2022 Full Year Presentation and Conference Call Transcript

February 9, 2023

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Jack Bowles, Chief Executive
Good morning everyone and welcome to our 2022 Full Year Results presentation. I am Jack Bowles, Chief Executive of BAT. With me this morning is Tadeu Marroco, our Group Group Finance and Transformation Director.

I am proud to share with you today that we have reached an exciting inflection point in our transformation. Over the last few years, New Categories have rapidly become a significant part of our business and are now a strong contributor to our financial performance.

As a result, last week we announced our new regional structure and management team realignment to drive us through the next phase of our transformation journey.

Our presentation today will take on a new format. First, I will give some highlights of the progress. Tadeu will take you through the details of our results, highlighting how in 2022, we continued transforming the business, delivered strong financial results, and successfully navigated a challenging macroeconomic environment.

Then I will talk about how we are taking BAT's strategy to the next level, and why we are confident in bringing forward our New Category profitability target by one year to 2024, as our transformation accelerates.

As usual, once Tadeu and I have taken you through the presentation, there will be an opportunity to ask questions.

Before we start, I would like to take this opportunity to give you an update on the progress of the transfer of our businesses in Russia and Belarus. As we have already shared, we are working as quickly as possible to transfer the businesses in compliance with international and local laws.

We are now in advanced discussions with a joint management distributor consortium with a view to completing the transfer in 2023. Our priority remains supporting our employees in the affected areas and safeguarding their employment. Upon completion, BAT will no longer have a presence in Russia or Belarus.

With that, I take it that you have all seen the disclaimer on slide 2 and slide 3.
I am delighted to share with you today our progress and delivery against the three priorities we set out in 2019. We are delivering a step change in New Categories, enabling us to bring forward our profitability target, driving value from our combustibles business, and at the same time, significantly simplifying BAT, our structure, processes and ways of working to drive greater efficiency.

Since 2018, we have grown our Non-combustible product consumer base by 30% on a CAGR basis, reaching 22.5 million in 2022 with again more than 4 million added in the last 12 months. And we remain confident in our target of 50 million consumers of non-combustible products by 2030.

Over the last 4 years we have grown New Category revenue by a CAGR of 33% and we are confident in achieving our £5bn revenue target by 2025, regardless of the transfer of our businesses in Russia and Belarus.

Non-Combustible revenue as a percentage of Group revenue has more than doubled from 7 per cent in 2018 to 15 per cent today and grew by over 2 percentage points in 2022.

In just a few short years, with Vuse and glo, we have built two, £1bn global brands. This is an enviable performance relative to any global CPG brand.

In 2022, Vuse further built on its market leadership position in vapour and delivered a 3rd consecutive year of over 40% revenue growth.

glo continues to outpace global THP category growth, delivering in excess of 25% revenue growth.

In Modern Oral, Velo delivered another year of over 40% constant currency revenue growth and maintained its leadership position in Europe.

ESG is at the centre of our strategy. All this is supported by a clear environmental focus, underpinned by science for each of our New Category brands and is actively contributing to our Group sustainability targets.

We continue to develop and publish a substantial body of scientific evidence. And we are investing in the R&D of products that have a lower environmental impact and improved circularity.
This means we are seeking to, design products that are easier to dismantle at end-of-life, improve ways to enhance reusability and recyclability, and convert to more sustainable packaging.

More broadly, as we reduce the health impact of our business, we must also drive progress across all other material ESG areas. In 2022, we appointed Mike Nightingale as our first Chief Sustainability Officer, implemented a new double materiality led approach to inform our Sustainability Agenda and continued to embed sustainability across BAT.

While we recognise we have a lot more to do, we are making good progress. In 2022, we achieved our renewable energy use targets three years early, which is why we have increased our target to 50% by 2030.

In addition, we are on track to reach our gender representation target across our wider workforce with women in management roles at 41% and we are delighted to be included in the 2023 Bloomberg Gender Equality Index.

Alongside this, our continued efforts have been recognised with a CDP "A" rating in climate change and inclusion in the Dow Jones Sustainability Indices for the twenty-first consecutive year.

Central to our purpose is reducing the health impact of our business. In our established markets we continue to transform at speed, with non-combustible already representing over 30% of our revenue in a total of 11 markets where we have been most active with our multi-category strategy and we expect more markets to exceed this 30% level in 2023 as we take our transformation to the next level.

I am especially proud that since 2020, we have improved New Category contribution by nearly £700m while also investing over £4.5bn.

Our New Category model is now meaningfully contributing to Group results, and our progress to date makes us confident that we will achieve Group profitability in 2024, one year early.

Our transformation continues to be fuelled by Combustibles value growth. Over the last 4 years we have delivered robust revenue, profit, and value share growth, while significantly reducing complexity to drive further efficiencies.
We have also delivered a total of £1.9bn of annualised cost savings over the last 3 years through Quantum, nearly double our initial £1bn target. Project Quantum has enabled new ways of working that are now fully embedded within BAT.

In addition, our strategy has enabled us to materially increase our free cash flow generation with 4 consecutive years of at least 100% operating cash conversion. As a result, we have been able to return a total of £19.2bn to shareholders through dividends alone over the last 4 years, which is around 30% of our current market capitalisation.

We know that innovation and transformation is fed by a broad diversity of views and experiences. Over the last 4 years, we increasingly attracted new talent to BAT with over 3000 new capabilities hires focused on areas of Science, Innovation, ESG, Digital, and Data Analytics while at the same time we have accelerated our diversity agenda, with 47% of our new hires being female. We have also improved our new hire turnover to a level well below market norms.

I am proud that our achievements are being recognised externally including most recently being certified a “Global Top Employer” for the 6th consecutive year. We have come a long way on our A Better Tomorrow journey, and I am proud of what we have achieved. Our strong momentum has continued into 2022. I will now hand over to Tadeu who will take you through the details of our 2022 financial performance.

**Tadeu Marroco, Group Finance and Transformation Director**

I am delighted to share more details on how we have delivered on our guidance in 2022.

I am proud to say, as Jack has highlighted, that we are accelerating the Transformation of our business and delivering robust financial results while successfully navigating an increasingly challenging macro environment as we moved through the year.

