in New Categories, and remain committed to our ambition, to achieve £5bn of revenue in New Categories in 2023/2024.

Facing the opportunities ahead it is clear to us that we need to evolve our strategy and purpose. We aim to build a better tomorrow. And at the heart of this is our new corporate purpose.

Our Purpose is to build a better tomorrow by reducing the health impact of our business through offering a greater choice of enjoyable and less risky products for our consumers.

The pillars of the strategy are first, our mission, which is all about meeting consumer needs through world-class brands. Second, combustible value growth and step change in New Categories, which are fundamental to, how to win. Third, we are committed to delivering a better tomorrow and creating value for all our shareholders and stakeholders. Last - we have a new ethos, energising the company to create an organisation fit for the future.

The presentations we have prepared for today will take you through more of the details of the strategy. But I would like to explain more on the most important aspects now.

Our mission is about stimulating the senses of new adult generations. And to do so we have to win in high growth segments and priority markets. As you will see later today, we are clear on where and how to focus our investment in order to win.

We are the only player to have a global business across four categories. This gives us unique & superior consumer insights & foresights. We leverage these to further develop and deploy remarkable innovations, partnered with powerful brands.

We are investing in a digitally enabled and connected organisation and we will energise our people and partnerships to bring these to life.

Finally, our business in the US gives us a truly global scale and a competitive advantage versus our peers. Our strategy recognises the importance of winning in the US.

Fundamentally our strategy is about meeting consumer needs and recapturing lost consumer moments. But it is also about addressing societal expectations. Over the years consumer moments that used to be satisfied by cigarettes have been replaced by other products.

With our unique cross-category consumer understanding we are clear there is a huge opportunity to recapture these moments with a broader portfolio of products that are less risky than cigarettes.

These are new products that may in time go beyond our nicotine products. Meanwhile we will continue to focus on generating value from our Combustibles business and adding a step change in our existing New Categories business.

For the long-term we will also investigate the opportunity to build a portfolio beyond nicotine as this represents a clear, future growth-opportunity.

We will do this in a way that is consistent with our new purpose. It is imperative we follow clear boundaries to guide our portfolio expansion. We are clear that any portfolio expansion has to leverage our strengths and our existing delivery platforms in Vapour and Modern Oral. Should reduce the health impact compared to cigarettes and make a positive environmental contribution. And of course be strategically and financially sound.

In doing so we will build a better tomorrow for our consumers by offering them a wider choice of products that are less risky than cigarettes and stimulate their senses. We are clear that our business should create value for all our stakeholders, for consumers for our shareholders our employees, and, importantly, for society at large.

Recognising the importance of this we are evolving from a business where sustainability and ESG has always been important, to a business where it is front and centre in all that we do.

We have therefore established a sustainability agenda with four key pillars. The first and most important pillar is to reduce the health impact of our products and our business. Yet we are also focussed on three underpinning priorities, excellence in environmental management, delivering a positive societal impact in our supply chain and ensuring robust corporate governance across the Group.

In line with this commitment we have set stretching ambitious targets for the future. By 2030 we aim to have 50 million consumers in our non-combustible business. And we have a clear ambition for our operation in Scope 1 & 2 to be carbon neutral by 2030. These are stretching goals which demonstrate our commitment to sustainability.

Our core strength has always been our people and that will never change. To build a better tomorrow we need an organisation that is fit for the future. We have already started to transform the organisation. In 2019 we announced Project Quantum the first step in building a simpler, faster, more agile organisation.

The project was largely completed in January of this year it has already delayed and streamlined the organisation and reduced 2,300 roles. It will also deliver £300m of savings in 2020 to create the space to invest and deliver against our financial commitments.

Project Quantum was not just about organisation design it has also simplified our ways of working across the organisation; allowing us to become more energised, a more efficient and a more resilient organisation.

In addition we are building the capabilities around the organisation. We need the capabilities for the future and have hired more than 300 new specialist managers in Digital, Innovation & Direct to Consumer.

And we have simplified our ways of working across the organisation to become more agile and efficient organisation.

But no organisational transformation can be delivered without its people empowered and committed to the change. We therefore have developed a new ethos with our people that defines the culture and behaviours required to drive the transformation and build a better tomorrow. We are, bold, fast, empowered, diverse, and responsible.

All of these pillars put together are the foundation of our strategy for growth and you will see this throughout all the presentations of today.

BAT is changing. Today, BAT is a powerful combination of British American Tobacco and Reynolds American. Also today BAT is a combination of a business with a strong multi-category business with a clear purpose of creating a better tomorrow.

And we have recognised this through a new execution of our corporate look and feel. This represents the BAT of the future.

So, in summary we have an ambitious strategy for growth. We are committed to deliver on our financial targets. We have stretching new ESG ambitions. We are creating the space to invest in the future and deliver on the financials.

Therefore Project Quantum will continue and we have the ambition to deliver £1bn of savings over the next three years. Tadeu will talk more about this in his presentation where he will explain what a better tomorrow means for our shareholders. Thank you very much.

Tadeu Marroco, Finance Director

Thank you Jack. Good morning and good afternoon everyone, I am Tadeu Marroco, Group Finance Director.

Our purpose for delivering a better tomorrow was set out by Jack in his opening remarks and I will now provide details on how this will drive sustainable shareholders returns.

Throughout my presentation I would like to reinforce the following key messages. Over the last few years BAT has managed to deliver strong financial results whilst increasing investments for the future.

We have taken a diligent approach to create space to continue investing for the future and keep delivering our financial targets.

BAT is a very strong cash generative company with a relevant exposure to hard currency markets and a well-balanced debt profile, and we are fully committed to continue to deleveraging the balance sheet.

BAT has the right strategy to promote a sustainable return for our shareholders.

Before I start my presentation, I would like to address Coronavirus upfront. Jack has already alluded to the humanitarian impact of it which we are all concerned and mobilised to mitigate as much as possible, securing the health and safety of our employees and partners.

From the business perspective we are fortunate to have a business that will be more resilient than others in the COVID-19 environment.

We are not exposed to China on the demand side given that our sales in that geography are immaterial.

We saw disruptions on our new categories supply chain in February. Operations resumed from early March and we expect to ramp up production over the next few weeks. We are also closely monitoring tier 2 and 3 suppliers and alternative logistics routes from China, all of them working relatively well at this stage.

But we are not completely isolated from the Coronavirus impact. On our New Categories side we saw some out of stocks in certain SKUs in certain geographies which are now recovering.

We postponed a few launches and we are seeing certain disruption in activation activities in a few geographies.

The impact of duty free in New Categories is immaterial. On the Combustible side, the supply chain is geographically diverse and it is operating well so far. On the demand side, apart from some softness in demand in some geographies badly hit by the virus, the biggest impact so far is in duty free which accounts for less than 1% of Group revenue.

I would like to update you on the plans we have put in place to respond to this crisis. Of course, the health of our people is of paramount importance. BCP and crisis management teams and actions are underway and we are adapting our ways of working utilising technology.

We are building stocks and supporting distributors across our network.

We have demonstrated our continued ability to generate cash. Resource allocation is reviewed on an ongoing basis and we are deploying tighter cash control measures. Last week we renewed our £6bn revolving credit facility backstop. This together with other funding lines which we continue to develop give us good access to liquidity.

As we stand today, there is no change to our 2020 guidance on Group revenue and earnings growth. We also expect to continue to de-lever our balance sheet.

New Category revenue, as mentioned at the year end results, will be impacted in 2020 by the disruption caused by the Coronavirus as well as the vaping markets still recovering from the US slowdown in the second half of last year and the uncertain regulatory environment.

We have a very resilient business as we saw in past crises and we will continue to monitor developments globally. And to the extent we see any further impact on revenue; we will seek to balance this with cost efficiencies which will be accelerated as required.

As BAT we are committed to delivery and have always delivered on our high single figure earnings guidance. Over the last three years, we have improved our results alongside investing to establish our New Category business.

We are coming from a strong past record. Group revenue boosted by consistent market and value share growth of our Combustible business. Meanwhile we also managed to grow across each of the three New Categories of THP, Vapour and Modern Oral.

Global powerful brands in Combustible have allowed a strong top line performance. We have also worked hard on our cost base over the last few years and today we are in a very healthy operating margin position. We are confident we can continue to grow the operating margin in the future.

If we deep dive into the operating margin, you will notice that we are investing in the capabilities we need to create a competitive multi-category business, whilst delivering today.

The underlying business progress shown in the slide, in green, is a consequence of the strength of our combustible business and operating efficiencies management. Alongside this margin growth we have been able to invest in the new capabilities as highlighted in the right side of the chart, as well as build the global brands in the New Categories space, which you can see in the investments in blue.

Our cash generation is easily above our long term guidance of 90% cash conversion. We were able to step up free cash flow generation, helping to pay down the corporate debt.

As a consequence of the cash generation, as well as our earnings growth, we have consistently being able to de-lever the balance sheet at a rate of 0.4x on a constant FX. Due to the difference on year end spot rates and average we didn't see a linear trajectory of deleveraging over the last couple of years. We are now at 3.5x multiple and have an ambition to reach less than 3x by the end of 2021.

We have now grown dividends on a continuous basis for more than 20 years. Over the last 15 years our dividend growth on an adjusted constant basis has averaged 11%, even higher than our earnings growth of 10% annual growth in the same period.

We are absolutely committed to maintain our 65% dividend pay-out ratio, with growth in sterling terms.

Looking forward we have set three clear financial focus areas to create the space to continue delivering. The first one is release funds to support future growth. The second one is maximise the effectiveness of our marketing investment mainly in New Categories. And the third one is to focus on deleveraging our balance sheet.

Let me show you each of them. Our first priority is to release funds. We have an ambition to deliver a minimum of £1bn in efficiencies on an annualised basis over the next three years, starting in 2020. This will support investments and continued delivery in the medium term as we build a strong business in New Categories.

To that aim, we worked hard last year in the first phase of project Quantum. As we announced before, this first phase was about a full review of the organisation design of the Group. This resulted in the creation of a much more agile, empowered and fast organisation by reducing layers and putting clear accountabilities in place. And although the main driver behind this first phase was to increase the business competitiveness in the way we operate, we will also achieve savings.

We will be delivering £300m from Quantum Phase 1 this year. Looking forward, we will focus on further work streams in Phase 2, including operational efficiencies, with a focus on route to market reviews.

We will continue to press ahead with our supply chain productivity agenda, operating as one virtual global factory with a one global planning hub and global procurement managing 90% of our direct materials and 80% of indirect spend.

We have considerably scaled up our investments behind New Categories in the past three years and we want to ensure we have the best returns from these investments. We will be diligent using our methodology called MAPS, backed by consumer insights, in order to prioritise the geographies and markets where we will be investing.

We will leverage data analytics and algorithms more and more to ensure we have the right information to make resource allocation decisions. We will be focused not just on growing New Categories revenue but also profitability.

A key point to make is that we will first focus on winning in the current categories we are in, and have a disciplined approach to further portfolio development. We will adopt a very disciplined approach to explore future opportunities in the beyond nicotine space when the right time comes.

Cash generation is a key priority moving forward. The focus will be on working capital management as well as our capex. We don't anticipate any large debt financed M&A. We expect to leverage on our newly created corporate venturing to develop the partnerships that are needed to further enhance our competitiveness.

Our target is to de-lever the balance sheet to a ratio below 3x by the end of 2021. Two years target helps to navigate through the FX volatility.

We see a massive opportunity in the non-combustible space. There are already 68 million consumers using nicotine non-combustible products and just around 15% of them are currently consuming our own products. There is a huge contestable space already existing today and our focus will be to grow in this space now and in the future.

