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Questions and Answers

Victoria Buxton, Senior Investor Relations Manager

Good afternoon everybody and thank you for joining us. I am Victoria Buxton, Senior Investor Relations Manager at BAT and with me today are Jack Bowles, our Chief Executive and Tadeu Marroco, our Group Finance Director, who are here to answer your questions.

And with that I will take the first question.

And our first question is, can you give more detail on why you’re so confident on hitting your 2025 £5bn New Category sales and profitability targets?

Jack Bowles, Chief Executive

Yeah, let me take that one. Hello everybody, I'm Jack Bowles and I'm here with Tadeu Marroco.

Well, I think the £5bn is in sight now because we have had three years of transformation of the company, we have created all the capabilities that we need. We are multicategory, we are already in THP, in Vapour and in Modern Oral. We have a strong Combustible business in order to fuel the resources that we need for the New Categories.
And in the second half of the year we have accelerated very strongly. So in the second half of 2020 we have increased our volume in the three categories by around 50% and also, we have increased by three million the number of consumers we have, we are now at 13.5 million consumers in New Categories.

And I must say that in the second half of the year we have added two million consumers and in the last quarter, 1.1 million consumers. So we are accelerating strongly. And we believe strongly that the £5bn is in reach in 2025.

**Victoria Buxton, Senior Investor Relations Manager**

Thank you, Jack. Our second question is BAT’s mid-single digit EPS guidance for 2021 reflects continued high NGP investment in the year. When can NGP investments stabilise or normalise? Thank you.

**Jack Bowles, Chief Executive**

Well I think before Tadeu completes my answer - I think what's very important to see is that we are growing strongly, and we see the year 2021 as a pivotal year where we start to reduce our losses in New Categories.

We have invested £460m more in 2020 and we'll continue on the strong base of investment for 2021. Why? Because as I said we are increasing the number of consumers very strongly, we have a strong springboard going into 2021 and we'll continue to invest behind our categories. But yet again, the losses on New Categories, will be starting to reduce by 2021. Tadeu, do you want to add something?

**Tadeu Marroco, Group Finance Director**

Yeah, look at the end of the day we will continue to invest in New Categories, but we're going to make more revenues out of the New Categories and hence the losses will start reducing from 2021 onwards.

Just to talk a bit about the guidance, the guidance, I would like just to remind you about two things. One, our guidance includes transactional FX, so we are expecting, based on the current spot rates, a 2% equivalent of operating profit hit in 2021, which is double what we had in 2020. So it's part of the mid-single digit figure, that in reality is a range that we have said.

And the range will depend on the clarity of the uncertainties that we mapped out, global travel retail is one of those, COVID is still very present in a number of markets, specifically in India, where ITC has been impacted by that and as a consequence BAT that report their numbers with a three-month lag gets impact in terms of the kickers on operating profit, from EPS.

The US market is still very uncertain given the circumstances, that's why we haven't provided guidance.

So as we go along all those clouds will be dissipating and we'll be following these up and keeping the markets updated on that.
Victoria Buxton, Senior Investor Relations Manager
Thank you Tadeu. Our next question is, of the £1bn in targeted cost savings what proportion do you expect to reinvest in NGPs?

Jack Bowles, Chief Executive
Well, as I said before, first of all the savings that we are doing we have a target of £1bn and we already at £660m in 2020, so that's beyond what we wanted to deliver in 2020. So we are very strong and very focused on reducing our cost base. I think we will continue to progress in that direction.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And our next question is, can you expand on your ESG strategy?

Jack Bowles, Chief Executive
Yes, I think what's very important in terms of our ESG strategy is that we have a very good foundation already. We are on the Sustainability Index for now more than 18 years. We continue to have ratings that are Triple Bs and we're doing more and more things in terms of ESG. In terms of the E, in terms of the S and the G.

And the programmes and the projects that we are doing are all geared towards our ambition of 2030, which is having for our business and our consumer base 50 million consumers that will be in the Non-Combustible category. Carbon neutral by 2030. And the reduction in terms of single use plastic.