Our reported results were impacted by a number of mostly non-cash one-off items, including, a full-year non-cash impairment of our businesses in Russia and Belarus. A provision recognised in respect of the DOJ and OFAC investigations. And restructuring charges driven by Project Quantum. These were partly offset by VAT credits in Brazil relating to prior periods.
To better understand the key drivers of our performance, we will now focus on constant currency adjusted results, unless otherwise stated.

In 2022, we delivered revenue growth of 2.3% driven by New Category growth of 37%, and strong combustibles price / mix of nearly 5%.

Profit from operations was up 4.3%, driven by a reduction in New Category losses of nearly £600m and continued Quantum savings.

Altogether, we achieved a 150 basis points increase in our operating margin at current rates. This drove adjusted diluted EPS up 5.8%, or 12.9% on a current currency basis.

Turning to New Categories, we delivered strong revenue growth with all three categories growing in excess of 25%, driven by share growth, innovation and Geo expansion. This demonstrates the importance of a global multi-category strategy with strong brands and great products, in the right markets.

I will now share more details on our key category drivers, full market shares across our key markets are available in the appendix.

In vapour, we extended our value share leadership position with Vuse achieving 35.9% in the key vapour markets up 2.5 percentage points. In the US, Vuse strengthened its No.1 position reaching 40.9% value share, up 8.4 percentage points. We expect further upside in the US going forward driven by existing vapour consumers switching to products that receive marketing authorisation from FDA together with increased enforcement. In addition, given the excise advantage of vapour over combustibles, we see a strong runway of growth as consumers can benefit from significant savings.

In Europe, our closed system value share, excluding disposables, grew strongly, and is now over 64%.

In Canada, we extended our value share leadership position growing 8.9 percentage points to around 90%. We launched the Group’s first connected Vapour device, Vuse ePod2 plus driving increased pod consumption.

Through our growing scale, we are making continued progress on driving profitability in vapour reaching a positive contribution in 3 of the 5 key markets in 2022.
Growth in the global vapour category has accelerated driven by modern disposables which have expanded the category. We launched our modern disposable, Vuse Go, with a premium price positioning and volumes which are accretive to our ePod platform. We have rapidly rolled out Vuse Go and are already the value share number 2 in the UK, France, South Africa and Germany.

In addition, we are starting to see some accelerating poly-usage with modern disposables coming from THP which creates a significant opportunity for us.

We are approaching modern disposables in a responsible way supported by our well embedded marketing practices including age verification processes for retail and take back schemes.

In THP, glo’s sequential revenue growth accelerated in the second half. Consumable volume growth outpaced the industry 1.7 times. The continued momentum of glo Hyper drove category volume share in key THP markets up 1.4 percentage points to reach 19.4%.

All key European markets continue to grow strongly. In Japan, glo’s volume share of the total nicotine market reached 7.4%, up 60 basis points with a record glo share in December.

glo Hyper X2 is delivering an enhanced product experience with positive early results in Japan. We broadened our price laddering with new Lucky Strike consumables, complementing our existing ranges.

We have also expanded our multicategory offering with a Velo city pilot, delivering attractive margins. This further demonstrates the strength of our consumer-centric approach with more to come in 2023.

Turning to Modern Oral where revenue grew strongly, at 46%. In Europe, we remain the market leader in 15 markets, with aggregate European volume share broadly stable at 69%.

In the US, the market remains small at around 2.5% of total nicotine value and highly competitive.

Revenue was up, as we pivoted to drive value, reducing promotional support for the brand, and prioritising investment behind Vuse.
In order to be well-positioned for the future, we have submitted a PMTA for a new Velo product.

We are also excited about the significant opportunity for Modern Oral in emerging markets. We are particularly proud of Velo’s performance in Pakistan, now our third largest Modern Oral market by volume. Enabled by powerful, digital activations, and innovations with local flavours Velo has reached a monthly volume of over 40 million pouches.

In 2022, we rapidly scaled up our business and moved to localised production in market, driving the lowest COGS across the Velo brand. As a result, Velo’s gross margins improved significantly during the year. Together with our other pilots this progress gives us confidence in our ability to unlock future emerging market opportunities.

Alongside significant investments in our New Category transformation, we continue to explore opportunities Beyond Nicotine notably in the fast emerging wellbeing and stimulation space.

BTV has completed 22 investments since launch. In 2022, this included 5 new investments and 2 exits. We are building world-class R&D together with our partners at Organigram and we continue to explore opportunities to expand our cannabis ecosystem. This included a non-controlling minority stake in Sanity Group and an investment in Charlotte’s Web in 2022 as we continue to monitor changes in the regulatory environment. Our approach provides us with evolving capabilities for the future across both New Categories and Beyond Nicotine.

Turning now to Combustibles, our volume declined by 5.2%, mainly due to the lower US industry volume, exacerbated by the partial unwind off inventory in 2022 and the sale of our Iranian business in 2021. Cigarette pricing remained strong, up 10.4%, offset mainly by geographic mix. Together, this resulted in a 0.6% decrease in revenue.

Group value share was flat with the continued strong performance in the US and APME offset by lower value share in Europe and AmSSA. Volume share was down 20 basis points.

Whilst our US business was impacted mainly by macro-economic headwinds, our targeted portfolio of brands across price tiers
enabled the delivery of a robust financial performance across APME, AmSSA and Europe.

Turning now to the regions, in Europe, New Category revenue was up 43%, driving total revenue up 7%. Europe is a true multi-category region. Non-combustible revenue already accounts for around 20% of total revenue and continues to grow fast.

Combustible revenue grew 1.2% driven by strong pricing partly impacted by the reallocation of the North Africa Area to APME.

Profit was up over 7% with improving New Category contribution and further cost savings as a result of Quantum.

In APME, New Category revenue was up 10%, with total revenue up 7.7%. Combustible revenue grew nearly eight per cent with resilient volume benefitting from emerging market recovery post COVID.

Profit was up 3%, with a robust combustibles performance partly offset by negative geo mix and the disposal of the Iranian business.

In AmSSA, New Category revenue was up 48% and was a strong contributor to total revenue growth of around 5%. Combustible revenue was up nearly 4%, driven by strong pricing and resilient volume. Profit was up over 4%.

Turning to the US, our Total Nicotine value share was up 40 basis point to over 37% driven by Vuse. New Category revenue was up 52%. Vuse continued to extend value share leadership and is the fastest growing brand in total nicotine in the US.