The winners will need capabilities including brand building, strong distribution reach, IPs and science, as well as knowledge to be able to navigate in a regulated environment. We already have all these capabilities in our business and this will be a differentiator factor moving forward.

We will be focused to ensure we have a future business in New Categories with profitability as robust as we have today in our Combustible business. We have already a very good position in terms of gross margins in two out of the three categories.

On THP, although consumables current margins are even higher than Combustible we expect some headwinds in future mainly from excise and tobacco regulation. Some of that will be offset by continuous cost saving reduction.

Over the last three years THP devices cost reduced by 30% and consumables by 60%. Consumables today are just 20% higher in terms of cost than our Combustible products with a clear trend to reduce further as we increase scale.

On Modern Oral, with the benefit of no need for devices, we already see high margins on our premium product, and, if anything, we expect margins to continue improving as we benefit from scale.

We also have a robust plan to enhance the Vapour profitability moving forward. This is expected to be achieved as we see consolidation of the business towards, close system and direct to consumer. The scale we will achieve as we consolidate our global brand will also be a key factor to improve profitability.

These are our targets moving forward, they will give us the flexibility necessary to create a competitive and sustainable business in the future.

Kingsley Wheaton, Chief Marketing Officer

Thank you Tadeu. Good morning everybody, my name is Kingsley Wheaton; I am the Chief Marketing Officer of BAT. I have been with the Group for 24 years and I have done a variety of senior management roles over the last decade.

Today I'd like to focus on three areas in particular of the evolved strategy. I would like to talk more about our mission, stimulating the sense of new adult generations and how we make that a reality.

I would like to talk about where we must win, which is all about winning in high growth segments for the future and key priority markets. And I will talk in some more detail about the capabilities that we are building in terms of how to win.

And finally I'd like to build on the purpose the Jack as talked about and think about key stakeholder outcomes going forwards, particularly with a lens on our impact on society.

So we are absolutely committed to delivering a better tomorrow. We have long said that we have a multi-category strategy, a strategy that puts the consumer first and right at the centre of all that we do. And we have unique insights across four global categories that can bring that to life.

Also we have many strengths which are deep set within the BAT business and we are investing in, and accelerating new capabilities. I will talk about the - what we're going to win with in terms of our portfolio, where we're going to win in terms of priority market focus, and how we're going to win in terms of activation and execution.

And finally this is a strategy which absolutely believe is about a sustainable future for BAT. And I will talk about that very sustainability at the end of my presentation.

When we started to develop and think about this strategy, we had a long think about the core beliefs that underpin our business. And indeed we have been showcasing and training those beliefs in a corporate advertising campaign, which has been running in the Financial Times since January. And you can see some of those executions in front of me.

You have articulated, we've articulated here, our purpose, how we are committed to progress through delivering consumer choice, powerful brands, which is underpinned by science and brought to life by the wonderful diversity which has always been a BAT strength.

Just to give some market context, there are about 68 million consumers of non-combustible products worldwide, of which BAT has currently about a 16% share with 11 million consumers, giving us ample contestable space to drive growth into the future.

Roughly that marketplace in terms of consumer splits two thirds from our international markets and one third from the USA.

Translating those numbers into revenue you can see that those 68 million consumers turn into about £16bn of net sales revenue, which with currently £1.3bn, or thereabout, BAT currently has a 14% share of that revenue pool. Again, indicating there is substantial contestable space to go for in the future.

The characteristics of our international markets are slightly different from the USA where the category is split three ways in our international markets because between Vapour, Tobacco Heating and Oral products; whereas in the USA we see almost exactly a 50/50 split between Oral products and Vapour products.

Of course beyond the consumer numbers and how that's translating into revenue there is a lot of change going on around us. And the context for our consumer first multi-category strategy for growth is the societal change that's going on around us. And let's face it with 115 years of history BAT has seen a lot of societal change, and delivered and succeeded through all of that.

That societal change is giving rise to consumer change, who are probably changing faster than we've ever seen before and the consumer dynamics over the last five years or so are probably the most progressive we've seen in the industry's history.

That is amplified and accelerated by social media and the speed of today's communication.

So if we have a strategy to win that strategy must be about winning in the high growth segments of the future, because it is upon those high growth segments of the future that we will be able to deliver long term, sustainable growth, which is absolutely critical.

If we take a step back and think about how that consumer has changed over the last 20 or 30 years we can quite easily see that 20 or 30 years ago smoking was able to satisfy a variety of consumer moments. And over time as there has been societal shift and regulatory change some of those moments have been reduced. And so therefore we think that with a new portfolio, with a broader portfolio of tobacco and nicotine and over time and beyond we will be able to recapture those consumer moments to fuel our sustainable growth over the long term.

And Jack talked about this earlier, a portfolio evolution which goes from Combustibles, through New Categories and beyond nicotine. And how social acceptance improves as we move from the left to the right.

If we unpack that a bit further, as we build a Combustibles business for value generation, which is the engine room of value creation if you like of our business we are able to regain moments with New Categories products and we're committed to delivering a step change in that. And we are able to find more moments and indeed more consumers when over time we think about moving into a broader portfolio that takes us beyond nicotine.

Of course the limits to that portfolio expansion are not boundless. And Jack touched upon the clear boundaries that we have set for that portfolio expansion. We must leverage the hard won competency and capability that we have in our current delivery platforms, particularly Vapour and Modern Oral.

We have very long standing capability in the areas of science and regulation, which will underpin our portfolio expansion going forwards. And that would all be nothing without using BAT's global marketing reach and expertise. And I think it would go without saying that our portfolio expansion would always be subject to stringent financial and strategic attractiveness tests.

And we are clear about the regulatory pathway that we seek going forwards and we are actively trying to shape the desired regulatory frameworks for our portfolio. We believe in category specific regulation, that is to say regulations for the three categories of Vapour, Modern Oral and Tobacco Heating. We think that regulation must be, and should be, scientifically evidenced and supported.

We argue for product standards, clear packaging and labelling, responsible marketing standards, which is something we've been doing since 2001 when we launched our first International Marketing Principles. And of course our products and our portfolio should be for sale to people of legal age and above only.

I have touched on the science and evidence base that underpins that regulatory view and how we're trying to shape regulation going forwards in a smart way. I just want to update on behalf of Dr. David O'Reilly where we are with our science programme. We are nearing completion of our glo scientific assessment. We are in a very strong position I think with Vuse given the PMTA submission we made on Vuse Solo in December and more of the Vuse portfolio is to come before the May deadline.

We have the science now to support Velo as a reduced risk product. And with the science package we are able to build increasing confidence with our consumers in our products, which supports our purpose going forwards. And we are in the early stages of doing the right scientific work, as you would expect, on our portfolio that will go beyond nicotine.

Another really important leg of R&D and our portfolio expansion is intellectual property. And we have been very, very active in that area. We have had a step change in patent filings since 2017, with twice as many patents filed in 2019 as just two years ago.

We are stepping up the talent and the capabilities we have in that area, with external recruitment, enabling us to bolster our capabilities. And we are not only building IP organically through our R&D hubs in Southampton and in the US, we are also buttressing that IP portfolio through the M&A that we've been doing.

And of course, I think it would go absolutely without saying, we are absolutely committed to robustly defending protected and pursuing our IP rights on a going forward basis.

So our mission is all about stimulating the sense of a new adult generation. I think this is really, really exciting for BAT, this is a consumer first strategy, and I believe we stand at a pivotal moment. I think we are will transition from a business, which defines itself by the product it sells to the consumer needs that it meets, through a broader, expanded portfolio of tobacco, nicotine and beyond.

In order to understand our consumer better, we have our proprietary intelligence segmentation methodology, or PRiSM and we talked about that last year at the Capital Markets Day.

That is a unique multi-category view of the consumer. It allows us to see over the horizon, over the arc of the horizon and be predictive about where the consumer is heading and what they demand of us next. And that PRiSM system allows us to guide our portfolio development and portfolio structure and frames what we have in terms of our portfolio today and tomorrow.

Using our market prioritisation system or MAPS we're able to take that portfolio and ensure that we are focusing on the right markets and the right priority opportunity spaces for the maximum commercial success. This is about deploying the right products in the right places, to the right consumers, driving maximum consumer resonance and investment efficiency.

We put it through - all of our products through a four step process where we look at the consumer and the commercial opportunity. We evaluate those products in any given marketplace, against the product satisfaction index or PSI, which Paul will talk about later.

We overlay the regulatory and tax environment, both today and as we anticipate it into the future. And we assess the distribution and channel landscape that's available and that allows us to figure out how to build the right portfolio in the right place and deliver the right returns to BAT.

And finally, capabilities - as I said earlier, we've been a business, a public listed business for 115 years, we have many deep set capabilities and we will continue to leverage our global marketing reach and scale.

But also we have new capabilities and we are using those to accelerate our transformation. We are investing in those for the future and we committed to speeding up the development of things like foresights, beyond nicotine, 21st century brand buildings, direct to consumer through our e-commerce model. And Paul will talk about those in more detail later.

In essence we're going to take our long-standing, deep set capabilities that this Group had and partner with them with new to world capabilities to accelerate our transformation story.

So if I put that all together and think about our consumer first multi-category strategy in action; we have a mission which is about stimulating the senses of a new adult generation. We have our proprietary insight system PRISM which guides our portfolio development. We use our MAPS system to understand priority markets, focus and investment returns. And then we link that to our in-market activation and execution to build our products and brands as fast is possible to deliver returns to BAT.

This is an exciting framework, which will power long term growth in high growth segments of the future.

I just want to come back to our sustainable future which was the third leg of my presentation.

We have split our stakeholders into four in our strategy, consumers, society and employees and shareholders. And we aim to deliver a better tomorrow to all four of those stakeholder groups. But I would like to focus here on how we deliver a better tomorrow to society in particular.

And Jack has outlined our ESG mission earlier. And that is a business where sustainability, which has always been important, is put front and centre in all that we do. And I personally am very, very excited about the mission and accelerating that journey going forward.

Although we don't do it for this, it is nice to be rewarded and recognise and we have been active in the world of sustainability for two decades and more.

We were industry pioneering when we entered the DJSI, and we have been a member of the World Index for 18 years consecutively. Most recently we received a SEAL award which places us in one of the 50 most sustainable companies in the world.

If you have a look at the all-important sustainability indices on the MCSI, we are currently BBB and on Sustainalytics we post a score of 65 out of 100.

There is a lot more work to be but we have a great starting point and we are committed to accelerating our ESG approach.

I'd like to now play a short video which encapsulates our ESG journey so far and a hint of where we're going into the future.

[Video Played]

Kingsley Wheaton, Chief Marketing Officer

Jack has talked earlier about our really big ambitions for the future. And I am really delighted to be able to reemphasise our commitment to these two ambitions for the future.

So we aim to have by 2030, 50 million consumers worldwide of non-combustible consumers. That's up from the 11 million we have today, a journey of an additional 39 million consumers over the next decade.

And also I'm very pleased to say that we have an ambition to be carbon neutral in our operations over the same time period, also delivering that in 2030. Those are our ambitions; the organisation is excited, motivated and energised about accelerating this ESG journey.

And to bring that to life we have framed a new sustainability agenda. The headline act of course is reducing the health impact of our business, but there are three really, really critical supporting pillars. That's about excellence in environmental management, making sure that we deliver a positive societal impact through our value chain. And as you would expect the highest standards of corporate governance.

But I think more than the agenda itself it's about accelerating those ambitions, it's about measuring those ambitions against clearly laid out metrics and objectives and making sure we publish our progress so that people, our stakeholders, can monitor our journey over the next years to come, culminating in those 2030 ambitions.

