

BofA Global Research ESG Consumer & Retail Conference 2021

March 31, 2021

Q&A Session

Speakers:

Mirco Badocco, Analyst, Bank of America

David O'Reilly, Director, Scientific Research, BAT

Jennie Galbraith, Head of Environment, Social and Governance, BAT

Mirco Badocco, Analyst, Bank of America

Thank you very much, that was a very insightful presentation, thanks for that.

As a reminder for investor connecting, please use the chat box if you want to send a question to me and I can read it out to our speakers.

So in terms of a few questions on my side to start with. The first question is on R&D and science versus regulation. You've made a very compelling case for a science driven approach to harm reduction in tobacco, but ultimately what's really needed to turn sentiment around is a clear endorsement from regulatory bodies around the world. We have a few exceptions like US and the UK which you alluded to; it feels we are very far from this at the moment.

So what should we expect in the next few years on this front? And related to that do you think that obtaining PMTA stamps from the FDA could accelerate the shift from ideology to science in other countries as well?

.....

David O'Reilly, Director, Scientific Research, BAT

Thank you Mirco for the question. I think we have to look back first and just see how far we've come in the last few years. And there has been an increasing endorsement of tobacco harm reduction that's probably the most effective and pragmatic public health policy to reduce the public health impact of cigarette smoking. And as you say there are leading governments like the US FDA, the UK with Public Health England and one or two other countries that are really leading the way here.

And I anticipate with more evidence both not just on the science and the research that we and others are doing. But as you see the transformation in the marketplace with more and more smokers switching to these products, you know, recreating the Swedish experience Snus that is the foundation of all of this, then I think more and more governments thinking rationally will follow this.

Of course, I think, you know we all look to the FDA as being the pinnacle of tobacco product science-based regulation and achieving PMTA status which is appropriate for the protection of public health is a big step forward, as is the ultimate seal of reduced risk which is their MRTPA standard. So once more products go through that I think there will be more evidence and more pressure on governments to accept this to the best approach to public health protection. And I think the momentum will continue.

So I am quite optimistic about the future. There is still some way to go of course, but we as BAT will play our part by innovating new products, putting the commercial firepower behind those products, and substantiating the reduced risk status of those products with our science.

.....

Mirco Badocco, Analyst, Bank of America

Great, thanks David. My next question is on heat not burn if we can, I think we can say Glo hasn't really delivered on the best of its potential in the past, but now we have Glo Hyper, so a couple of questions here.

What makes Glo Hyper a much better product than its predecessors? And maybe if you can share a bit of colour on retention rates and customer satisfaction that would be great, so from the point of view of science and technology.

And second, if Glo Hyper is indeed a much better product should we expect you will start pushing it harder also in Europe now, where I know you haven't made big inroads in the past?

And finally, what about PMTA applications in the US, should we expect anything on that front?

.....

David O'Reilly, Director, Scientific Research, BAT

Yeah, so thank you Mirco. Well obviously, Glo Hyper is I think it's 3rd or 4th generation tobacco heating product coming out of our pipeline. It's a real step change improvement in the previous products, in fact it's our most successful THP launch to date. The improved product performance comes with several advances that have materially improved consumer satisfaction.



So you know Glo Hyper was - we were the first THP product to globally introduce a powerful new induction heating technology. It has a faster ramp up time, a boost button to deliver additional satisfaction and impact and it has new consumables with 30% more tobacco and a familiar demi slim stick format, delivering more taste and flavour. And consumer testing has validated this improvement, as has the acceleration of Glo's share gains, both in Japan and Europe.

On key consumer attributes it scores the same or better than the industry leader. Hyper drove our stick volume growth, accelerating to approximately 50% in the second half of 2020. And as we shared at our full year results, Japan - Glo's total nicotine share is now above 6% with over 100 basis points of total nicotine share gain since August and it's about 20% of the THP category share.

In Russia we had about 1.5% total nicotine share in December 2020 and our share in Moscow is close to 5%.

We are also making great progress in the Ukraine, Romania, Italy and in other countries.

So in 2021, you're quite right, we will be building on consolidating Hyper's success and momentum in those ENA markets as well as rolling it out into other selected markets.

And whilst we have previous generations of Glo under regulatory review with the FDA, with Glo Hyper we will be pushing hard to get a PMTA authorisation with the US FDA, but obviously that takes some time.

.....

Mirco Badocco, Analyst, Bank of America

Understood, thanks. And if we can go back to Combustibles now, you've highlighted a lot of progress in the ES&G, part of ESG in your presentation, which is great, but 90% of your revenue is still coming from Combustibles and on your £5bn target for New Categories that would still be less than 20% of your revenue by 2025, do you think this is enough to move perception on ESG, or should you push even harder, you know, bigger targets in New Categories?