Combustible industry volume was down around 10% mainly reflecting: post COVID normalisation of consumption patterns, and macro-economic deterioration through the year. Our volume was down 15.5% additionally reflecting the partial unwind of our prior year inventory movements, volume share loss, and lower retail inventory levels across the industry at year end. Over the last 3 years, industry volume has declined in line with historical levels at around 5% CAGR.

The premium industry segment remained resilient with volume share declining by only 50 basis points. As a result of the increased impact of macro-economic headwinds the low-end segment grew volume share by 90 basis points.
In this challenging environment, our value share grew 10 basis points despite volume share declining by 30 basis points. Value share growth was driven by the continued strength of Natural American Spirit and Newport which together drove premium value share up 20 basis points.

In addition, Lucky Strike was the fastest growing combustible brand in both volume and value share terms in the US, reaching an exit share of nearly 3%. This more than offset losses in Pall Mall at a total industry level.

In 2022, our US pricing remained strong, up 10%. At the consumer retail level, our average pricing in the year was up 5.6% lower than key industry peers and significantly below elevated consumer price inflation as we activated targeted commercial plans to support our consumers.

Despite the more challenging macro-economic backdrop, our profit was up 3.5%, with operating margin up 330 basis points to 53.7%. This was driven by continued improvement in New Category contribution from both Vuse and Velo, alongside cost saving initiatives.

Taking a step back to look at the broader US context, US consumers faced strong macro-economic headwinds in 2022 with record inflation, seven interest rate hikes, and high gas prices resulting in real disposable income falling by nearly 7%.

Looking into 2023, we are starting to see some very early signs of recovery with gas prices stabilising, levels of unemployment remaining low, and the gap between wage growth and inflation narrowing. Most notably, elasticities remain stable at 0.4 comparable to pre-COVID levels and affordability remains high.

Through Revenue Growth Management, we have targeted investment in specific brands, channels, and states with price laddering across all brands.

We expect the US economy to stabilise as we progress through the year and together with the remaining unwind of our 2021 inventory movements, we expect our performance to be second half weighted.

With our multi-category strategy and strong portfolio of brands, we are well positioned to benefit from macro-economic recovery.
Group operating margin expanded strongly, up 150 basis points on an adjusted current rate basis. We successfully absorbed increasing inflationary pressures and a 1.5% transactional FX headwind on profit. This was supported by our strong progress towards New Category and Quantum savings.

Our improved New Category contribution was largely driven by increasing scale leading to operating leverage and further automation reducing cost of goods. With all three New Categories and all regions contributing.

In addition, our growing brand equity has enabled us to increase pricing on both devices and consumables supported by insights from our digital tools.

We have reached an inflection point in our New Category model. Having invested significantly in the base, we are now in a growth period where we can invest more and deliver improved profitability.

In 2023, we will capitalise on our momentum, and further invest in our transformation to accelerate our innovation cadence and drive faster geographic expansion. With that we expect to continue to improve New Category contribution in 2023 and are confident in delivering our target of profitability, ahead of plan in 2024.

Alongside £1.9bn savings delivered through Quantum, we continued to drive further simplification. Moving forward, we will deliver efficiencies through our established continuous improvement mindset to offset inflationary pressures and fuel our transformation.

In addition, we are committed to reporting no further significant P&L impacts from adjusting items related to restructuring programmes in the medium term.

Turning now to EPS, we delivered constant currency adjusted diluted EPS growth of 5.8%. This reflects our robust operating performance the benefit of the continued recovery in ITC post-COVID, and the share buyback which more than offset increased net finance costs and tax.

The underlying tax rate was 24.8% and with existing tax rates, we expect a similar rate of around 25% in 2023.

Operating cash conversion was strong at 100% reflecting our focus on cash delivery.
As in 2022, we expect gross capex for 2023 to be below adjusted depreciation and amortisation at around £600m pounds capex.

We continued to reduce leverage within the 2-3 times corridor, and have a manageable maturity profile, with 97% of our net debt fixed average maturity of around 10 years, and close currency matching.

BAT is sheltered from unprecedented interest rate rises but is not immune. While the majority of our net debt is fixed, we have an approximately 18% exposure to fluctuating interest rates when you consider cash holdings and refinancings. Our average cost of debt is 4% which is below the current market rates, so we expect to see the impact of higher rates in our net finance costs in 2023 and moving forward. As a result, we expect 2023 full year net finance costs to be around £1.9bn subject to both FX and interest rate volatility.

The Board actively reviews our capital allocation priorities taking into account macro-economic factors and potential regulatory and litigation outcomes. Our framework includes, continuing to grow the dividend with an average pay-out ratio of 65% over the long term, maintaining leverage within our target corridor of 2-3 times adjusted net debt / adjusted EBITDA; potential bolt-on M&A opportunities, and share buybacks.

At this time, the Board has decided to take a pragmatic approach. Given our incremental investment plans in 2023 to further accelerate our transformation and in light of the uncertain macro environment, higher interest rates, outstanding litigation, and regulatory matters, the Board has decided to prioritise strengthening the balance sheet.

This will provide greater business resilience while continuing to support future financial agility as we aim to reduce leverage more quickly towards the middle of our target 2-3x corridor.

We strongly believe that share buybacks have an important role to play within our capital allocation framework and we will continue to keep it under review as we progress through the year.

Finally, in line with our long-standing commitment to dividend growth, we are pleased to announce a dividend of 230.9p for 2022 with growth in line with our constant currency earnings.

Looking forward, 2023 results are expected to be driven by another year of strong New Category growth and a further reduction in losses,
alongside a resilient combustibles performance, supported by continued efficiency savings and strong cash generation.

We expect to deliver organic revenue growth of 3-5% excluding Russia and Belarus, adjusted mid-single figure EPS growth, second half weighted, reflecting incremental New Category investment higher net finance costs, transactional FX headwind of around 2%, and a second half weighted US performance.

When we think about the corridor for adjusted mid-single figure this year, it is a little wider than usual at 3.5% to 6.5%. This is because it is impacted by both the volatile macroeconomic environment at the timing of the transfer of our businesses in Russia and Belarus.

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

And finally, as already mentioned we expect to continue to progress towards the middle of our 2-3 times leverage corridor.

In summary, we have a clear momentum behind our New Category transformation, which is now a significant contributor to the Group financial delivery.