So we have a clear consumer first, multi-category strategy for long term sustainable growth. This strategy is about winning in high growth segments of the future to deliver sustainable value. There is a large pool of non-combustible consumers today, some 68 million of them, and growing, and we aim to have 50 million consumers by 2030.

We are going to do this through a broader portfolio of tobacco products, nicotine products and beyond and we have a system for activation and execution which takes us from mission, through our insights, guides our portfolio, through our MAPS system in terms of where to win, which we link to our capabilities to ensure powerful activation and execution. And all of that is supported by two big sustainability goals, the number of consumers we have in the future and our commitment to carbon neutrality in 2030.

So I've been with BAT for 24 years. I feel more excited today than when I joined 24 years ago about the future of this business. I am very excited to see this evolved strategy in action. And as I said I think we are at a crucial moment as we turn from a company that defines itself by the product it sells to the consumer needs that we can increasingly meet.

Thank you very much indeed. I think we will now have a short coffee break.

Paul Lageweg, Director, New Categories

Good afternoon and welcome back. I am Paul Lageweg. My role is Director for the New Categories.

In the last year, my key focus has been about step changing the performance in the New Categories.

This is obviously a key pillar of the newly articulated strategy. You have heard Jack and Kingsley explain this.

We are making good progress. Firstly, and this is very important for you, I want to reinforce that the growth of New Categories is a very positive development for the industry. It provides higher and more sustainable levels of industry revenue growth for two simple reasons.

Firstly the gross margins of these products are generally higher than what we are enjoying for cigarettes. And secondly, we are regaining consumption moments that we have lost for cigarettes. And BAT is increasingly doing well.

There is an enormous amount of work happening in building the right capabilities. And that is to ensure our competitiveness over the mid and long term through a major transformation BAT itself.

While we are not yet where we want to be in Tobacco Heating Products, but we are making good progress in closing down the gap in product performance especially in terms of sensorial satisfaction.

We are now already the clear winner in all key Vapour markets by consistently growing share. And we have also become the global leader in Modern Oral, a category with a massive future growth potential.

And as part of our newly articulated strategy, we also see a mid-term opportunity to explore beyond nicotine. You should recognise that the emergence of New Categories is still in its infancy. Not only far more people will switch to reduced risk products, but also the categories themselves will transform. And we want to lead the industry evolution as this offers a massive growth opportunity to BAT.

And this growth is value accretive. Not only as the margins per unit are generally higher for reduced risk products due to lower excise rates, but also as we are regaining consumption moments and even consumers that have not fully converted yet - who are using a combination of Combustibles and New Category products - are also more profitable as they tend to use New Category products at times that they cannot smoke.

We are already seeing how this is sustaining higher levels of industry revenue growth. We grew revenues by 5.6% last year supported by our growth of our New Category products. Now very few large global consumer packaged goods companies managed to deliver that level of revenue growth.

As you know, we as BAT have always believed in a multi-category portfolio. This is core to our strategy. And the level of satisfaction that each different category delivers in each market is an important driver of its commercial success.

So this is a simplified version of our Satisfaction Index. In low flavour markets, for instance, like Japan and Korea, THP provides a high level of satisfaction. While in mid flavour markets like for instance in Eastern Europe, the picture is more balanced. While in most of the rest of the world, in the high flavour markets, Vapour is clearly preferred.

Now the important thing for me is that Modern Oral has a universally high appeal and has therefore a very large truly global potential. This product satisfaction index is only one of the inputs in how we determine which categories to launch in which markets.

We also take into account other factors like for instance the regulation and excise environment and our capability on the ground - our ability to win. This really allows us to launch the right categories in the right markets with optimal resource allocation.

A multi-category portfolio approach is right, but we must prioritise ruthlessly.

Kingsley already shared that cigarettes have lost some of their historic needs and moments and are now in especially the developed markets they predominantly occupying this classic space.

But through our multi-category portfolio we can reclaim most of the lost moments and needs. So we are growing the cake itself.

And we are targeting each of these consumer spaces with one dedicated brand. Now 'Flow' is the new space beyond nicotine and I will explain a little bit later in more detail.

We have a solid foundation. We are the global leader in Modern Oral. We are also the leader in vaping in Europe. And we are increasingly becoming the number two in vaping in North America. And we are also the number two in Tobacco Heating Products. So in total we have now 11 million consumers using our non-combustible brands on a weekly basis.

But we want more. And for that we need to establish new capabilities. So we are working hard on an entire transformation of BAT itself. We are building several new and powerful capabilities that will become our key source of competitive advantage over the mid and long term.

So let me just give you a few examples. It obviously all starts with the consumer. We believe that having superior multi-category consumer insights and foresights will be a true competitive advantage. We are the only company that has this multi-category understanding of consumers.

And in those fast changing categories, we need foresights and more fundamental understanding of the underlying consumer drivers. We also need to collect these forecasts faster, for instance instead of doing traditional consumer surveys with traditional field work and tabulation of results that could easily last up to two months, we now have online expert panels for each of our categories that provide insights within a few days.

A lot of our consumer research was always done locally, but it did not ladder up to relevant global insights. We have replaced this with a global programme where all data goes into a large database and we can mine for any question we have about our business. And we are also extensively leveraging this powerful database of 7 million consumers.

I think the designs of our New Category devices, including of course the user interface and user experience are very important choice drivers for consumers. Now we lacked capability in this area and our devices are simply not looking good enough.

But we have hired a world class Head of Design who is now building hubs in Asia and the UK where we work with leading external partners to ensure that the design of our devices drives very strong consumer appeal.

We are building a more agile and externally focused innovation model. And this has already cut our development time in half and built a much stronger pipeline of truly breakthrough technologies.

For instance we established Open Innovation hubs in China – Shenzhen – and the UK last year and we will do the same this year in San Francisco and Israel. And in those hubs we systematically scan the market for new ideas and solutions; but also we develop most of our new platforms with strategic external partners.

So let me just give you one more example, we are also entirely changing how we interact with consumers. We have now 7 million consumers in our database and we know a lot about each of those consumers. And that allows us to interact with them a highly personalised basis.

This is very effective and it is reducing conversion cost by up to 85%.

Now we are also driving more of our consumer base to e-commerce through for instance subscriptions models. So our e-commerce is now becoming a multi-category platform, and that also allows us to introduce new categories, but also new offers at a very low cost.

So this is a truly a major transformation of BAT itself. And we are bringing a lot of new top talent into the company to lead this transformation. Last year we recruited more than 300 managers externally.

And of course that has all been funded by Project Quantum and the resource allocation that we're doing within the business.

Let's now quickly walk through each of these categories. Starting with Tobacco Heating Products where we are not yet where we want to be. We are working hard to improve our product competitiveness.

As a first step, we launched glo Pro & glo Nano at the end of last year. We are also building on the learnings of glo Sens. We will make further improvements this year through the launch of glo Hyper in April. So step by step, we will be closing the gaps.

An Acceleration is clearly required, last year we only grew only 23% in terms of revenue. And our share for most of the year was flattish. And so today we have only 15% of the global THP category and that is predominantly concentrated in North Asia, where the category is already saturating.

We have always done well among Considerates. This is a relatively older cohort that is looking for milder taste, they care less about the design, but want products that are easy to use and clean and value is also important to them.

But clearly the much bigger opportunity however is among the innovation enthusiasts, even more so in Europe. These are relatively younger consumers that come from smoking higher flavour cigarettes, so taste intensity is very important to them. They like to explore novel flavours. And for them the size and design of the device are important. So for us to grow our business in Tobacco Heating Products, we need to do much better among this group.

As a first step, we launched therefore glo Pro and Nano at the end of last year. And glo Pro is really the first device that has induction heating. It has a boost button as well and it delivers much better taste intensity. While Nano is more stylish and a first step therefore towards addressing our device appeal.

We were flattish for most of last year, but since the launch of Pro & Nano we are back to growth again in Japan. And the same counts elsewhere like Russia where we are still focusing only on the top five cities, but we are growing strongly now from a low base, and we have 2.2% share now in Moscow of total nicotine and will therefore now be expanding to another 10 cities Russia.

Not only our growth has improved, but also our conversion rates have improved after the launch of glo Pro and Nano. So this is a good step in the first direction.

But not all our launches have been as successful. The performance of glo Sens has been below our expectations. But we fully understand why performance is not better and we have captured the learnings as we still see a sizable opportunity in offering the best of both worlds between Tobacco Heating Products and vaping. This was still a legacy product, but we have to clearly have to design it a bit differently and that is what we're doing now.

It is evident that step by step we are closing the gap. The next significant step forward is being launched right now - glo Hyper. This product delivers the best taste intensity in the market. It has a regular Premium King stick format with 30% more tobacco. It also uses our patented induction heating technology with the Boost button for extra satisfaction.

For most of last year we still had an inferior platform, but going forward, we are now very competitive especially on sensorial satisfaction, on taste and on flavours. And then we have this regular Premium King format that we know consumers know and love. So this is a big step forward. But there is always more to be done, for instance we have more work to do on device appeal.

It is clear that consumers like Hyper experience. We offer a much higher level of taste satisfaction, that can also be controlled through the boost button. We have a familiar Premium King stick format with 30% more tobacco versus our slimmer format.

Unlike the market leader we offer a wide range of capsules with different flavours. Two thirds of our franchise is already today in menthol and other flavours. So this is also a key area of strength that will also benefit us during the menthol ban in Europe this May.

In summary, we are making step by step progress to reduce our gap in competitiveness. Still loads more to be done, but I am confident that we will gradually emerge from a distant number two to a strong number two in Tobacco Heating Products.

Let's now move on to vaping. This is already a category where we are ahead of where we are in THP. As a result, we are now consistently gaining share in truly all key Vapour markets. We are the clear market leader in Europe and we are determined to become the global leader.

These results are driven by a superior portfolio, combined powerful consumer engagement building a strong global brand and we are making progress to enhance profitability. And, as I mentioned, we are clearly winning now in all key Vapour markets.

This is our superior portfolio, so we have the stylish ePod, what is called Alto in the US, which is superior on all key attributes versus the competition. And we also have the power horse ePen3, which delivers almost 3 times the vaping cloud of our competition and this is especially relevant in the European TPD markets with nicotine ceilings.

So both are superior platforms and therefore it's not surprising that consumers in the UK have therefore awarded us now for the second year in a row with the Product of the Year Award against all key competitors.

Not only our platforms are superior, we have done a lot of work recently on our flavours and we are now rolling out a portfolio of flavours of which most are the absolute best within the entire industry.

And then we are doing a lot of work to premiumise our brand offer through limited editions, colour ranges and accessories.

For all of our brands, we are doing a lot of work to improve our environmental footprint, the impact on the environment. For instance, in the case of Vuse we eliminated the silicon hygiene caps from our cartridges. Our new packaging that we will soon be introducing will not have any outer plastic wrap any more.

We are also increasingly starting to recycle cartridges themselves across our markets.

But a really key driver of our success is our highly effective marketing campaigns. We have won several prestigious advertising awards including an EFFIE and an IPA. This is unprecedented for our industry and a great reflection of the strength of our marketing efforts.

And as part of that we are also transforming our retail stores. We may remember that we acquired a number of vaping retail chains in recent years in the UK, Germany, Poland and South Africa with a total number of about 750 stores.

Now all these stores are totally different today with names like Twisp, High End Smoke and VIP. And we also have a very different portfolio in all of these stores, so we have piloted bringing these stores together under the same Vuse Inspiration store banner with the same portfolio, the same layout and the same consistent retail practices.

This has been hugely successful, so we are now planning to convert all of our stores in 2020.

In addition, we plan to open new stores as well. For instance, just today we opened a new store here in London, on Oxford Street.