So I think we are very consistent in terms of what we are doing, and we'll continue to do so. So a strong foundation that we have at the moment and we have put ambitious targets in front of us in order to continue to accelerate on this base.

Victoria Buxton, Senior Investor Relations Manager
Thank you. Our next question is Quantum savings for 2020 appear to be running well ahead of the target provided at the H1 stage. Is there scope for additional savings, or is this simply a case of generating savings much earlier?

Jack Bowles, Chief Executive
Well what we’ve done with Quantum is to put really in the middle of our delivery the fact of saving as much money as we can. But it is also about simplifying our business and increasing the efficiency of that business. So it is both that is happening at the same time. So we are transforming the organisation in order to accelerate the transformation of our business.

And I think that we're ahead, that's very good, and we'll take it as we go along. We'll update on a regular basis, half year and full year, in order to see how we fair. But I think that it's a very strong start in terms of that programme and we'll continue to push very hard, we'll make sure on that.
Victoria Buxton, Senior Investor Relations Manager
Okay. And the next question is, you showed a slide which said that two thirds of the growth towards your £5bn, 2025 New Category revenue target will come from share gains. What will be the biggest driver of those gains, THP or Vapour?

Jack Bowles, Chief Executive
Well what you see at the moment is in terms of the three categories we are growing strongly. We are growing by 50% in the second half of the year in volume, that is a very, very strong result and that's a great springboard moving forward.

In terms of THP we are growing in the second half of 2020 by 59% in volume. In terms of e-cigarettes we're growing by 45%. And in terms of Modern Oral we're growing by 56%. And let me tell you we take the three categories very seriously. And what I can tell you is that these categories because we're a multicategory consumer centric approach we have the whole system in order to know what products to launch in what geography in order to make sure that we have the most efficient portfolio.

So I think that what is important is that we are multicategory, we are growing by 50% in the second half of the year and we'll continue to push very hard related to that.

We have growth in the three categories, and we'll continue to accelerate in different geographies.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And the next question is, have you applied for a PMTA for glo in the US, or do you not think that it's worthwhile given the full flavour nature of the US cigarette market?

Jack Bowles, Chief Executive
We are doing everything that is required in order to make sure that we are on top of our game really towards this. You know, what is very important is to see that also the PMTA progress in terms of e-cigarettes is going to be extremely important and it is going to be a contestable space that we consider has around US$1.5bn in terms of revenue that will become available as we go along.

So as you know we are extremely strong in e-cigarettes in the US and we have already 15 states in the US where we have leadership. Now two years ago nobody would have thought that we would be able to do that. But the reality is we have the capabilities in the market, we have a very strong salesforce, we have a very strong digital platform, and we are doing great progress. So I think that the PMTA process in general gives a level playing field in the US market, which is absolutely fantastic.
Victoria Buxton, Senior Investor Relations Manager
Thank you. And the next question is, you were close to the top of your debt range, when do you feel that you will have sufficiently de-levered and will you reinitiate buybacks at this time?

Jack Bowles, Chief Executive
Well the ongoing - and Tadeu will complete my answer on this one of course, but the ongoing philosophy that we have is to go around three times net debt to EBITDA by the end of 2021. That has been a very, you know, straightforward journey since three years now and we are continuing to push very hard for the deleveraging. But Tadeu, I'm sure you want to add something on that.

Tadeu Marroco, Group Finance Director
Yeah, you probably have seen from our presentation our clear capital allocation priorities that we stated. We are where our key shareholders - they are very pleased to be remunerated through our dividend policy of 65% dividend payout. And we are very proud in reality of 20 plus years of history of increased dividends. And even in the years like we saw last year with the pandemic, a very disruptive year, we were able to keep increasing the dividends, we kept the dividends and we ended up being at the end of the day, we became the company with the highest dividends paid in the FTSE.

Now, we also indicated that we are a very cash generative company. And we proved that last year. So we want to - we expect to be able to generate over the next five years just below you know £40bn and more than £40bn in free cash flow. And after the dividends there will be around £15bn that we can be using for debt, for share buybacks, for continuing investment.