The current challenges we face in the US are mostly macroeconomic related and we expect stabilisation from the second half of 2023.

In 2022, our results have enabled us to return a total of £6.9bn in cash to shareholders. In 2023 we are taking a pragmatic approach and prioritising strengthening the balance sheet. Share buybacks will be kept under review as we progress throughout the year. And with that, I will now hand you back to Jack.

**Jack Bowles, Chief Executive**

Thank you Tadeu. At the start of today’s presentation, I highlighted the significant progress BAT has made since the launch of our purpose led A Better Tomorrow™ strategy in 2020, building a New Categories’ consumer base, growing powerful global brands, and developing capabilities for the future.

The speed of our transformation over the last 3 years means that now is the time to take BAT’s strategy to the next level. In 2022 we have shown that our multi-category model is working, meaning that we can both continue to invest, and deliver improved profitability.
In this final section, I will share how we are getting Fit for Growth with our new operating model. This means that alongside investing more, we will also be investing smarter. Enabling us to accelerate New Category profitability and reach our target one year early, while also preparing the business for sustainable long-term profitable growth.

Firstly, let me remind you of the opportunity. Total Nicotine industry revenue is growing, with a 3.5% expected CAGR to 2025. This means an additional £11bn revenue at industry level. 75% of this industry growth is expected to come from New Categories with a forecast of 15% CAGR.

This is supported by the growing number of New Category consumers increasing from around 80 million today, to an estimated 130 million by 2025. The percentage of smokers interacting with New Categories is growing fast especially in established New Category markets. Variations between markets are largely driven by regulatory environments, alongside differing consumer tastes and pricing relativities.

Sustainable New Category growth is also supported by consumer demographics. In established New Category markets, solus usage is now above combustible levels among adults under 45. This shows the clear potential to make a significant positive impact on public health and deliver sustainable high-quality growth.

Alongside accelerated decline in cigarette solus usage in established markets, poly-usage within New Categories is growing fast. This means that with our consumer-centric, multi-category strategy, we are well positioned to capture future growth. So the opportunity is big.

Given the significant variation in New Category development across markets, we must prioritise our investments smartly and focus our activities and resource allocation to maximise returns. We must be fit for growth.

Following our comprehensive strategic review, we have taken the decision to further simplify the Group to enable even greater collaboration, and faster decision-making.

Our new organisational design will be based on fewer, larger business units, reducing the number of regions from 4 to 3, and
business units from 16 to 12. This led to the senior management changes and realignment announced last week.

We are further optimising our footprint. Phased over the next two years, we plan to exit around 30 smaller markets where we don’t see a near term opportunity to execute our New Category strategy.

When completed, this means we will be selling at least 20 billion fewer cigarettes annually with a limited impact on our P&L. This will enable us to increase profit and unlock cash through resource reallocation into markets which generate higher returns.

Should the conditions and the opportunity for New Category products materially change, then we will reconsider our presence in these markets.

In addition, we have identified six different market archetypes to guide strategic choices and resource allocation. We understand that markets vary significantly by category maturity, driven both by consumer tastes and preferences and more importantly by different regulatory environments.

We continue to work hard to engage with regulators around the world to help inform them of the science that supports the potential benefits of smokers switching to reduced risk products.

New Categories already represent a significant percentage of the revenue and growth in a number of archetypes, and we expect these archetypes to be dynamic, over time. Overall, we are getting fit for high quality sustainable growth.

Together these projects and initiatives will deliver a reduction of over 3,000 roles in the next couple of years with the majority of this effort happening in 2023.

Moving forward, we will leverage the foundations created by Quantum. We will keep delivering efficiencies through our established continuous improvement mindset, with an ambition to generate at least £1bn additional savings over the next 3 years.

These savings will help the business continue to offset inflationary pressures, fund New Category investment and improve New Category profitability.
We are committed to building A Better Tomorrow. As our transformation journey gathers pace, we are further sharpening our operating model, enhancing our agility and continuing to build new capabilities. We are transforming BAT into a high growth, multi-category, consumer led, CPG, with a reduced impact on public health and ESG at its core. I am confident this will create value for all our stakeholders.

Thank you for listening. I will now open it up to questions.

Questions and Answers

Telephone Operator
Thank you. Ladies and gentlemen, if you would like to ask a question please press *1 on your telephone keypads. If you’re using a speaker phone please make sure your mute function is turned off to allow your signal to reach our equipment.

We’ll pause for just a moment to allow everyone an opportunity to signal for a question.

We will now take our first question from Nik Oliver from UBS, your line is open, please go ahead.

Nik Oliver, UBS
Hey good morning guys, two from my side. First one on the US, on the minus 15.5% combustible performance. Is it possible to disentangle how much of that was industry, the inventory moves and then some of the share losses that you mentioned?

And then I guess as we look forward, is the better way to think about the US in terms of total nicotine share, as opposed to just a focus on combustibles? That’s question one. And then question two ...

Jack Bowles, Chief Executive
Yes, we start with this one yes. So I mean first of all we are having a very strong portfolio in the US and as you know we’ve grown in the last three years value share, volume share and profit and operating margin. So our position in the US is extremely strong.

Now related to the 15% versus the 10, of course you saw that we have lost a little bit of share. But the premium is very resilient, only using 50 bps and the low is not growing more than 90 bps.
At the same time the price elasticity is 0.4, so I think that the market is very resilient. When you see the average over the last three years you see very clearly that the average reduction in terms of volume has been around 5%. So you saw that we lost a little bit of market share, okay that’s fine. And then we said last time that we had around £200m in terms of stock that we would have to unwind and now we are doing that at pace. And we are halfway through the journey really to that. So I think that we’re going to do a further enhancement of our performance in 2023.

The second part of your question is related to looking at total nicotine. And you’re absolutely right, I mean the reason why our performance in the US is strong is because we have a very resilient combustible business. The macros are now improving so you will see improvements related to the macros in the US that will benefit the size of the market.

And the second thing is our performance in terms of New Categories is just stellar. I mean remember three years ago everybody said that we will never take a position related to e-cigarettes. Now we are not only the leader, but we are the leader in the US with price index to competition at 140.

So we’re doing extremely well and we’re continuing to grow in terms of New Categories. So I think that looking now holistically at the total market is something that makes total sense moving forward.