When we attract consumers into our superior closed systems, we try to guide them very quickly to our e-commerce platform. So this is growing rapidly. We had five million visitors last year and we are doing a much better now to convert them to loyal users, for instance leveraging subscription models among others. This is on average providing 40% higher profit per user.

Vaping is by far the largest reduced risk product category in terms of the number of consumers. But we also have to improve its profitability. The good news is that industry profitability continues to evolve very positively.

You will remember that this category just a few years ago was dominated by open systems, so you have thousands of brands, with open liquid, that were predominantly being sold in both vape stores and dedicated websites that gained most of the margin out of the category.

This is now quickly transforming to branded closed systems sold predominantly in our traditional retail, where our strength is and where the retail margins tend to be typically lower. So the industry is quickly consolidating around a few global brands that are all controlled by the tobacco majors. Regulation like the FDA in the US will only further accelerate this trend. And for the US generate a contestable space of \$1.5bn by around May 2021.

In addition to this positive industry trend, we are also doing a lot of things to improve vaping margins. There are two areas that specifically stand out. One is the retail margins, on average retail margins in vaping are about 40%, that's compared to roughly 11% for cigarettes. This is because the category was created by many small players.

Obviously our increased scale with a powerful brand will help us to manage retail margins. But we are also working for various reasons to convert more of our user base on to a D2C platform, so onto our e-commerce including through subscriptions.

This will also to personalise and customise our consumer communication. And we can also sell a much wider range of liquids through e-commerce. And as you may know this has been a key driver of the success historically of open systems.

Another key opportunity is really in the cartridge costs. A quite shocking fact is that the liquids in our cartridges account for only 7% of the total cost. So we are now fully automating our cartridge manufacturing. So ePen3 we fully automated last quarter and next quarter we will do the same for ePod. This will drive significant savings.

Further margin improvement will also come from consolidating our portfolio. Behind one leading global brand Vuse, our two winning platforms, we are also harmonising our global liquid portfolio behind the best liquids that we had in the portfolio and they will all be produced in one factory in Poland.

How is all of this translating in our performance? Well we are now winning everywhere. This is the US, the most important market, where we are consistently getting more new consumers into our brand. If you look at the last period, 65% of all new device kits sold were from Vuse.

As a result, we have been consistently growing share in the last six months. Tripling our Alto share and doubling our total Vuse share over the six month period.

In the state of Georgia we tested a new marketing model, which yielded even better success. And no surprise that we will be replicating key elements of this model now nationwide.

Our PMTA submissions are on track. And frankly our portfolio is very well positioned for success in this environment, unlike our competition. As you can see from this data we clearly have no issue with underage usage and we are also successfully building a portfolio of lower nicotine strength products.

Canada is a similar story where we had the highest device share in the last six months and as a result, we are consistently, every single month growing share at the expense of the market leader.

Then on to Europe where we are the clear market leader. Like in France where a year ago we were still neck to neck with myBlu, but now we are more than twice their size. In October, we launched ePod and you can see how this accelerated our share momentum.

The same counts for the UK, where our total share is close to 40%, but this is just showing the Vype share at 12%. It is important to note, that only from May we will be rolling out ePod at scale and you have seen how this has helped us to accelerate our share momentum in France.

Also in Germany, we have clearly now overtaken myBlu to achieve market leadership and we are almost three times the size of JUUL.

So we are the clear leader, actually, in all European markets all the way from Poland to the Netherlands.

So in summary we are building the world's best Vapour business, with a superior portfolio of award winning products. And a powerful brand supported by award winning marketing campaigns.

We are leading in Europe and we are becoming a strong number two in North America. So we are well poised to become the Vapour leader globally. And we are improving our profitability at the same time.

Then on to Modern Oral. We are already the global leader in Modern Oral. But we aspire to scale this category to its full global potential that we believe will be very large.

We are the global leader both in volume but also in value, given our strength in Europe.

We believe that this category has the potential to be very large. There is a massive advantage of not needing a device. It takes away the high cash outlay for trial and therefore makes the category more accessible for developing and emerging markets.

And this is a category that offers true discretion. You can't see when you are using it and you can truly use it anywhere and anytime. So increasingly we start selling a lot of these products in airlines as well.

Satisfaction levels are universally high and we have therefore very high conversion rates especially among millennials and adult gen Z.

The commercial model is also very attractive with margins per unit on average 2.8 times what we make on cigarettes and this is without the large upfront device costs.

So we see a large global potential, we expanded last year to 17 countries and our growth is strong, but from a low base. So we are working hard to grow the category size in existing markets and obviously we will be expanding to new markets as well.

We do have a portfolio gap in the United States as we only have 2 mg and 4 mg nicotine variants and also a more limited flavour range. But we are doing well on the segment we are focused on and this is the fastest growing segment of the market and we have an opportunity to address the portfolio gap through future submissions to the FDA.

We have been the fastest growing brand in the United States since we launched last July. So we do not have really a product performance issue. Based on our research our product is actually superior to competition at the same nicotine strength and we are therefore enjoying very good conversion levels.

But we are clearly doing very well elsewhere as well. And probably the thing that excites us most is the pilots we did last year in Pakistan and Kenya but they demonstrated the true potential in the developing and emerging markets where more than 60% of our business is based today and of course where most of the world population is living as well and we are very, very pleased with the results that we got out of Pakistan and Kenya.

So as you know, we will be migrating where legally possible all our Modern Oral brands to Velo and we are very confident in the future of Velo.

We also have a great track record in migrations having successfully migrated over 100 brands in the last decade.

And we have some outstanding products, outside of the US, we have a unique and patented nicotine delivery system which is a clear competitive advantage. But we are working on more. We will soon be introducing another unique and patented upgrade, with longer lasting flavours and this is a clear unmet need in the categories.

And we are working on a lot of exciting packaging innovation, for instance to make the product more portable.

So our focus will be on scaling our leadership in Modern Oral, to build this category to its true global potential, leveraging our superior patented technologies and a single global brand in Velo.

We have a strong foundation. We will be scaling, as I mentioned our leadership in Modern Oral to build this category to its full potential. We are building the world's best vaping business and we aim to emerge as a strong number two in Tobacco Heating Products, through addressing our competitiveness.

But as I mentioned in the beginning we also see a mid to long term opportunity in this beyond nicotine. And this is all around this consumer space that we call Flow. So this segment is particularly large among adult gen Z and millennials.

These consumers are still looking for ways to manage their flow, their energy levels, during the day. But they want to use more natural active ingredients that are better for you. And we think that we are very well positioned to come up with some breakthrough offers for these consumers.

But we will do this in a disciplined way, focusing on leveraging our core capabilities. For instance, we cover more retail outlets in the markets where we operate than any other consumer product company.

But we will also leverage our superior delivery platforms, so let me explain why we believe that is such an important competitive advantage. Because, there is a reason why cigarettes historically have been always been so successful. Any active that is delivered through the buccal and the aerosol systems is simply far more effective, you straight away get the impact - so you enjoy the impact immediately.

You can use less of the active as well and you can control a lot better how much you want to consume. So for any active from, for instance, CBD to caffeine this is the more effective way to satisfy consumers.

So our initial focus is on two areas, one of them is our consumer foresights so we see three attractive consumer spaces where we're doing more work: focus, boost and calm or relaxation.

Secondly we're doing some early work on the science and here we really followed three important principles. We would not mix any of these potentially new actives with nicotine. We will utilise the right science in terms

of product safety and of course the efficacy of the products. But all of this is still very much in an exploratory stage.

In summary the growth of new category helps to sustain higher levels of industry revenue growth. We as BAT, we are building the right capabilities to emerge as a winner in this industry transformation.

We are step-by-step closing our gaps in Tobacco Heating Products to emerge as a strong number two. We are winning in all Vapour markets and building the world's best Vapour business. We are leveraging our leadership in Modern Oral to scale this category to its full potential. And we are also now starting to explore the mid-term opportunity beyond nicotine.

We are confident, I am confident that we can deliver £5bn revenue in 2023/24, despite some of our severe headwinds this year.

Thank you very much I'd now like to hand over to Chris Sijtsma, who will take you through our core business, our Combustible business.

Chris Sijtsma, Group Head of Combustibles

Thanks very much Paul. My name is Chris Sijtsma and I am the Group Head of Combustibles.

Today I will present the role of Combustibles within the context of our new strategy and how Combustible underpins sustainable value growth.

Here are my key messages; the objective for the Combustible category is to drive for sustainable revenue growth with continued volume share and value share growth.

We will continue to develop and invest in our brands for equity and future value, by offering winning brand and product propositions, enabled by purposeful innovation. And this is underpinned by a hard drive to accelerate the delivery of efficiencies.

We will further consolidate our portfolio of strategic brands and delivery efficiencies through a much leaner portfolio, with far fewer SKU designed to a margin.

Revenue growth management is a critical enabler to unlock future value and our resource allocation will be focused and prioritised to deliver better results with fewer initiatives.

Over the past three years Combustible duty paid industry volumes have declined at a CAGR of 3.6%. However, industry revenues, they have grown at 1.1%.

BAT has grown its revenues from Combustibles at a rate 2.5 times the industry average and at a CAGR of 2.8%. With further momentum in 2019 when we grew revenues from Combustibles with 4.6%.

In 2019 we have grown our Group volume share and our Group value share with 20 basis, with 70 basis points share growth for our strategic brand portfolio.

This chart shows the price mix for BAT for 2018 and 2019. The reason for the revenue acceleration in 2019 is an improved geographic mix. Our performance has been delivered in a market with total consumption down, moderately down, at a CAGR of 2.3%. And here total consumption means the consumption of duty paid cigarettes, plus the consumption of illegal cigarettes.

Over the past few years we have seen an acceleration in the growth of illegal cigarettes, putting some further pressure on duty paid industry volumes.

Due to the growth of illicit cigarettes, Combustible duty paid industry volumes have declined at a CAGR of 3.6%.

The year started well in the United States, for the full year we assume the US cigarette market to be down by 5%. Globally there may be some limited impact from the Coronavirus. On balance with our knowledge of today we maintain our current outlook and are forecasting duty paid industry volumes to decline with circa 4%.

This is slightly worse than the historical rate of decline due to significant excise increases in two low value markets, Indonesia and Turkey.

Aggregated performance, however, only tells a partial story. And to give you a flavour of the depth and breadth of our performance I will now take you through our high value markets, the United States, Australia, Japan, Germany and Romania; three developing and emerging markets, Russia, Pakistan and Nigeria; and three markets, Malaysia, South Africa and Brazil where the size of the illegal cigarette segment is very significant and I will conclude with a few markets we internally refer to as our Hidden Gems.

Together these 15 markets represent 63% of our revenues and 42% of our volumes. They are all facing their own unique challenges and opportunities. But they have one important thing in common. In the majority of these markets we grow revenues on the back of strong equity brand portfolios.

2019 was a good year for our US business; against a flattish volume share we have grown our value share with 30 basis points. And this is important; we're growing in the right consumer and product segments.

We have grown our share of premium with 50 basis points, our share of menthol with 70 basis points and our share amongst 21 to 30 year old smokers with 30 basis points.

This performance has delivered revenue growth at a CAGR of 2.3%, with further momentum in 2019 when we grew revenues from Combustibles with 3.8%.

Our strong performance is a direct function of the strength of our brand portfolio. The chart shows the price elasticity for our strategic brand. The industry average price elasticity is minus 0.38, but with better, much better elasticity for Camel Crush, Newport Menthol and Natural America Spirit.

In terms of revenues 67% of our revenues have a better than average industry price elasticity. 76% have an equal or better than industry average price elasticity. Better elasticities translate into better volume performance. In 2019 the US cigarette market was down 5.6%, Natural America Spirit outperformed the market with 580 basis point, Newport with 310 and Camel Crush with 420 basis points.