It's important that we keep our new corridor of three to two on side because we want to continue having access to the markets, because we have a net debt of just below £40bn, so we want to preserve that. We have made some commitments. That's why it's so important for us to get to this corridor. And we believe that by the end of 2021, as we said before, we'll be close to the three times and by then we're going to have much more flexibility to decide what we're going to do. We can even analyse the share buyback of the circumstances are right. But we expect first the priorities that you saw in the slide.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And the next question is, how confident are you that you can return to high single digit earnings growth after full year 2021?

Jack Bowles, Chief Executive
Well it's after COVID and I think it's very important to consider that if we would not have invested everything that we have invested in New Categories in 2020 we would have been in a much stronger position in terms of this. But the reality is we consider that it's very important to invest in the business and to continue to accelerate in terms of the development of the New Categories. We have momentum and we want to continue on that. Tadeu?
Tadeu Marroco, Group Finance Director
Yeah, I fully agree with Jack here. I think that - we have the plan, the right plans to be able to do that and we want to persevere, and we are sure that we can get there.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And the next question is, can you elaborate on the margin impact from NGP investments on overall operating margin for the next five years?

Tadeu Marroco, Group Finance Director
Okay look, operating margin - the NGPs are going to give a kind of holistic picture on that. on the Modern Oral the margins if anything is even higher than the ones we have currently with Combustible. And we expect to continue increasing because of the scale as we progress, and we expand geographically.

In terms of THP, the margins are still very robust, although we expect some headwinds in terms of excise increases. In our case that our consumables are produced at the back of our manufacturing footprint, we will have a lot of legroom to reduce the cost of our products and hence the margins at the end will also end at a very favourable position compared with the ones that we have today in cigarettes if not higher.

And the Vapour, which is the category that has been below the margins that we have today in Combustible, we have clear plans to accelerate the improving margins. We have already taken a leading position in markets like France and the UK and this is making our life easier to start renegotiating the margins as a consequence of that. So we have already done that in some key channels and key accounts in some of those countries very successfully.

E-commerce is another area that we have been putting a lot of focus. We increased our e-commerce sales by 69% in 2020. And the profitability in e-commerce is more than double in the traditional key accounts.

In the areas that we are putting also a lot of focus on revenue growth management, so we can target differentiation, through differentiated pricing depending on elasticity in different geographies. So we can push prices up as well, without losing competitiveness.

And finally we have invested in a tool for market spend effectiveness that is helping us to allocate better in terms of consumer touchpoints.

So when you put all these together, we are very, very pleased with the progress we will be making on the margins and expect to reach very good margins moving forward.

Victoria Buxton, Senior Investor Relations Manager
Thank you. The next question is your European e-cig revenues are higher than your European THP revenues, why have you prioritised investing in the
European Vapour market, which is fragmented and likely to remain so, and thus generate little margin over European THP?

**Jack Bowles, Chief Executive**
Well I think that if you look worldwide there is about 100 million consumers that are using New Category products, a lot of them are in Europe. And we have determined very soon through our tools in terms of consumer assessment that Europe was a very good market for e-cigarettes, so we've pushed very hard on e-cigarettes. And we have a leading position in terms of e-cigarettes in Europe and we're very proud of that.

Now the second thing is in terms of products, in terms of THP, we have launched, about six months ago, our first to the world induction heating product, which is glo Hyper, and now we're rolling out that product across Europe and we're seeing very good success related to that. And we are accelerating on the development of these launches in Europe.

So yes, we are multicategory, we are proud about it. There are markets in Europe where THP is not working. There are markets in Europe where e-cigarettes is working very well. And when there is the opportunity, we play our full portfolio, depending on the different geographies, Tadeu?

**Tadeu Marroco, Group Finance Director**
Yeah, I think that just a reminder, because we note that we had a problem in terms of THP products, on the satisfaction, and we addressed that. The launch of the first to the world induction technology puts us in a very different position in competitiveness and we have accelerated now our deployment of resources behind THP and we are seeing very strong results coming out of that in Europe.

**Victoria Buxton, Senior Investor Relations Manager**
Thank you. And the next question is glo Pro was also induction heating but was not as successful, is the technology in the Hyper different in some key way, or is it the stick size that has made the big difference?