**Tadeu Marroco, Group Finance and Transformation Director**

That’s right. And just to be clear about the 15.5 and the 10% most of the gap is related to the unwind of the stock, this shouldn’t be a surprise because we have flagged that a year ago.

**Jack Bowles, Chief Executive**

So I’m confident in the progress of recovery of the US market and our strong position in terms of our portfolio. I mean we have – at the upper end of the market you have American Spirit that is super premium if you want to call it this way, that is growing share and value share. And you have the most successful launch in the VFM with Lucky Strike, which is now reaching 3 points of share, that’s the most successful launch in the last at least 15 years in the US.

So we have a very well balanced portfolio and now we have to do price laddering through the different brands in order to make sure that we help the consumers to navigate.
Also always remember you know, the US is a very large market and I spoke about price elasticity at 0.4. We have to remember that some prices in some states are $11, and some are at $6. So there’s a lot of gametes of different markets. And you see that the price elasticity in our range is 0.4.

So I think that we have a very strong business over there that has grown share and value share in the last three years. And the operating margins are going in the right direction. We are delivering 3.5% profit growth in 2022 and we are confident in the US business.

**Nik Oliver, UBS**

Great, thank you Jack, and Tadeu. And then just the one final one for me and then I’ll hand over. Just on the no new buyback this year was kind of quite topical with investors this morning. But I guess in the press release you mentioned that would be reviewed during the year. Maybe Tadeu just a few words on the thought process of not announcing one now, and then what would need to change for that to happen later in the year?

**Tadeu Marroco, Group Finance and Transformation Director**

Yes Nik we have been focused on cash generation, at least for the last three or four years in a very intense way that’s reflected in our conversion being consistently at 100%. And we managed to leverage the company to the corridor of 3 to 2. But we are still in an uncomfortable position being at the high end of this range. And the world has changed, we have a very high levels of cost of capital today after seven interest hikes in the US alone throughout 2022. Our cost of capital is much higher than before and we are still seeing a lot of volatilities in that environment.

So one thing that we would like to observe more clearly is where these will stabilise. For sure when the Board takes decisions in terms of capital allocation it’s always looking ahead from the regulatory side, the litigation side. You note that we have provided for investigations that we have around the DoJ, OFAC and we still had to pay for those. We don’t know exactly when this is yet concluded, we expect it to be in 2023 but it’s not completely up to us.

And also we have the CCAA that there is a mediation process in place. I cannot comment further on that but in the medium term we have to prepare the company for that.
So there reason why we want to accelerate to land in the middle of the range is to create this space so we can have a more resilient balance sheet, and much more financial agility moving forward. And this is a benefit for us in the medium, long term of the company.

**Jack Bowles, Chief Executive**
I mean to speak clearly since three years we have done a lot of transformation, we have done a lot of acceleration in terms of our business. Now we have the possibility to decide. Last year we done £2bn of share buyback, the interest rates are going up. Deleveraging is important, taking care of our balance sheet. We want to be in that corridor of 3 to 2 and to accelerate faster through the middle of that corridor. That's the pragmatic way of looking at it. And frankly share buyback, we are convinced with share buyback, we did £2bn last year and we will review in the course of the year. And we will make the decisions as we see, pragmatic to do so and continue on that journey. I like share buyback.

**Nik Oliver, UBS**
Great, thanks so much Jack and Tadeu, that's really clear.

**Jack Bowles, Chief Executive**
Thank you for your questions.

**Telephone Operator**
Next up we have Richard Felton from Goldman Sachs text. Your line is open please go ahead.

**Richard Felton, Goldman Sachs**
Thank you, good morning Jack, good morning Tadeu. My first question is a follow on US combustibles and your relative performance. So the numbers you’ve given, in your prepared remarks, the 10% industry decline and the 15.5% decline in your portfolio is on a four year basis. Now if I think about the second half specifically it does look like that gap versus the market has got a little bit larger. So my question is what has sort of driven that, where are you seeing the relative weakness in your portfolio and what actions are you taking to narrow that gap into 2023? That’s the first question.

**Tadeu Marroco, Group Finance and Transformation Director**
Just to make it more clearly because it’s difficult to analyse by half but there were a lot of movements in the US. We mentioned the unwind of stocks but remember that's in the first half of 2022, we also introduced our TaO system, we rolled out the TaO system, so we had to build up stocks just before that.
So your first – the unwind stocks in reality materialised more towards the second half of the year. So that’s why you see a different picture in the second half as compared with the first. And this also, you know, explained the reason why we expect to be more second weighted this year because we are lapping a first half of last year that was impacted by the stock build from the introduction of the TaO system in the US. So I just want to make this point clearly.

In terms of the macro became much more visible through the second half of the year. We started taking commercial initiatives related to that as we present in the presentation, we have been much more active in terms of revenue growth management. Granular in terms of pricing decisions at state level, channel levels. We have been laddering now in different price points. So we are ending the year 2022 in a much more competitive basis. And we saw that in terms of our share performance in Q4 compared with Q3 where we see some stabilisation of that and we continue, this trend should grow as we approach 2023.

Jack Bowles, Chief Executive
You know, in the big players, not in the low you saw that we defended share much better than competition. And we have a pricing environment where you always have to remember that the pricing that has been taken by the industry even in Q3/Q4 was far less than CPG in general. So we had much more leaner pricing activity in the second half of the year than CPG. That gives us some runway in terms of pricing in 2023.

So I think that the overall market has suffered in terms of size. The consumers, you know, we always speak about the price of oil but it’s not only the disposable income, it’s also the Americans go less to the shops. And if they go less to the shops with the product that they buy every day or every second day, then you have a bit of reduction in terms of the total market.

But I think with the performance that we have in premium where we’re growing and the downtrading that has been very reasonable in that environment and the price elasticity at 0.4 and the portfolio that we have, I’m confident on the US for 2023. But it’s going to be more geared towards the second half for the stock issues and for the recovery of the macros moving forward.

And always remember, I think that the point that was made before is very important, total nicotine and in total nicotine including e-
Richard Felton, Goldman Sachs
Thank you that’s very helpful. My follow up is going to be on e-cigarettes in the US. So obviously a very impressive performance on Vuse on a top line basis and improving profitability. But my question is on the volume performance of US vapour. And looking at the numbers on the second half it looks like volume growth did decelerate a little bit. So my question is how to think about the growth drivers for Vuse in the US moving forward. I mean should we expect it to continue to be pricing led growth or are there, you know, more investments that you need to make to reaccelerate the volume performance of Vuse and I suppose the overall category? That’s the follow up, thank you.