Our strong performance amongst smokers between 21 and 30 years old is a further contributing factor to the price resilience of our brand portfolio.

To conclude in the US, despite the market volume decline and because of the strength of our brand portfolio the price resilience of our brands and the strong performance amongst 21 to 30 year old smokers we're confident that we will continue to grow value for Combustibles in the US.

Australia is one of the most regulated tobacco markets in the world. A retail display ban and plain packaging have been in place now for many years. And with prices for a pack of 25s average at £17, cigarette prices in Australia are amongst the highest in the world.

In 2017 we have seen a sharp market volume contraction due to excise tax increases. And over the past three years Combustible duty paid industry volumes have declined at a CAGR of 5%.

But we are performing well; we have a strong portfolio with high equity brands. B&H is the leader in the premium segment, Winfield is the number one brand in the aspirational premium segment and Pall Mall is the leading brand in low. By effective price laddering and by offering superior and differentiated smoking experiences we have grown our share since January 2017 with 360 basis points.

This performance has delivered revenue growth at a CAGR of 6% over the past three years. And Australia shows and demonstrates that also in highly regulated markets we can deliver sustainable revenue growth.

With 77% of consumption in Combustibles and 23 in Tobacco Heating Products, Japan is a true multi-category market. Nicotine industry volumes over the past three years have declined at a CAGR of 3%, with Combustibles declining at 9%.

We are performing well; we have grown our THP share with 64 basis points, our cigarette share with 102 basis points, driven by strong performances of Lucky Strike and Cool. Across the two categories we have grown share with 170 basis points. And this compares with share declines for our two key competitors, with 50 basis and 130 basis respectively.

We have had strong revenue growth over the past three years at a CAGR of 23%. In 2019 the cigarette market declined 8%, in contrast to that we have grown volumes with 7% and revenues with 14%.

Germany is a stable market with Combustible duty paid industry volumes moderately declining at a CAGR of 2%. But Lucky Strike in premium and Pall Mall in the value segment we have a strong and consolidated portfolio of brands. And over the past three years BAT Germany has grown revenue from Combustibles at a CAGR of 9%.

One of the very few growing markets in Europe is Romania, over the past three years Combustible duty paid industry volumes have grown at a CAGR of 3%. And on the back of a very strong brand portfolio, with Dunhill in premium, Kent at mainstream pricing and Pall Mall in the value segment, we're holding close to a 60% share of the market.

Over the past three years we have grown revenues from Combustible with 13%.

Let me now continue with the developing and emerging markets. Over the past seven years the Combustible industry volumes in Russia have been consistently declining as the government progressively increased excise tax on cigarettes. Today the tax incidence on cigarettes is 65%. And this has resulted in market contraction, in the growth of the consumption of illegal cigarettes and market down trading.

As a consequence of this our revenues from Combustible in 2019 were down by 10%.

With excise on cigarettes normalised we expect the outlook for the Russian market to improve. We are well positioned for that. We have had strong share growth driven by our strategic brands in particular by Rothmans.

Due to excise tax changes industry volumes in Pakistan have been fluctuating, net-net and over the past three years Combustible duty paid industry volumes have grown at a CAGR of 7%. We have had strong share growth, driven by the outstanding performance of Pall Mall and today we are holding a category share of close to 75%. Over the past three years Pakistan has grown revenues from Combustibles at a CAGR of 8%.

Nigeria is one of the most important markets in sub-Saharan Africa. Over the past three years Combustible duty paid volumes have been gradually growing at a CAGR of 1.5%. With category leading brands like B&H, Rothmans and Pall Mall we are holding a strong and growing consumer share. Over the past three years we have grown our revenues at a CAGR of 10%.

I would now continue with three other markets, Malaysia, South Africa and Brazil. In these three markets that size of the illegal cigarette segment is very significant. And we are holding shares between 55 and in excess of 75% in South Africa, so reverting illegal cigarettes back into the duty paid market represents a real and significant value opportunity.

Malaysia however is not a great story; total consumption is 20 billion sticks, with 64% of that in illegal cigarettes. As we are the market leader this development mostly impacted BAT. And in 2019 our revenues were down 19%. But things can turn around very quickly.

Which takes me to South Africa, South Africa needs and introduction; there has always been a certain level of illegal cigarettes in the South African market. But things really spiralled out of control, when these traders started building factories in South Africa mainland, manufacturing billions of cigarettes without paying a penny of excise tax.

Total consumption of the South Africa market is 37 billion sticks, half of that is in illegal cigarettes.

A few years back we started a very aggressive campaign to attack illegal cigarettes, Take Back the Tax. And we started getting traction for the issue. So much so that in mid 2019 the illegal manufacturers were forced to raise their prices. At the same time we modernised our brands and we price laddered our brands. And after years of decline in 2019 we are growing volumes again, with Combustible revenue growth of 4%.

Another market that is significantly impacted by illegal cigarettes is Brazil. Total consumption is 116 billion but more than half, 55% to be precise is in illegal cigarettes.

Amid this turmoil we embarked on a very ambitious journey to migrate a brand of local brands to our strategic brands. This journey started in 2009 where we migrated Carlton to Dunhill, that was followed by the migration of Free to Kent in 2017. And in 2019 we migrated another significant local brands, Derby to Kent as well.

And at the same time, we have consolidated our local low price brands into Rothmans. Today our strategic brands have a volume contribution of 72%. We have a much better portfolio with much better equity ready to recapture volume from the illegal cigarette segment.

In 2019 we slowed down the growth of the illegal cigarette market, we slowed down our volume decline and BAT Brazil has grown revenues from Combustible with 6%.

Hidden Gems, are markets that may not necessarily be top of mind. They are smaller in terms of their volume contribution, but they are very profitable. On the chart you see four examples, Sri Lanka, Papua New Guinea, New Zealand and Norway. Year on year on year these markets deliver revenue growth contributing to the Group's results.

So far in my market update I showed you 15 markets, they are all facing their own unique challenges and opportunities. But as I said, they have one important thing in common, in the majority of them we consistently grow revenues, backed by a very strong portfolio of high equity brands.

We will continue to develop and invest our brands for equity and future value by offering winning brands and product experiences enabled by purposeful innovation. Today I will briefly touch on the performance of our strategic brand portfolio.

Together our eight brands represent £53bn in terms of consumer spend, in terms of consumer price turnover. A brand like Pall Mall in terms of consumer spend is comparable to the global spend on a brand like Pepsi, the consumer spend on Kent is comparable to the global spend on Diet Coke, and the spend on Newport is comparable to Cadbury.

Our brands are significant, they are sizable and they are performing well.

We now have eight years of consistent Group volume share growth behind us. And over the past three years since January 2017 we have grown our Group volume share with 70 basis points. This is driven by stellar performance of our strategic brands, which have grown 310 basis points over that same period.

In 2019 we have grown six of our eight strategic brands. And we are growing in the right segments, the megatrend in Combustibles is consideration, non-full flavour, products that offer a more considerate smoking experience, slimmer - products with a circumference thinner than regular king size, and freshness & stimulation, products that offer an exciting flavour experience are all different expressions of consideration.

On the chart you see the share growth of each of these three product segments and our share of that growth. We are punching above our weight by taking more than our fair share of the segment growth.

I will continue with our efficiency agenda, portfolio consolidation, portfolio rationalisation, revenue growth management and resource allocation. BAT has always been a multi-brand company, but it doesn't mean that scale is not important. Back in 2004 and with a volume of 128 billion sticks our strategic brands accounted for 19% of our total volume. Today the strategic brands' volume contribution is 64% and our ambition for the next few years is to take it significantly beyond that.

And we will do this as follows, we will continue to organically grow our strategic brands and where opportune - migrate local brands to one of our strategic brands.

Secondly, for some of our local brands we adopted the shadowing concept, meaning that we take the brand mix of a strategic brand and apply that very same mix to a local brand to make the management of these brands simpler and more effective. We will go a lot further in this than what we have done so far.

And finally there will always be a tail of local brands that cannot be migrated for whatever reason. For these brands we will develop a common strategy, a range of standardised brand and product expressions, again to make the management of these brands simpler and more efficient.

Over the past few years we have significantly reduced the complexity of our business by reducing our SKU count by 10%.

In 2019 we agreed to make a real step change in complexity reduction, with a further SKU count reduction of 25% from the basis of quarter two 2019. Now this will have many benefits across our primary and secondary supply chains. But most importantly and at retail it will create a space for expanding our new category assortments.

And we design our SKUs to a margin, the principle is simply - we developed a framework of flexible brand standards, allowing high margin markets to adopt a high end product spec, giving low margin markets the flexibility to go for a lower end product spec, this all within clearly defined quality standards and parameters.

In a mature category like Combustible revenue growth management is absolutely key. It is about building a digitally enabled, analytics and insights capability to execute pricing as effectively as possible, to optimise assortments and trade investments. Over the next 18 months we will progressively build this capability in our high value markets.

I talked about the importance of the three product segments, non-full flavour, slimmer and freshness & stimulation. In 2019 88% of our new brand launches were against these three product segments. By better

focusing, by better targeting, we reduced the number of new brand launches since 2016 with 60%. But we are achieving better results.

We call a new brand launch successful if it achieves half a point of share within 12 months' time. Historically our success rate was 26%, but in 2019, and with a success rate of 56% we're setting a new industry standard.

Altogether the new brands launches contributed 1.4 percentage points to our Group volume share, representing £700m in terms of revenues, which is 70% of our revenue growth.

The objective of our efficiency agenda is to improve the revenue to gross margin conversion. On the chart you see the progression of revenues and gross margins for our strategic brands since 2017, with 2017 indexed at 100.

We have grown revenues at a CAGR of 5.2%, but more importantly gross margins ahead of that at a CAGR of 8.7%. By further consolidating our portfolio, by rationalising the tail of our portfolio, through our framework of flexible brand standards, the revenue growth management capability we are building, and through focused and prioritised resource allocation we will confident that we will continue to grow gross margins ahead of revenues.

That takes me to the end of my presentation and let me summarise. Over the past three years industry volumes have declined at a CAGR of 3.6%, revenues however have grown at 1.1%. We have grown revenues at a CAGR of 2.8%, but with further momentum in 2019 when we grew revenues with 4.6%.

For the next few years we have a few very simple priorities. Our objective is to drive for sustainable revenue growth with continued volume share and value share growth. We will continue to develop and invest in our brands for equity and future value. And this is underpinned by a hard drive for efficiencies. Thanks very much, thanks for listening and let me hand over to Marina, thank you.

Marina Bellini, Director, Information & Digital

Thank you Chris. Good morning, good afternoon. I am Marina Bellini Information & Digital Director, Chief Information & Digital Officer, in the Group since 2018, with over 20 years' experience working across the globe, with AB InBev, PepsiCo and PwC.

Leading the digital agenda for BAT over the past two years has been very rewarding, because strong results are being delivered and the opportunities ahead of us are also big while leveraging technologies in our business to deliver exponential value.

In our strategy, digital plays a key role in strengthening many capabilities across the organisation, such as insights, consumer brands, innovation, and connecting ourselves internally and externally in an agile way.

Our approach to digital is to apply new technologies to existing and new business processes to accelerate our results. Key principles we follow in this path are - digital being applied across the enterprise, big focus on consumer marketing and also way beyond it, in the entire value chain of BAT.

Technology is a key enabler, and its exponential value comes to fruition when the organisation has the skills, ways of working and culture of how to exploit it. Data and analytics is centre to how we manage technology in the Group, continuously challenging ourselves to bring automation, insights and foresights to drive sharper and differentiated decision making inputs to our managers.

The story I am excited to share with you is the following. Digital has delivered in 2019, we are for sure not an old dinosaur as sometimes people see the tobacco industry, here technology has been applied in a meaningful and modern way and brought results to BAT.