**Jack Bowles, Chief Executive**
Yeah, I mean it starts with - it's a very good question. It starts with the format size and what you see in Japan for instance is that we have a portfolio now that is 6.3% of the market, total nicotine. And we're doing extremely well with that. And what we see is that there are consumers, the older franchise that want to have the super slim format and you have the younger generation where we were less strong where we needed to have the glo Hyper. And we launched glo Hyper and now since August 2020 we grew 100bps in terms of market share in Japan.

So I think that we - in the most competitive market in terms of THP worldwide, it represents more than 50% of the total volume. And you see that we have the portfolio in order to accelerate.
So as Tadeu said, we have very strong markets in terms of e-cigarettes, now we have the right products in terms of THP and we’ll accelerate the deployment. I think we're doing a good job at understanding the consumer to see what is the best launch mechanism and what is the consumer acquisition model that is best adapted by geographies. That's because we have a global consumer, multicategory tool that allows us, that was presented during the charts that you saw today. And that gives us a very strong understanding and high efficiency. So we are rolling out very strongly and we are growing very fast at the moment.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And the next question is, BAT has a 29% ownership in ITC valued at £8bn. My question is, what are the possibilities to unlock value from this ownership given the foreign investment in cigarettes and tobacco substitute products is disallowed by the Indian Government?

Tadeu Marroco, Group Finance Director
Yes, I think that you are already answering the question. There is a restriction in place and even if you find a buyer for that business it would be difficult to go beyond - they have to change the laws first in the country.

But let me tell you one thing, I think we consider ITC a very strategic investment for BAT. They have had a difficult year because of COVID, but they have done transformation in their own portfolio as well and have delivered strong results and we are very pleased with the investment in India.

We are a global company and being present in India can open up other opportunities for us in the future, even in the New Category space as well.

Victoria Buxton, Senior Investor Relations Manager
Thank you. And our next question is, can you talk about your pricing and promotion strategy on glo, where your products seem to be very discounted versus your key competitor, why is that the right approach?

Jack Bowles, Chief Executive
I think that there are two things that you have to separate. One is the consumables, which are the sticks that you put in the devices and the second one is the devices. Of course when you are in the phase of acquisition of consumers you will do some activities and promotional activities in terms of the devices, totally normal. So we follow the market as we go along.

As we did for instance in the US some time ago where you had a competitor that dropped the price quite brutally, then we followed, and we made sure that we flexed our muscle in terms of distribution and in terms of consumer understanding in order to get the best out of the situation. And that's what we did. And you see very clearly that the acceleration of e-cigarettes for us in the US if fantastic. We have doubled our value share during the year 2020.

So we know how to navigate price situations and price skirmishes. So we are in the acquisition phase of consumers and we'll make the money on the
consumables and on the pods, which is totally logical at this stage of our development.
Victoria Buxton, Senior Investor Relations Manager

Thank you. And our next question is do you expect any changes to menthol regulation in the US under the new Administration?

Jack Bowles, Chief Executive

Well it’s a broader question, I think. You saw that not long ago the FDA maintained menthol in e-cigarettes, and you see also that there are a lot of states already in the US where menthol is not there.

The reality is consumers are first consumers of cigarettes, are first consumers of Combustibles. And then after that they are consumers of that ritual that is related to the product. And then thirdly and only thirdly they are users of menthol. So when you have menthol bans that are happening, albeit in Europe for instance, or be it in Canada, you see that the retention rate that we have is always beyond 95%. And even when you add in there the New Categories you can be beyond 100%.

So I think that we know how to navigate all this, and we'll play our cards, our very strong cards, as we go along with the restrictions coming in.

Victoria Buxton, Senior Investor Relations Manager

Okay, thank you. And a follow up, can you clarify if your new long term leverage target two to three times, versus 1.5 to 2.5 times before? What drove that change and does it influence your need in 2021 to extend weighted average debt maturity?

Tadeu Marroco, Group Finance Director

No. basically the decision is related to - first of all we have clear credit rating ambitions, we believe that with this new corridor we can be spot on those credit ratings that we are targeting. And on top of that we believe that that's the necessary range to address the business needs.