Jack Bowles, Chief Executive
I think what’s important to consider is first there has been a new category that has emerged in the US which is the disposable within nicotine okay. And you saw that it grew very fast and especially in non-organised trade. So that has taken some consumers in terms of the cigarette business that have moved to this kind of category.

But in reality, it’s an additional pull of consumers that have been created and the FDA now wants to regulate that environment. And that will allow us to have even more oxygen, so just in the transition. But what’s very interesting to see is that the vapour, traditional vapour with pods has continued to grow. It did not replace one another, the traditional is continuing to grow.

There will be more regulation in synthetic nicotine products so then that will create an additional expansion bubble if you want for us for the next few years to come. But I think not only we have the best brand in the market, we have as I said before, a price index of 140 to the nearest competitor. And we’re continuing to grow, the market is continuing to grow at the smallest pace. And we have that additional bubble of oxygen that is coming our way which regulation related to the FDA.

So I think that we’re on for something very good in terms of e-cigarettes in the US. And at the same time you saw the profitability, you know, I mean the numbers speak for themselves if I may say so.

Richard Felton, Goldman Sachs
Thank you very much.

**Jack Bowles, Chief Executive**

Thank you.

**Telephone Operator**

Next up we have Rey Wium from SBG, your line is open, please go ahead.

**Rey Wium, SBG**

Good morning Jack and Tadeu. Also just two questions from my side. I just want to quickly focus on the combustible market share. You mentioned it’s down 20 basis points so there’s a bit of a reversal of what we’ve seen in prior years, I know you’ve mentioned that it’s the US. But in your report you also state that the market share was lower in AmSSA in Europe so I was just curious about where you’ve seen market share declines and what you can do to reverse that in the combustible side?

**Jack Bowles, Chief Executive**

I think that the first thing to consider is that 2022 has been a year where there were more tensions in terms of pricing across the globe, let’s put it this way. Then also you had the macroeconomics that were hurting the consumers in the second half of the year. But I think that what we start to see in the last quarter is that really is transforming again into growth in terms of volume. And there is more benign pricing environment, i.e. the pricing is coming through.

As I said earlier always remember a lot of FMCG, CPG companies took a lot of pricing in Q4. Then it’s different for us, we took reasonable pricing because consumers buy every day, and we can continue to take that pricing. So we see the volume and the pricing in a good environment for 2023.

**Tadeu Marroco, Group Finance and Transformation Director**

Yes I just want to comment, I think that what we saw in 2022 is a very resilient combustible business to start with. We referred to 1.2% FMC THP worldwide decline. If you see combustible is around 2% and if you see emerging markets, it was pretty much flatish. We saw volume growth in places like Brazil which we are very strong, as well as Bangladesh, Malaysia, Vietnam. So a lot of markets and we saw even in places like Italy, Spain, Europe. So we had a number of markets where without the macroeconomics headwinds, inflation, we still saw volume growth.
In terms of our performance in market share, we are not really concerned about that. This is very specific for some specific markets. For Brazil for example we had some price skirmishes there and we prioritised some value. And we had - in Turkey because of this macroeconomic situation, we saw a lot of increase in illicit trade, and we are more exposed because we are strong on the lower end of the market. So we lost some share there and it has a big weight.

But it's not something, it's very specific for some countries. But I think the key message is that we are seeing a very resilient business across the world.

Rey Wium, SBG
Excellent. And then just a question for you about the interest guidance of £1.9bn. It looks a bit high to me, you know, so I just want to know, I mean it sort of works out by my calculations like an average coupon rate of about 5%. Now is it an issue that you probably expect your free cash flow to be a bit lower this year? Because I mean I just wanted to tie the two ends together here.

Tadeu Marroco, Group Finance and Transformation Director
Okay, no it's not that. It's well we had our starting point would be a £1.6bn in terms of interest cost in 2022. And then what we are seeing, and that's why I referred to 18% in terms of our exposure for 2023. We have some refinance to do so we used to refinance at 4/4.5 and this is higher than that. And I don't think that is as high as we saw in October because the market has come down a bit more to this year. But can be much higher than the average cost of capital. And we also have needs in terms of working capital, city markets, bilateral and those rates were very, very minimal, back in early stage of 2022 and now went up substantially.

So that's where you see the gap between where it was and where it is now, plus the commitments that we have in terms of other finance costs and in terms of maturities. That adds up to something close to 18% of our needs, you come to this number of 1.9. And it's important to flag that because we will be seeing this analysed impact in 2023. So it's one off that we see in 2023 and then we create a new base moving forward.

Jack Bowles, Chief Executive
And in terms of our cash conversion I mean you saw that we had 100% in average in the last three years, and we have a number of 95% and higher. So I mean we are very dedicated to that and after that the free cash after dividend, what you see is that last year was £2.1bn, last
year of 2021. 2022 was £2.7bn and we continue to make a lot of efforts. Also you saw that we had a programme of Quantum, that was £1bn originally three years ago, we delivered £1.9bn and we just said that we’re going to do another billion in a few years to come.

So I think that you know, we’re getting to a position where our financials make a lot of sense, where our business is making a lot of sense, where we’re accelerating our transformation and we’re on the mid term to long term. So it’s about now at the moment the balance sheet, the corridor 2 to 3 and we’ll review during the year. So I’m very confident in the quality of the business that we have. We take some decisions because we have the possibility to take decisions and we have the choice, and we exercise that choice. Because it’s for the good of the growth of the company and the sustainability moving forward.

Rey Wium, SBG
Okay, thank you very much.

Jack Bowles, Chief Executive
Thank you.

Telephone Operator
Next up we have Jared Dinges from JP Morgan. Your line is open, please go ahead.

Jared Dinges, JP Morgan
Yes, hi guys. Maybe first to come back to the US. What impact do you expect from the California flavour ban across your portfolio? And maybe if you could talk a bit about maybe some very early signs, if you have data from there so far.