.....

David O'Reilly, Director, Scientific Research, BAT

Well at the moment we think those are realistic targets. Obviously, we'd hope to exceed them if we can. You know we're pushing really hard on the science, the innovation, we're investing a lot behind the commercialisation of these products and we're making great progress. So this year will be the first year that we will reduce our losses and over the next three or four years the entire categories will be profitable.

But a lot depends on external factors as well. You know, we need regulatory support in terms of allowing us to sell some of these products in some countries where currently



we can't, in public health communications to smokers that switching to these products will be a good thing for their health. So it's a very complicated journey we're on. But we are 100% committed to it. And we are pushing as hard and as fast as we can.

Again, our core purpose is to reduce the public health impact of our business. And that's our commitment and our mission.

.....

Mirco Badocco, Analyst, Bank of America

Okay, thank you for that. So moving on to a different topic, so that's one for Jennie I guess, so plastic. You showed the target to eliminate unnecessary single use plastic and make all plastic recyclable by 2025 so a few questions on this.

How much of total plastic is currently recyclable and where are you versus plan?

And also, what are the areas that will be more difficult to address in this respect, is it on packaging or is it on the product itself?

And finally, how should we think about the costs associated with your plans for plastic?

.....

Jennie Galbraith, Head of Environment, Social and Governance, BAT

Yeah, happy to take that one. So yeah, absolutely we've set ourselves some really stretching targets on plastics, but we are making good progress already. So at the end of 2020 the number was 82% of our packaging was recyclable, so we are making really good progress already.

And I touched on a couple of those things in my presentation already, so single polymer cases for Velo Mini is already in place. We have removed silicone and plastic film from Vuse. We're removing the insert trays and the plastic overwrap from Glo, so lots and lots of things have happened and lots of things in the pipeline.

But you know stretching targets do have challenges, that's why we've set them. They wouldn't be very well received if we set ourselves easy targets. So there are some challenges. The good news is that particularly when it comes to the new category side of things the rate of innovation is so high, we're just designing these things out for the next iteration. So it's not hugely challenging to do.

There are some things there though, so when it comes to the packaging, when it comes to the plastics that are involved in product integrity that's obviously a trickier area, we can't just pull those out, they are not classed as non-essential. But we're confident. You know we're working with start-ups, we're working with our material suppliers, we're confident we'll find a solution.



When it comes to the product itself, again, you know we can design many things out but what we're talking about here is making sure we're designing for easier disassembly and also you know introduce single polymers, that sort of thing.

So lots of things in play and great progress, we'll continue to report how we get on there.

I think your last point was on costs. And I think here, you know, a lot of this isn't around a cost, this is about removing something, so there's actually a saving there when it's in place. There clearly will be some costs, take back schemes and other things that we need to consider.

But actually I don't think it's right to think about this type of thing in terms of a straight cost because this is a value proposition. So we are absolutely clear that this is what our consumers want to see. We are absolutely clear that this is what our employees want to see, so from an attraction and retention point of view, this is also - you know this is very much a value proposition and not a cost of doing business.

.....

Mirco Badocco, Analyst, Bank of America

Understood, very clear, thanks Jennie for that. My next question is on reputational risk for New Categories. I mean you are clearly investing and focusing a lot on R&D and quality and not all players are doing this, right. And right now it is somewhat difficult for the consumer to differentiate given the proliferation of offerings, especially in vaping. So is there a risk that low quality offerings could sabotage the good progress made in harm reduction? And how do you prevent this from happening?

.....

David O'Reilly, Director, Scientific Research, BAT

Yeah, I think that that risk has been there for some time now and we've seen it, you know, with scientific studies of some poor-quality products showing emissions of toxicants that we wouldn't tolerate. Of course we all know about the EVALI crisis in 2019.

That said, I think if responsible players like BAT who do invest in the science, in the consumer product safety and the product quality, you know as we progress and build bigger product portfolios, bigger brands that consumers can trust, then I think you'll get more migration towards those products and brands that are trusted.

And of course regulation helps here as well. You know you take the US situation at the moment where all Deeming products - all vapour products have to go through a PMTA evaluation. We anticipate that within the next year the US marketplace will be transformed and only those products on the market will have met the high standards that the FDA stipulate as being appropriate for the protection of public health.



And in other countries we engage with regulators, but also with standard bodies, you know bringing our science and our product knowledge to set high standards for all manufacturers to comply with.

So I think you know companies like BAT that have invested in the category, that are investing responsibly in the category, we play a leading role in raising the bar across the marketplace so that the entire category gets a greater level of trust and there is less of a concern for reputational damage.