We have, like we always said, we want to continue investing in the New Category space like we have just done in the US with the acquisition of Dryft. We want to be able to be flexible and go for a share buyback if the circumstances prove to be the right ones. And we believe that the three to two will give us this mid room. And at the same time address the credit rating targets that we have set ourselves.

Jack Bowles, Chief Executive

So the first milestone for us to towards the time of reaching around three in terms of net debt to EBITDA. And let me tell you we will invest in the business when it is important to invest, as we did - like Tadeu said on Dryft, in Modern Oral. Although a small category in the US I mean we started with 8% share, with the acquisition of Dryft and pushing the machine of BAT in the US, we are now around even 13% share in the US. So we are growing strongly, and we are growing fast.
So I think the right balance between making sure that we invest in the business and then that milestone of around three and then we review the situation again.

**Victoria Buxton, Senior Investor Relations Manager**

Thank you. And our next question is, Jack, you've been CEO for over two years, what are you most proud of so far and how would you define your success in five years' time?

**Jack Bowles, Chief Executive**

Well that's a very personal question but let me answer it this way. I think what I'm very proud about is first the people in the BAT. They have proven that they have the entrepreneurial spirit that we need for our business. I think the change is embedded in the genetics of BAT and we have accelerated that transformation at a high pace.

We have done that transformation and put in front of not only the consumers, but also society in general, a new purpose, that is to reduce the health impact - three years ago, the health impact of our company and we are doing so. We are putting our money where our mouth is. We have invested heavily in capabilities and we are investing heavily in innovation. I think we have a strong portfolio now of three brands, each in the different categories, that allows us to steam ahead.

I think that the result of the second half of 2020 is a testament to that commitment to continue to invest heavily in the New Categories and make sure that we develop our business.

So we're in the phase of acceleration, we're in the phase of transformation of the company - which is one of the three core priorities of BAT, the first one being extract value from the Combustible business, step change in the New Categories and transform and simplify the company.

So we have the Project Quantum that we just spoke about. And also you saw during the presentation the Project Quest, which is to transform completely the company and the operating model. And we are doing that at a high pace, which is extremely good.

But the roadmap is very clear, we know that we want to be at £5bn in terms of New Categories by 2025 and having a transformed organisation, a transformed company, this $5bn and having more flexibility as we are going to continue to deleverage the company will give us an extremely strong base in 2025 to continue to accelerate.

So I think it's an ongoing moving target of fulfilling the aspiration that we have of 50 million consumers in New Categories. This is radically transforming our business and we have shown in the last three years that we are extremely committed to do it and to deliver that change in the organisation.
First the people, we are very impressed by the transformation and the way we work in the organisation.

Victoria Buxton, Senior Investor Relations Manager
Thank you, Jack. And now I’d like to turn it to you for closing remarks.

Jack Bowles, Chief Executive
Well thank you very much, thank you very much for the time. I think BAT in 2020 has been about delivery, transformation, and acceleration. We had a very strong 2020 in value in Combustible, that allows us to fuel the investment in NGP, in New Categories and I must say we are very proud of the growth in volume of all three categories.

So we are the only company, worldwide company with presence also in the US which represents 40% of the value, we are very proud to have in all three categories around 50% growth in volume. We have added two million more consumers in H2. So this is a strong acceleration.

Of course we are adamant that we continue our dividend policy of 65% and we have done a terrific job in terms of cash and deleverage.

Now it’s a journey, 2021 is a pivot year for the company and we have momentum, we have strong foundations with the right strategy. We are a global consumer, multicategory company. And we are accelerating our transformation.

So let me tell you, in 2021 we will reduce the losses in NGP, we’ll be around three in terms of net debt to EBITDA, we will deliver on Combustible, we are the fastest growing company in value in terms of Combustible. We will continue to accelerate in terms of the New Categories. And we will simplify our business and our organisation with Quantum where we are already beyond our targets year to date. And Quest, that is the transformation of the enterprise of the future.

So it’s a pivotal year for BAT where we will continue to deliver, transform, and accelerate.

Thank you very much, thank you very much for listening.

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