Jack Bowles, Chief Executive
Yes, a good question. I mean California represents around what 5% of the total market in the US and it’s a market that we are looking at of course very, very carefully. It’s very difficult to read the early signs in the California market because we had a lot of stock movements in December. As you know, the ban came in 21st of December, there was still a lot of stock that was available in the shops in January. So you’ll have to wait April/May in order to read all this.

If you look at the size of the market and the way the market is faring at the moment, it’s robust. But you have to offset all these movements in terms of stocks. Our brands are doing well, we’ve launched new SKUs and e-cigarettes is doing very well also.
So we’ll have to navigate all this and it would be too early or too confident from my side to say that the job is done. It’s going to happen in the next few months and I’m optimistic in terms of the solidity of the business.

Remember in all the different geographies where you have that kind of things that happen, in Canada, in Europe, in Turkey, or in other places. The retention rate was around 95% and more. And then on top of that you had related to New Categories another increase in terms of retention rates.

So the jury is out but the start is very good but very mixed in terms of numbers. You would not be able to find your ducklings in there because it’s all stock movement, trade, availability and trade. There is the key accounts, the organised trade that has been more speedy in terms of stopping these products. General trade is very important in California and that is less measures accurately. So give it a bit of time but I think that it’s going to be a good outcome for us.

**Jared Dinges, JP Morgan**

And then maybe switching gears over to THP, you know it was another good year. But I noticed in the second half of the year especially the price mix was weaker, especially in Asia. Can you talk maybe a bit about what’s driving that especially given that you had the launch of Hyper X2 and good device sales. I would have thought that you would have a mix boost from that.

**Jack Bowles, Chief Executive**

As you see I mean we are now close to £3bn in terms of New Category revenue to a point that represents 50% of the total company. And you saw that in the different categories, vapour grew very fast. And the percentage of growth of THP has slowed down a little bit and there is more price competition within the different segments.

So you have different competitors that have come in at different price points, different product offerings so I think that there’s a bit more of an internal competition in the segment. I must say that we’re very happy with our performance and we continue to plough forward. We are only in 50% of the markets that are carrying THP as we speak today so we still have a lot of geo expansion to do and we’re improving our pricing as we go along, our price index as we go along.

So I think that we have a very good start with glo X2 in Japan, it has reached record share in December, and we grew during the years.
So there is more intense competition but we have a lot of space to grow in. And when you look at for instance Europe, that is nearly 50% of the total market. I mean we’re doing extremely well and growing fast.

Overall New Categories as we said in the presentation, eleven markets where we have already 30% of our revenue, that is there yes for the total company. So we are strong, and we’ll have an innovation pipeline that is strong, not only in 2023 but also in 2024. So we have more launches that are coming and we are doing the roll out of X2 that is very accepted by the consumers. It’s smaller, it’s lighter, delivers more flavour and we’ve done a lot of improvement also in terms of the consumables. So I’m confident.

**Tadeu Marroco, Group Finance and Transformation Director**

Just to complement that in Japan, and it’s not different in Europe, every single product we sell in THP has higher margins than our combustible products. So even the newly launched deluxe track that we did to complement our range in the markets has higher margins than the compostable. So for us it’s a financial opportunity to strengthen our business in all those locations. We are very pleased with, to be honest, through the progress that we have made in all categories throughout 2022 margin wise.

We have already on THP on the consumable side margin that is higher than combustible. The same is happening in modern oral. And in vapour we have reached worldwide at 50% of gross margin compared with the cigarettes which is abound 68%. And in the US alone it’s even higher than that.

So it’s a big improvement, that’s what is really driving the reduction and loss as well and we are really heading towards a very sustainable business where we’ve been different between selling cigarettes or selling one of these products.

**Jack Bowles, Chief Executive**

I mean we took the view three years ago to do multi-category and that’s starting to pay off because you have more interaction between the different categories. Tadeu was sapling about the fact that there is now relations between THP users and modern oral for instance, or in other markets THP with vapour. Just remember that the number of consumers in vapour is close to the double of the ones in THP. And this is interesting to see that increased interaction between the categories.
So being truly multi-category as well now and having done that for three years, gives us a head start in terms of being able to serve better the consumers. And we have now profitability that is coming through in vapour. So all this put together gives us a very strong position where again I insist, we said we will invest in '23 and in '24. And we'll priorities that because as we saw we can grow volume and revenue faster and reduce our losses by £600m.

Guys, it’s not a small thing, you know, when we said a few years ago that we will profitable in 2025, people said, ha-ha. Now we’re saying we’re going to be profitable in 2024 and we’re going to continue to invest more because we have the brands, we have the capabilities, we have reorganised the company three times in all. Not we’re doing everything every time, no it’s blocks of transformation that we did through Quantum 1, Quantum 2 and Quantum 3 to be able to do what we’re doing as a transformation today, in order to accelerate the delivery.

So we’re on big guys, I mean we really believe that the strategy not only is paying off but is putting really the company forward in terms of delivery of our transformation and accelerating the delivery.

Of course at the same time you have the net debt to EBITDA, you have to take care of that, your balance sheet and everything. So we continue to invest hard and continue to plough through. I’m on the mid to long term, Tadeu and myself we see, you know, these numbers all the time. And of course we want to do the best for the business and you will see us for some time.

Jared Dinges, JP Morgan
Thank you.

Telephone Operator
Next up we have Gaurav Jain, from Barclays. Your line is open, please go ahead.

Gaurav Jain, Barclays
Hi good morning, thank you. I have three questions. So first Tadeu for you on the restructuring charge in the comments you said, so last year BAT had restructuring of £770m and over the last twelve years it is £400m on average. And now you are saying going forward it will be zero. So if I had assumed the £400m restructuring charge for next year, your adjusted EPS growth should be high single digit. Is that the right way to think about that?
Tadeu Marroco, Group Finance and Transformation Director
Well let’s look first of all just on the £770m that you are referring to. So as we highlighted in the announcement, we think that we have a factory closure in very costly locations, know that that’s there. We have a pull out of, or we are closing operations in some markets as you saw and places like Egypt, Yemen and they come also with some tax liabilities that should be settled so this is in there as well. Then we have like Jack said without the archetypes of markets and the closure of factories, we have almost 2,000 employees leaving in the next coming years and most of it in ’23. So it’s also provided there.