.....

Mirco Badocco, Analyst, Bank of America

Thank you very much for that. So I guess we have a question from the audience now.

So what are the key milestones and deadlines we should expect in terms of BAT being able to demonstrate that science that supports reduced risk products, so the milestones you have in the pipeline, or what should we expect there?

.....

David O'Reilly, Director, Scientific Research, BAT

So that's a great question, thank you for asking it. So by the end of this year we will have completed our entire assessment of our three platforms, so all the way through from emissions through to population studies. And those will all be published in independent international peer reviewed scientific journals, so there for the world to see. So that's a big milestone for us, that's been a multiyear journey.

The second milestone of course will be US PMTA and ultimately MRTPA applications being successful in the US. Obviously, that will take some time.

And in the meantime, we have to demonstrate that we can transform the marketplace. So we have targets, the ultimate target of 50 million consumers by 2030, a massive transformation. We're already making and accelerating our consumer acquisition from smokers to our New Categories. So you see the 2025 ambition as well.

So it's a combination of the science, building credibility to the reduced risk nature of these products, but also outperformance in the marketplace, taking volume and share and growing numbers of non-combustible consumers.

.....

Mirco Badocco, Analyst, Bank of America

Thank you very much for that. So I'd like to touch a bit on the financials if we can or going back to that Beyond Plastic. The cost to deliver ESG targets has been a key feature for consumer staples overall, you know putting pressure on margins. So how



does this play in respect to BAT? Should we expect increasing costs of doing business and more pressure on margins because of ESG going forwards? Or is it something you can easily absorb with efficiencies and pricing?

.....

Jennie Galbraith, Head of Environment, Social and Governance, BAT

Okay, thanks Mirco. I think when we're looking at ESG costs and margins there's two broad areas where this falls into. So we're either talking about New Categories or we're talking about the more traditional ESG.

And I think if I take New Categories first, you know, we've been clear, Jack has been clear that this is a pivotal year for. A large part of that is that for the first time New Categories will contribute to earnings growth.

We have already spent a lot of time building the capabilities that we need to win in that space, whether it's insights, whether it's digital, whether it's in our distribution. And these are largely in place now. So we are at a place where we can continue to invest in New Categories, but our loss over time will reduce.

I think also at the recent CAGNY presentation we were absolutely clear about why we're confident that we'll be breaking even on New Categories by 2025.

Taking a step back and beginning to look at the broader ESG piece and what that means, yeah absolutely for all of our targets we've got a well-defined glide path. You know we've costed out, subjects, new technologies, all of those caveats.

But again, the thing I touched on in my previous answer, I don't think it's necessarily right to always think about this in terms of costs. So you know first of all we're talking about reductions or removals a lot of the time. So there are savings to be sought there, whether it's removing plastics, whether it's about reducing energy use.

Much of what we do will also be integrated into existing ways of working. So whether that's about closer farm monitoring for child labour and training of farmers by our field techs, or whether it's about replacing plant and machinery when they need to be upgraded for more environmental types that will deliver more efficiencies in that space. So again, it's not a straight cost, these are things that are happening within the business and part of our ways of working. And I showed on my slides how well integrated ESG is now.

Clearly, as well we think there will be some efficiencies around economies of scale, particularly as we ramp up the New Category side of things when it comes to the circular economy. So costs around new materials, etc, will be reduced.



We are already looking to partner with start-ups and entrepreneurs which will keep the costs of new innovations low.

But this is a value piece for us, so, you know, consumers, employees are all very interested in this space. It's a value opportunity and not a cost. That said, we will need to invest in places. Jack and Tadeu are very clear that we're going to return to high single digit earnings growth post COVID. And all of the investment that we've assigned for ESG is included in those statements. So we're confident.

.....

Mirco Badocco, Analyst, Bank of America

Amazing. Thank you very much for that. So we are running out of time, the last question from the audience. How do you think about the long-term demand also for nicotine over the next 10 to 20 years, is it going to remain broadly flat in volumes, declining or even improving?

.....

David O'Reilly, Director, Scientific Research, BAT

Yeah, overall, and this is a long-term historical trend - but the demand for nicotine grows with population growth generally. And that remains true today. Obviously, we'll see a decline in the consumption of cigarettes and that will be replaced, as we're seeing now, with the consumption of safer alternatives like THP, vapour, and oral products and that that trend will continue to grow with population growth. So it's a good and sustainable outlook, I think.

.....

Mirco Badocco, Analyst, Bank of America

Okay, thank you for that. With this I am afraid that we're running out of time, so we need to stop here. So thank you everybody for participating and attending our ESG conference and thank you for David and Jennie for your time, we much appreciate it, very insightful.

.....

END