We know how to drive change, this has started and is accelerating at pace. The Group's priorities of Combustible value growth, step change in New Categories and simplification of the company are powered by new technologies.

We have an ambitious plan and are on track to achieve it and this is and will always be done guaranteeing a stable and efficient and secure technology stack building on our strong foundations, addressing GDPR, cyber and overall compliance requirements such as TPD, SOX and others.

In 2019 strong results were delivered in BAT leveraging digital. Over 25 million consumers of which 7 million on New Categories that we have in our database and we are communicating with on their journey of migrating to and engaging with reduced risk products.

Our 88,000 farmers and almost 700 tobacco leaf technicians are supported by a mobile solution that allows us to have crop yield estimation, track sustainability metrics, transact contracts all real time, bringing efficiency and accuracy to the process.

£0.5 billion of packaging materials inventory is constantly optimised enabled by advanced analytics tools, it has allowed for 5% reduction of this working capital item.

Through robotics, analytics, several new technologies and external partnerships we've delivered over £40m in efficiencies in shared services and IT. While launching a digital expertise programme that has already covered over 1,000 senior managers.

Strong resources and plans were put in place behind strengthening the technology and digital team - and we have skilled resources in our markets and in four tech hubs in Poland, Malaysia, Mexico and the US. And we are setting up our innovation labs in San Francisco, London, and Tel Aviv and to further develop external partnerships that can accelerate our journey building a better tomorrow.

With the new employer proposition, BAT's purpose and vision and our Digital transformation plans we were able to hire over 100 people from top companies of many different industries such as pharma, big tech, fintech, FMCG. While improving on the diversity of our teams, with over 30% women, almost 60 nationalities and people with very diverse professional experiences in BAT and from outside.

Key skills are being enhanced in the Group such as design thinking, disruptive technology and data science through training and on the job learning. And it is not only about skilling up our people, but also building

strong partnerships that bring experience and value to the Group at speed with companies such as McLaren and Salesforce.

To deliver digital transformation at scale in the Group our strategy is, first, to drive processes to be data centric, one using multiple data sources and AI for a better informed pricing approach in Australia, with micro segmentation with discounting and portfolio defined at store level.

Another example using more and more real time insights with social media, e-commerce, traditional and new methods of consumer research and other data sources brought together to improve consumer engagement in the UK, Italy and Japan. In Japan the engagement rate is up by 21%.

Then we've trained the organisation to use agile methodology and leverage technology solutions globally and allow for the local differentiation that brings competitive advantage at speed.

One example is that we have over 10,000 trade reps worldwide in a single global technology platform that all leverage on a daily basis and gets activated by each market with the components that matters by differentiating the solutions that helps them win in each marketplace.

Also another case, we have 6 million New Category consumer records in a global consumer relationship management platform, deployed at speed in 19 markets, with solutions in different channels in line with each market opportunity, regulation and experience, in countries such as Japan, US, UK. And using these records we have sent over 90 million personalised messages last year.

Third, our strategy pulls value from a structured innovation process, connecting many new external partners, big tech, entrepreneurs, VCs, to deliver a solution like we are piloting in Chile, Mexico, South Africa and Brazil to have an Uber like network to deliver to our trade partners, reducing logistics costs potentially by 5 to 30% and achieving greater than 99% delivery on time.

A great case also, driving consumer research not on an eight month time frame, but eight weeks as we just did in the US and Japan for new actives.

And in innovating solutions on age gating, they have been piloting and are looking very promising for retail and e-commerce.

Last we are embedding digital in BAT's DNA, specific training for marketers, technologists, HR, Legal, Finance people in digital market. Digital immersion programmes for our senior leadership. And squads, mission based teams in Canada, Mexico and Japan, successfully delivering on New Categories growth.

Supporting our Combustible value growth priority, we improved our B2B revenue 5x in 2019, freeing up costs and time from our sales team to support higher performance of our trade partners.

We've created analytics models as part of the plan to fight illicit trade in Brazil and were able to bring back to the duty paid part of the market 1.8 billion sticks.

We are now investing to continue to grow our B2B channel and better serve our trade partners, leverage our global trade platform that enables multi-channel and multi-category route-to-market.

And continue expanding analytics and execution solution to support micro segmentation to price and portfolio manage our offers.

Digital has been critical to the acceleration of New Categories, in 2019 we grew by 3.5 times our followers in social media, we achieved 7 million consumers of New Categories in our database that we engage regularly with. And, moving forward, we will continue to deliver on the growth via direct to consumer e-commerce sales improving margin, experience and services.

We are going to grow the consumer database and the personalisation of messages with each one of them to continue to expand their understating and engagement with the non-combustibles products.

And, as it is just happening today in Oxford Street here in London, our BAT Vapour retail stores will offer a unique shopping experience connecting all consumer touchpoints.

Delivering on the priority of simplifying BAT was achieved through changes in organisation and process as mentioned before by my colleagues, and also by exploitation of technology at scale. Automating back-office process and achieving in billing, pricing and some other activities up to 90% reduction in processing time and reducing by circa 30% energy consumption of our data centres.

With higher complexity in our supply chain, given the increased portfolio in New Categories, concurrent planning is coming live in Australia, Brazil, Japan and the UK this year that allows for a more responsive and flexible operation. Leveraging IoT in our tobacco leaf operations will bring speed and a more precise quality differentiation. And increasing the number of bots in our organisation will further deliver efficiencies to the Group.

We are on track to deliver on our ambitious plans to be amongst the most technology enabled FMCGs. We aim to have 25 million New Categories consumers in our database that we engage with in an individual way. We will have personalised products as we grow in understanding of individual preferences and can customise accordingly.

We aim to have almost zero-touch factories, running at maximum efficiency and flexibility. And a workforce that focuses on value-added activities and a bot workforce that delivers on the transactional and repetitive tasks.

We will be top quartile on cyber security, top quartile on digital quotient. We are going to be not only amongst the best companies to work for overall, as we are already today, but also the best companies to work for millennials and gen Zs.

We will be amongst the most tech enabled FMCGs globally.

This is an exciting story of digital having delivered in 2019, an organisation that knows how to drive change and leverage technology at scale, supporting our priorities and delivering against our very ambitious plans.

Now I will hand over to Jack for closing remarks. Thank you.

Jack Bowles, Chief Executive

Thank you Marina.

So we have covered a lot of ground today and I am sure you will agree with me that our foundations are strong. As I said in my opening presentation we are very fortunate that ours is a business that is one of the most resilient in these difficult times.

The welfare of our employees and our stakeholders remains our priority. However, despite the challenges we are all facing due to the Coronavirus pandemic to date we have seen no material impact on our business.

Today we have shown you that we are resilient and have consistently delivered against our financial guidance and we delivered again in 2019.

And, while we do not know what the future may hold at present we are maintaining our guidance for 2020, with 3 to 5% revenue growth, high single figure EPS growth and continue to de-leverage the balance sheet.

We have an ambition to build a better tomorrow by reducing the health impact of our business through offering a greater choice of enjoyable and less risky products to our consumers.

Our strategy is clear and we know where and how to win. And we are building capabilities across the organisation that we need to support our growth.

As an organisation that is bold, fast, empowered, diverse and responsible, we have the right culture to accelerate our delivery.

The strategy I have outlined today underpins our confidence to continue delivering revenue growth of 3 to 5%, with £1bn of savings and efficiencies over the next three years. This allows us to deliver on our financial commitment, make substantial further investments in the growth of our New Category business and continue to deliver the deleveraging of balance sheet, while also delivering on our stretching new ESG ambitions.

In summary we are a resilient business and remain very confident in our ability to deliver on our commitment to high single figure EPS growth into the future.

Thank you and I will now open for questions.

Telephone Operator

If you do wish to ask your question, please press '01' on your telephone keypad. If you wish to withdraw at any point, you may do so by pressing '02' to cancel. But, once again, it is '01' on our telephone keypads if you would like to register for any questions.

And our first question comes from the line of Nico Von Stackelberg from Liberum. Please go ahead. Your line is open.

Nico Von Stackelberg, Analyst, Liberum

Hi, everyone. Thanks for the question. I just wanted to ask what pricing in some of your key markets - so, now, last year was a very strong year with pricing, price mix of 9%, can you tell me a little bit more about where the pricing will come from this year and how you see the geographic mix playing into this? Thanks.

Jack Bowles, Chief Executive Officer

Yes. Thank you very much for your question.

I think what's very important to realise is that the springboard that we have coming out of 2019 is a very strong one. That gives us the ability to deliver on our numbers for the year. Yet, of course, there is the Coronavirus, which is going to be an unknown as we go along, but, yet, to date, we didn't see any major impact on our business moving forward.

So, I think that this is going to be the biggest impact, the biggest risk, but we are a very resilient industry and we are very successful company in that industry.

Nico Von Stackelberg, Analyst, Liberum

Okay. Thank you.

And my next question is on Next Generation products. I'm just wondering, can you tell me what percent is repeat purchase versus how much is merely pipeline fill, or how do you break that down internally? And can you put some numbers around it, please?

Jack Bowles, Chief Executive

Yeah. Thank you very much.

What's important is that most of our volume is not related to pipeline filling because we had very little launches at the end of the year.

So, most of our volume is effectively genuine volumes coming through because, as you saw in the presentation of Paul Lageweg, we have an acceleration in terms of share, both in the three categories, and that will continue in the months to come.

What we see very clearly is a very strong springboard in Q4, and that will continue to help us for delivering our numbers for 2020.

Nico Von Stackelberg, Analyst, Liberum

Excellent. Final question, please. On the Beyond Nicotine category, so I assume it's something around cannabis, CBD, eutrophics and so forth, but could you just tell me a little bit more about which segments you find economically attractive?

So, I've seen a number of heavyweights in the industry, you know, really suffering recently. I really question the economics of some of these categories. Can you give us a bit more confidence that some of these categories will prove profitable and attractive for shareholders in the long run?

Jack Bowles, Chief Executive

Yes. First of all, what you have to remember is that we have three categories today, and these three categories are going very well. We grew by 32% last year.

Now, we have still a lot of ground to cover and a lot of space for growth and a lot of potential in these three categories as they exist today.

But, nonetheless, we are going to go further and, beyond that, on the mid-term, long-term, so we have time for that.

First, what is very important is to have the right scientific understanding coupled with our consumer insights that we have across the three categories. And then, as we said during the presentations, it is going to be first focusing on the different platforms of delivery that we have. And that makes absolute sense for us. We don't want to spread ourselves thin. What we want to do is to build from strong foundations with a very clear framed approach in terms of science in order to make sure that we are successful. So, that's for the long-term.

Nico Von Stackelberg, Analyst, Liberum

Okay. Thank you, Jack

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. Our next question comes from the line of Owen Bennett from Jefferies. Please go ahead. Your line is open.

Owen Bennett, Analyst, Jefferies

Afternoon, all. A couple of questions, please. Firstly, on the vape performance, there was no mention of iSwitch. I was hoping maybe you could comment on what's happening with this product and the future plans.

And then, secondly, you've spoken about the improvement driven in Japan by Pro and Nano, I was just wondering when can we expect these to be rolled out beyond Japan? Thank you.

Jack Bowles, Chief Executive

Yeah. So, the first question, as Paul said in his presentation, what we're doing is we are refocusing our portfolio in terms of number of SKUs, but also in terms of number of devices. What we have for the time being is two very successful ones that are ePen 3 and Alto.

We are successful, extremely successful with these two platforms, and certainly very successful in the US. So, we'll continue to push on these platforms. What is important is that we have the focus related to the different platforms.

And the second question was, sorry?