So what we are referring, you’re absolutely right in the sense that we believe that with the conclusion of Quantum now we are not incurring in the restructuring adjusted items anymore. This will be a positive for the cash to be honest. Because when you see adjusted numbers you are taking these out but on the cash it’s still cash outflows, some of that. There are some other elements that are non-cash items. But this will be helping us more I would say in ’24 because a lot of this provision we will result in some cash outflow happening in ’23. But from ’24 it’s where we expect the major benefits coming from the cash side.

Gaurav Jain, Barclays
Sure. My second question is on the NGP breakeven guidance on FY24, and a lot of people are concerned about the US e-cigarette business, because 30% of NGP is in US e-cigarettes where the FDA has given two Vuse menthol variants an MDO. And they also commented that Vuse was second rank in the FY22 youth prevalence survey (?). So most likely Vuse Alto Menthol will also get and MDO and maybe a tobacco also gets and MDO. So with all this regulatory uncertainty how certain are you that you will hit NGP breakeven in FY24?

Jack Bowles, Chief Executive
Yeah, I mean to be blunt we will not say that we'll accelerate the profitability of NGP to 2024 if we would not have looked at all these things but it's a very valid question. I think what you have to see is the consumers are increasingly coming to our portfolio and to our brands. And we have now 22.5 million consumers that are there which only represents, you know, a small portion of the 80 million that are existing at the moment. So we have a lot of space to grow and to grow against competitors.
The second thing is the FDA is of course doing all the regulatory work but it has slowed down dramatically. Because they have a lot of things to do which I understand. So I think that the speed at which regulation and new regulation will come in and regulation related to all this is going to be slow. And I think that we have adapted very well in the past to all the regulators, and we know that we have very strong brands so we have space to grow. And we know that we have a very strong brand so I’m confident in the way forward.

These things are multi years, things with a lot of litigation, regulation, discussions and all this will take time. We have these kind of debates since now five years and it’s only starting to move slowly and there’s not even a definitive view in terms of what is going to happen.

So we’ll take the time and we’ll make sure that we do the right thing for the business. And we reiterate, I reiterate the fact that we’re being profitable in New Categories by 2024. I could even be profitable sooner but I want to invest the money in order to make sure that we grow the base of the business and that’s what we’re doing in the right way. Already last year we reduced losses by £100m, this year it’s another £600m. So it’s all about continuing to grow. We have 40, sorry we have 80 million consumers that are there already, I said that that's going to grow to 130 million consumers with a lot of available income. We are 22.5 at the moment, I have still a lot of space to grow.

So yes it's always a complex market, if it was not a complex market we would not be so much benefiting because we have wired the organisation to be not only much better in terms of combustible. And we've done a great job in combustible in the last three years. We have appointed now a Board member in terms of combustible in order to make sure that we extract the value and we're going even to take out around 30 markets yes, which we're the first ones to do seriously. And so reducing the number of cigarette users.

And at the same time we’re going to have another billion of reduction of cost in terms of our structure. We’re reorganising our structure in a way that is geared towards category management. And we're making sure that our financials are sound in order to make sure that we continue to invest. We’re making money and we’re investing that money so that’s what we do.

**Tadeu Marroco, Group Finance and Transformation Director**

The only add to what I would say to your question is that the FDA has embraced the risk continuum, so you would believe that all the
decisions they would take is actually aligned with that, and not incentivise consumers to go back to cigarettes. That’s …

**Jack Bowles, Chief Executive**

I think it’s a very important point of Tadeu the fact that they give PMTAs to e-cigarettes means that it’s a less risky product, recognised, yes, so it starts there. So that gives a lot of traction also in the rest of the world.

**Gaurav Jain, Barclays**

Sure. And my last question is on you will have a new competitor next year and bring the market in the US with a heated tobacco product. You know, you have filed for the glo Hyper PMTA in December ’21 if I remember correctly. So when can we expect that PMTA to come in, would you launch soon after in the US market?

**Jack Bowles, Chief Executive**

Yes, first of all you have to take it piece by piece you know. First, combustible business is extremely important in the US yes. Even if you don’t like cigarettes, it pays your bills every day, that gives you the resources to be able to invest, that’s number one. The second thing is there is already 20% of the market that is in New Categories, mostly e-cigarettes, that’s already there. And that’s getting very, very interesting in terms of margins per thousand.

The third thing is there is a lot of things that have been said in terms of THP in the US. It has been on the market for two years; it has not worked and high tar levels and everything. But at the end of the day what is important is what position you have in New Categories in the US. And we have a presence in the three categories. We have PMTA’s that are in progress, and this is going to be more in two years from now at least. So you have to take your time and look at what is there, what is growing. And then that’s for the mid to long term. I am confident that when you see what has happened in Europe between THP and e-cigarettes, there has always been a very strong space for e-cigarettes in high tar markets.

In Japan it is different because there is very low tar and nic consumers that are already there. So the satisfaction gaps are lower and you have always in the process of PMTAs, you have to have the science that goes with it. So you don’t have the latest product that comes to the US, you have the products that were there three or four years ago where you have the science that you have to take the time for making the science. And then you can come to the market with a product that has been there long time ago in other markets.
So that’s an iteration process where New Categories I’m very pleased to say is growing in the US and where there will be more opportunities in the three to five years to come okay. And as you see in our results in the US, now the New Categories with e-cigarettes is having a major part in terms of our profitability and our financial numbers which we are very pleased with. Okay.

**Gaurav Jain, Barclays**
Sure, thank you so much.

**Jack Bowles, Chief Executive**
Thank you very much.

**Telephone Operator**
It appears that there are no further questions at this time, I’d like to turn the conference back to Mr Jack Bowles for closing remarks.

**Jack Bowles, Chief Executive**
So thank you very much for joining us today. I’m very proud of our performance in 2022, our results show that we’re transforming the business at speed and delivering strong results in a challenging macro environment.

We expect 2023 to be a stronger year with organic revenue of between 3 and 5, led by New Categories and stronger combustibles.

While higher interest costs and our exit from Russia and Belarus means that we are guiding mid figure EPS for this year. We’re also making active choices as our New Category growth model continues to accelerate and deliver. This means that we will invest more and that achieving New Category profitability in 2024 one year early. We have made choices, and this is the right thing for us to do.

I’m excited that building on the strong progress that we have made today will continue to transform. Driven by our brands, our capabilities and determination to drive long term value creation for all our stakeholder. So thank you very much for listening and have a very good day.

**END**