Owen Bennett, Analyst, Jefferies

Just on the improvement driven in Japan by Pro and Nano. I was just wondering when they may be rolled out beyond Japan

Jack Bowles, Chief Executive

Yes. It's a very good question.

What we do always is we, I would say, concept-proof the launches that we have, and we've done that in Japan. These two platforms are working very well for the reasons explained by Paul during the presentation. And, gradually, looking at resource allocation, and looking at MAPS, and looking at the consumers, we'll expand these launches through the year.

What is very important to us is the new launch that we're going to have in the next few weeks, and that is going to be extremely important for us because it has 30% more tobacco and it has also a boost button and it has also a larger heating surface that allows us to put more tobacco and to have more flavour coming out of it, thus increasing the satisfaction to the consumer.

We had some gaps, and we are going to continue to push on that, and we're closing the gaps.

Owen Bennett, Analyst, Jefferies

Cool. Thanks, Jack. Appreciate it.

Jack Bowles, Chief Executive

Thank you very much.

Telephone Operator

Thank you. The next question comes from the line of Sanath Sudarsan from Morgan Stanley. Please go ahead. The line is open.

Sanath Sudarsan, Analyst, Morgan Stanley

Thanks very much. Thanks for the presentation today. Very insightful. Can I ask two quick questions, please?

One, can you please help me understand better the level of migration of current smokers to NGP? You have set a target of about 50 million consumers in a decade. How bigger share of the NGP market do you expect this to be, and where is the category sourcing consumers from, in your view? That's question number one.

And question number two, can you give us much more insight on the level of pricing power you still have in many of these markets given, you know, from the data you've shown on combustibles, pricing has remained

very strong across even the job market, so longer term, over the next five, ten years, how do you see the pricing power evolve? Thank you.

Jack Bowles, Chief Executive

Yeah, I mean, first of all, I don't have a crystal ball, but what we see is that there is a strong pricing that has happened in 2019. What we see at the beginning of the year, with 65% of our pricing that was planned, that went through. It means that there is pricing opportunities moving forward.

The second element is what Chris Sijtsma spoke about, which is the fact that our pricing elasticity numbers are very good, especially in the US, and it gives us a lot of space to grow. At the end of the day, what is important is the other question of the pricing and the speed at which the pricing is taken, and, at the same time, the affordability to the consumers.

So, I think that we're in a good position looking forward, but it's very difficult to plan further and beyond the two years to come.

The first question was, sorry?

Sanath Sudarsan, Analyst, Morgan Stanley

So, in terms of your NGP number you set out for addicted beyond being near 15 million consumers, so how big a share of the consumers of NGP do you expect that to be, and where do you expect to source these consumers into the market? Are they coming from smoking, are these new consumers? How do you think that evolves?

Jack Bowles, Chief Executive

Yes. First of all, mostly they will come from smokers. What we said is we want to have a health footprint that is reduced and that will give us a more sustainable and a more, I would say, dynamic company. So, that's the first point.

The second point is the migration will happen gradually. You know, we thought two years ago that there will be one category. That's what the industry thought. Now we know that there are three categories. We thought that the consumer was a bit monolithic. You saw through Paul's presentation that it's a very dynamic environment with a lot of consumers.

Our insights are telling us much more, but we know that these categories will continue to evolve. Why? Consumer acceptance, two satisfaction, but also regulation and price and excise.

So these three categories will develop differently as we go along. What is important is because we have a portfolio of three categories. We are more immune in a way to the developments that are coming, and we will be making sure because we have an agile organisation, agile ways of planning our business, and a very strong new organisation with new capabilities. We will be able to navigate better on these developments of these different categories.

We want to have the 50 million consumers because this is important to us.

Sanath Sudarsan, Analyst, Morgan Stanley

Sorry, Jack. Just to follow up on that, so those two questions together, so much do you think price could be a variable pushing consumers out of smoking into NGP, so accelerating that shift?

Jack Bowles, Chief Executive

Yeah, I think you have to come back to Chris Sijtsma's presentation on that one which is you saw, for instance, in Australia, where the prices are very high - average prices around £17 - the consumers are reducing in number but the value of the market is increasing.

What I'm interested in, and that's what I said in the three priorities I outlined one year ago, is that on Combustibles, I'm going after value. I don't want to lose my shirt, of course in terms of share, and we grew share last year, but the most important is the value. And I think that there is still a lot of space in terms of pricing for the future.

Sanath Sudarsan, Analyst, Morgan Stanley

Thank you very much.

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. The next question comes from the line of Jonathan Leinster from Societe Generale. Please go ahead. Your line is open.

Jonathan Leinster, Analyst, Societe Generale

Thank you very much. Good afternoon, gentlemen. A couple of questions, if I may.

The first one, with regard to the Modern Oral segment, as a sort of industry leader on that, particularly in Europe, when you talk to regulators about this market, what are their concerns regarding Modern Oral and what are you looking for in terms of the sort of regulatory outlook for that segment?

Jack Bowles, Chief Executive

I think it's a very good question, and a very fundamental question. What we want to have, as we said last year, is a clear regulatory framework in each of these different categories. That Modern Oral category is developing very fast, yet we are trying to follow systematically with the regulatory framework that is discussed and engaged with the different governments in the different countries in order to make sure that we're on the right side of the regulatory framework. To ensure, as we do a lot in terms of science, to ensure the quality of our products, and that the overall competitive environment is not only a level playing field but also, I would say, a secure environment for our consumers.

So, we go step-by-step, yet, at the same time, Modern Oral, as was said, is a very good way of recapturing consumer moments - for the consumers in the different countries. That gives us the possibility to expand

quite fast. And, by the way, we have no limitations at the moment in terms of capacity of production. We have patents, we have good products, and we'll continue to deliver these good products.

As Paul said, we are starting to sell in airlines, and that's a very good sign in terms of the potential expansion of the different categories.

Jonathan Leinster, Analyst, Societe Generale

Okay, thanks.

And, secondly, on the Heated, just to be clear on the Heated Tobacco segment, you seemed to indicate that the focus this year outside of Japan was going to be very much on Eastern Europe rather than Western Europe. Is that broadly correct? Is Western Europe relegated to a relatively minor role because it's a high tar market?

Jack Bowles, Chief Executive

I would answer that question first by saying that it's a quite sensitive competitive information that you're asking me, so I'm not going to answer directly your question. But the second thing is I think that we have some launches that are going to happen this year in H1. We had some launches that have happened in Quarter 4 last year. We are taking the learnings because we have insights on the four categories, and we'll continue to expand our footprint in the right way moving forward.

Jonathan Leinster, Analyst, Societe Generale

Okay. Thank you very much.

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. The next question comes from the line of Alicia Forry from Investec. Please go ahead. Your line is open.

Alicia Forry, Analyst, Investec

Hi. Good afternoon, Jack. Two questions from me. One on the Vapour product consolidation. I'm curious why you've chosen to consolidate behind the VUSE brand. You put up a lot of charts showing how Vype has outperformed a bit more strongly in Europe than VUSE have in North America. Perhaps if you could discuss that?

And, also, it seems like consumers of these products are quite fragmented and everyone wants something different from it, so can you explain how one, you know, brand umbrella can really satisfy all of these various needs of the consumer, please?

Jack Bowles, Chief Executive

Let me start with this one.

Alicia Forry, Analyst, Investec

Yes, of course.

Jack Bowles, Chief Executive

Okay. So, first, thank you very much.

First of all, Vapour, very important. It was an extremely fragmented market. Now it is consolidating. So, we have more focus on the one major brand, and we took the decision of that brand against that one because we knew that the different capabilities that we have related to that brand, the consumer resonance, and the way we can market in the different markets, allowed us to take that brand, which is VUSE, and to put it everywhere.

At the same time, what we're going to do is to reduce the number of SKUs, to reduce the number of flavours that we have, and have a more consequent approach in terms of the financials and a more radical approach in terms of concentration.

Alicia Forry, Analyst, Investec

Okay. Thank you.

And on menthol, we haven't touched too much on it here today, but it does seem to be under a lot of attack from various legislative bodies at varying levels of the government in the US. If we assume that this pressure on the segment continues, and possibly could even worsen, what is BAT's strategy for the possibility of transitioning to a menthol-free US market in the future? What can you say about your preparations for that possibility?

Jack Bowles, Chief Executive

Yeah. Thank you very much. A very good question.

It is true that menthol has been a bit off the agenda recently. It has been very high on the agenda in the last two years. Nonetheless, nothing has changed. Why? Because there is no scientific evidence that makes any difference at the moment. There is no piece of information that says that it is going to go further in terms of scientific evidence.

We do strongly believe that menthol should be in the market, and we see in the US that, even for Vapour products, you are still allowed to use menthol products.

First, you have to remember that, even for Combustible business, first of all, consumers are smokers. Secondly, they are using a brand, and they are very proud and they're very happy to use this brand. And, thirdly, we have the strongest cohort in terms of the beyond 21-years-old in terms of menthol. So, I think that we have an extremely good resilience.

There are markets, as you asked the question, there are markets where a menthol ban has already happened, like, for instance, Canada. What has happened in Canada in 2017? Menthol was banned. What happened? Retention was 98%, and the consumers continued to use their own brands that they liked and enjoyed.

So, I think that there is a lot of experience in BAT in how to tackle these new environments, but also I don't think that the risk is extremely high at the moment in terms of the US.

In terms of Europe, you will have a menthol ban during the summer, and we are very well-prepared in order to go through and to come out stronger out of that menthol ban.

Alicia Forry, Analyst, Investec

Thank you.

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. Our next question comes from the line of Gaurav Jain from Barclays. Please go ahead. Your line is open.

Gaurav Jain, Analyst, Barclays

Hello. Thank you. I have three questions.

So, question one is that some of the consumers' stable categories, such as food products and hygiene products, have seen a huge amount of pantry loading right now. Now, this has led to a question whether consumers are taking money out of some other categories, such as tobacco, and whether consumers are down-trading. So, can you please talk about what's happening in the US as well as also in Italy and Spain? That's my question one.

Jack Bowles, Chief Executive

Okay. Let's start with that one, if I may.

First of all, what's important is that we don't see any change in terms of patterns of consumption recently. Why? Because cigarettes do the opposite of a lot of other categories, is a daily purchase. So consumers continue to go to the shops. And, even in Italy and in France, you still have the tobacconists that are open and consumers can continue to supply.

So, we don't see important stockage or building stocks from the consumers, it is much more the daily consumption that is happening, and that is continuing to happen.

We didn't see any changes in the last two months in terms of that pattern.

Gaurav Jain, Analyst, Barclays

Sure. That's very, very helpful.

Question number two is you heard yesterday that they have passed the rule on graphic warnings on cigarette packs in the US, and this has to be implemented by next year. How do you think this will impact your business over the next three to five years?

Jack Bowles, Chief Executive

I didn't hear your question. Is it about the health warning in the US?

Gaurav Jain, Analyst, Barclays

Yes. The graphic health warnings on cigarette packs in the US. How does that impact your business?

Jack Bowles, Chief Executive

Our position has always been the same. We are supporting of regulation, yet that regulation has to be balanced regulation. So, first of all, we have to see the content, and we are in close contact with the regulators in order to make sure that we have a voice at the table in order to make sure that that regulatory framework is balanced.

So, we'll take the opportunities are we go along, as you said. That's going to be for the mid of 2021.

Gaurav Jain, Analyst, Barclays

Sure. And, last question, and this is for Tadeu, you know, one of the initiatives earlier this year was that you will drive working capital savings through better inventory management. And I think you mentioned during a discussion on Coronavirus that you are building up stocks, so do you think that inventory management initiative will get pushed out?

Tadeu Marroco, Finance Director

Yeah, I quoted that as one of many that we are doing in order to manage working capital, and it's not just about working capital, it's about capex as well. Remember that we made this commitment to reduce the capex to the level of depreciation.

We see this as temporary measure. It's difficult to predict now exactly how long this will take. At the end, we do not expect to have a major impact in terms of working capital and in our numbers.

We proved in the last two years that we have a very cash generative company in terms of free cash flow, and our levels of conversion are very high, in 90s plus. So, we don't expect to be any different this year compared with the previous one, although, in the next coming months, probably you'll have some drag coming from the working capital which, overall, shouldn't be a big weight for the position of the Group.

Gaurav Jain, Analyst, Barclays

Thank you.

Telephone Operator

Thank you. The next question comes from the line of Vivien Azer from Cowen. Please go ahead. Your line is now open.

Vivien Azer, Analyst, Cowen

Thank you. Good afternoon. Two questions from me, please.

The first on glo Hybrid. How are you guys thinking about pricing both on the device and the consumables? Will they be priced at a premium or parity to the legacy products? Thanks.

Jack Bowles, Chief Executive

You're speaking about Hybrid?

Vivien Azer, Analyst, Cowen

Yes, please.

Jack Bowles, Chief Executive

Yes. So, I mean, these are things that - It is exactly the model that I spoke about. We launch something in the market because we've seen an opportunity. We do believe that Hybrid, in specific markets, because of regulatory frameworks, is an interesting concept for the consumer.

We have done a lot of research on it, post, prior and during the launch, and we know, as Paul said in his presentation, that there are a lot of things that we can improve. So, that's a unknown category that we're discovering as we speak. We are the ones that are pioneering in that category, and we'll continue to do so, and we'll take the learnings and continue to expand.

Vivien Azer, Analyst, Cowen

Sorry, and I apologise if I'm misunderstanding something, it sounds like this is, you know, a new device. It's certainly a bigger, different consumable with 30% more tobacco, and so I'm just trying to understand would this product be priced at a premium to the legacy glo products that are in market, or would it be priced on par?

Jack Bowles, Chief Executive Officer

Are you not confusing - I'm not sure, I'm trying to understand the question, are you speaking about the Hyper or hybrid?

Vivien Azer, Analyst, Cowen

Sorry, no, I apologise if I'm mischaracterising it, but let me just more clear. You've got some consumables and now you have these new consumables that have 30% more tobacco. Will it be priced the same or would the large consumables with 30% more tobacco be priced at a premium?

Jack Bowles, Chief Executive

Thank you. So, you're referring to Hyper.

Okay, thank you very much.

Vivien Azer, Analyst, Cowen

Oh, I'm sorry.

Jack Bowles, Chief Executive

No, no. No problem. No problem.

So, this is the consumable and the device that we're going to launch in a few weeks from now. I think this one is a very important one in our portfolio in terms of THP. Why? Because we know that the satisfaction index, and we can refer to the chart that was in Paul's presentation, the satisfaction index is extremely important, and we know that, with the current products that are in the market at the moment, there is a gap in terms of satisfaction in all the markets that are not low-tar.

So, what we've developed is a product where the consumable is bigger and thicker, closer to the format of a normal cigarette, first point.

The second point is it has 30% more tobacco, which allows you to give more flavour to the consumers with the risk reduced product.

And, thirdly, there is more heating surface around the stick that allows you to heat better, the tobacco, and to get the satisfaction to the consumer.

And, lastly, there is a boost button on that device. So, that should increase your level of satisfaction and the delivery to the consumer. So, this is a breakthrough that we're going to launch in the next few years.

In terms of pricing, it will be depend on the different market situations. In Asia, and in the rest of the world, in order to make sure that we have the best equation and the best trial levels for the consumers.

Vivien Azer, Analyst, Cowen

Okay. That's fine. Thank you very much.

As you think about the US marketplace, clearly, you know, your market share performance in 2019 was really quite healthy, and I appreciate your comments on price elasticity, but as you kind of think about the outlook for the US, or certainly been, you know, some alarming predictions around unemployment could come given COVID and, you know, the lockdowns that are happening in key cities, so how have you guys thought about the evolution of price elasticity to the extent that the macro landscape in the US deteriorates pretty meaningfully. Thanks.

Jack Bowles, Chief Executive

Yes. First of all, I think the important first point is that we see our situation, or our position in the US as extremely strong. We have the strongest brands, we have the strongest development in terms of the different

categories that we operate in, and we have a better price elasticity, coefficient than others. Our portfolio is extremely strong.

As you said, our share is good, and our value share is increasing quite significantly. So, it will continue to go in the same direction.

What we see now, looking at moving forward, is the first two months of the year - the market has been 1% better than the same period last year, which is a good indication for the beginning of the year of the health of the industry in the US.

Vivien Azer, Analyst, Cowen

Thank you very much.

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. Our next question comes from the line of Michael Lavery from Piper Jaffray. Please go ahead. The line is open.

Jeff Kratky, Analyst, Piper Jaffray

I'm in for Michael. Thank you.

So, beyond nicotine, would we understand correctly that cannabis and hemp are under consideration? And, for any non-nicotine push, do you expect to use M&A or launch products organically?

Jack Bowles, Chief Executive

Okay. So, there are two things. One is, in terms of products for that Next Generation of products, we're looking at a variety of different stimulants. The list is long. And we are reviewing them all at the moment. And we're doing all the assessments that we need to do in the frame that we spoke about earlier in the presentation.

What we have to make sure is that we understand the different factors related to the launches, and we have to make sure that this is health... beneficial to our consumers moving forward.

So, we'll review in time, and that's for mid-term to long-term, further and beyond what we have at the moment in the market.

Tadeu Marroco, Finance Director

Can I just comment on the M&A side? We are not expecting to do any type of major acquisition in that space. We rather prefer to use our newly created corporate venture entity, exactly to explore partnerships and joint ventures that would be interesting for us to develop the capabilities that we need to in that new space.

Jack Bowles, Chief Executive

You know, I mean, I think it's a very important point that you're raising.

In the future, you will see more and more partnerships with other companies in terms of either IP or technology or processes, and what we want to do is to own as much as possible the end-to-end in terms of the development and the launches of these products, supported by third parties.

I think it is very important to us to own our future and to be able to leverage in the future.

Jeff Kratky, Analyst, Piper Jaffray

Got it. That is a really helpful comment thank you. And just a quick follow-up on M&A - You mentioned it as a strength in part of your strategy, what level of leverage would you need to consider another large deal? Would that only be after going below 3x in 2021?

Tadeu Marroco, Finance Director

Yeah. We have fully committed, like I said several times in the past, to deleverage of the company at this point in time.

We don't envisage any substantial M&A coming forwards in the next short term or medium term.

We want to now focus on our corporate venture capital because, to be honest, if you see what's happening in terms of M&A in that space, they haven't been very successful, independent of our current position. We think that we'll be better off leveraging the capabilities that we are building through the corporate venture, and, like Jack said, trying to explore potential joint ventures and partnerships in the future. I think that will be much more effective and efficient for us.

Jeff Kratky, Analyst, Piper Jaffray

Great. Thank you very much. I'll pass it on.

Jack Bowles, Chief Executive

Thank you.

Telephone Operator

Thank you. Our next question comes from the line of Priya Ohri-Gupta, from Barclays. Go ahead. Your line is now open.

Priya Ohri-Gupta, Analyst, Barclays

Good afternoon.

I was hoping that you could further build on some of your comments around actions you highlighted that are specific to the short term, sort of COVID-19 response. For example, could you tell us a little bit about the tighter cash control measures that you're implementing?

And then, given some of the seasonal cash flow needs that you typically experience in the first half of the year, particularly around like MSA payments, do you anticipate having to need accessing any of the credit lines you have available to improve your liquidity position, even if it's out of an abundance of caution at this point? Thank you.

Tadeu Marroco, Finance Director

Yes. Thank you for the question.

Some comments on that. In 2019, we refunded in order to reduce our exposure of 2020. So the other point that is important is that we have already proven over the last two years that we are able to generate almost £2bn in terms of free cash flow after dividends, and most of it had been used to pay down debt.

So, our debt and our bonds and bank maturities is adding up to £4.3bn now in 2020. We expect some debt being paid down, like we did in the previous two years, with the free cash flow that we generate.

And we have been active in terms of CP markets in the euro and the US dollar, and we have just renewed our new RCF 6bn tranche, which is a liquidity backstop with a syndicate of 21 banks. They are very solid and diverse banks. There is no financial covenants around those. We are pretty sure that we can have access to them at any time.

There is no reason for us to do a pre-emptive movement at this time.

Priya Ohri-Gupta, Analyst, Barclays

Right. Thank you so much.

Telephone Operator

Thank you. Our last question comes from the line of Nico Von Stackelberg from Liberum. Please go ahead. The line is open.

Nico Von Stackelberg, Analyst, Liberum

Hi there. Thanks again for the question. I have a follow-up.

I hear from rumours that there might be a EUTPD 3. Do you know what's in scope or have you had any conversations around EUTPD 3? Is there anything worth noting there in terms of closed systems?

And I have one more question, thanks.

Jack Bowles, Chief Executive

Yeah, there are always rumours, yet, at the end of the day, facts matter more than rumours, and we don't see anything at this stage.

There might be some adaptations in terms of regulations. I think that we've always said regulatory framework is extremely important, and if that regulatory framework makes sense for the consumer moving forward then we will be interested in this.

First, let's start with TPD that is going to happen soon, and we're well-prepared for that, and we'll make sure that we take the benefit of that change in the regulation because we want to be a successful company, and we are successful company.

Nico Von Stackelberg, Analyst, Liberum

Okay. Great. And then I want to ask about menthol cigarettes, and I'm going to sort of use your question to understand what might happen in the US if menthol cigarettes are banned at a federal level. Can you tell me about what you're doing currently Europe on the menthol ban here? What are some of the learnings that you had for your Canadian experience? So what are you doing differently versus Canada over here in Europe, and is there any of it really apply in the US or is it just such a different market?

Jack Bowles, Chief Executive

Right. Thank you very much. It's a very good question, and it's going to happen in a few months. I understand the concern and the interest.

Let me tell you, we're very well-prepared for it. We know how to navigate these kind of changes of regulatory framework, and we know how to adapt our portfolio as we go along in order to make sure that we continue to grow value share, and that we continue to grow market share.

What's important to us is serving the consumers in the right way, having strong brands and continuing to deliver our business moving forward.

Nico Von Stackelberg, Analyst, Liberum

Okay. Thank you, guys. Take care.

Jack Bowles, Chief Executive

Thank you very much.

Tadeu Marroco, Finance Director

Thank you.

Jack Bowles, Chief Executive

So, I think it was the last question, so thank you very much. I know it has been a long day. It's an unusual format for this day. We've tried to make it as clear for you in terms of where do we want to be and how do we want to evolve the company, but let me recap a little bit.

First of all, we started the year very well.

The second thing is we are very resilient company in a very resilient industry. We have a very clear strategy in terms of growth moving forward. We even gave ourselves some ambition for 2030, because you need to have visibility and navigation. 50 million of non-combustible product consumers. Carbon neutrality.

And also, as Tadeu has demonstrated during his presentation, we want to deliver on the financial side of our business further and beyond growing share and growing value share.

We are confident in high single figure EPS growth for 2020.

We are building a better tomorrow, which is a company with a purpose, a company with a direction and a company that has delivered not only in 2019 but that will deliver in 2020 and will continue to do so. So, we are extremely confident in our long-term growth opportunity for BAT moving forward.

I think it is a very robust company that has very strong foundations, and that will continue to deliver in the future.

Thank you very much for taking the time, and looking forward to seeing you soon. Thank you.

END

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