

2023 Half Year Results

Presentation and Conference Call Transcript

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Tadeu Marroco, Chief Executive

Good morning everyone, I'm Tadeu Marroco and I'm delighted to welcome you as BAT's Chief Executive to our Half Year Results Presentation. With me this morning is Javad Iqbal, Interim Finance Director.

Once we have been through our presentation Victoria Buxton, our Group Head of Investor Relations will join us on stage to enable us to take your questions, both over the phone and through the webcast facility.

I will begin with our financial highlights for the half year, the progress we are making on our transformation and outline my key areas of focus as Chief Executive. Javad will then take you through our financial performance in more detail.

With that I'll take it that you have all seen the disclaimers on slide 2 and 3.

I am pleased with how BAT has performed in the first half of this year, delivering growing revenue, profit from operations and earnings per share. Our reported results reflect the impact of one-off items in the prior period, including impairment of our business in Russia and Belarus, the US DoJ OFAC provision, restructuring charge relating to Quantum and positive FX tailwinds.

We will now focus on constant currency adjusted results unless otherwise stated.

One of the important strengths of our company is the breadth and the scale of our global footprint, enabling us to consistently deliver balanced and sustainable results.

In the first half this is demonstrated by our strong performance in AME and APMEA, offsetting the US.

Overall we have delivered an increase in revenue, up 2.6%, profit from operations up 3.6% and EPS up 5.3%.

I believe this is a resilient performance in today's environment and we are on track for our full year guidance.

I am particularly pleased with our performance in New Categories with revenue up nearly 27% driven by good volume and growth and pricing. Consumer numbers up over 1.5 million year to date and encouragingly we are

now very close to breakeven.

As a result we continue to transform rapidly with non-combustibles already reaching over 30% of our revenue in 23 markets. This represents nearly one third of the 71 markets where we are currently present in New Categories.

And our transformation is even more advanced in many markets. Non-combustibles as a percentage of revenue is already over 30% in France and more than 50% in the UK, led by Vuse. Over 50% in Japan, Poland and Kazakhstan led by glo. And over 70% of our revenue in Sweden is now in oral tobacco, driven by our success with Velo.

Notably Sweden is on track to become the first smoke free market in the EU, with the smoking incidence approaching 5%. With a long-standing history of oral tobacco consumption and a fast-growing Modern Oral category Sweden is a powerful example of the positive impact of tobacco harm reduction in action.

As you know I have been in my new role for ten weeks now. During this time I have been focused on examining how we can sharpen our execution. As a first step last month I announced the refreshed Management Board. I would like to highlight two important changes, Johan's new role as Chief Operating Officer, focused on delivering growth with accountability for driving business performance, operational excellence and best in class execution.

And Kingsley's new role as Chief Strategy and Growth Officer focuses on enabling growth with accountability for strategic development and sharpening the consumer focus through an integrated approach to brands.

This new structure supports my commitment to build an agile modern and progressive BAT, with a collaborative and inclusive culture, enabling simultaneous performance and transformation. As part of this we must operate to the highest ethical standards, and this must remain a priority for both our employees and our business partners.

So let me share some of what I have been doing in my first ten weeks. One of my immediate priorities has been to visit a number of our key markets with my Management Team. I have to tell you that those visits have been both humbling and reassuring in equal measure.

BAT is a company with a great heritage, our two biggest assets have always been our people and our brands. I have spent time with our people in these markets and I have taken the time to listen. What is clear to me is that through the right enablers our organisation is ready, our people are excited

about the transformation journey ahead, with the opportunity to drive real change, both for BAT and society more broadly.

I am clear that BAT has a unique set of strengths and capabilities already in place. However, we can and must do better in order to evolve and accelerate our transformation.

While my Management Team and I agree that our multicategory strategy is right, we are also fully aligned on the areas that need great focus, supported by a more collaborative and inclusive culture.

Firstly, recognising our diverse global footprint we must set out the organisational focus and priorities in a clear way to ensure we execute flawlessly across all our markets.

Sharpening execution is central to our market archetype model, enabling better resource allocation around fewer, bigger priorities that can be measured and for which the markets are accountable.

I understand that this may seem a little theoretical so let me bring the model to life with two markets, each representing a different archetype.

In Bangladesh we have actively focused on investing on continuing to grow value share revenue and profitability in Combustible while we await clarity on New Category regulation.

And in Poland where over 50% of our revenue is now in New Categories, we continue to grow share, driving strong New Category revenue growth and improved contribution, alongside value from our Combustible business. Every smoker we convert to our New Category brands in Poland is margin accretive to our business. This benefit is further amplified as our share of the market in New Categories exceeds that of Combustibles.

These two markets are clear examples of where the model is working by making better resource allocation decisions and delivering strong results. We will replicate these executional insights and ways of working across our footprint.

Secondly, we have further improved our New Category contribution, reducing losses by £200m in the first half. Having invested significantly in the base, New Categories are meaningfully contributing to Group results as we benefit from our increased scale.

We are now profitable with New Categories in 20 countries, more than doubling the number from the first half of last year. It is important to note that we do not expect our pathway to profitability in New Categories to be linear. We are making an active choice to continue to invest in our transformation, with levels of investment reflecting our enhanced innovation cadence, further geographic expansion and market openings.

With our strong progress to date I am confident that we will achieve New Category profitability in 2024.

Vuse is a key driver of our performance with our progress driven by our continued focus on three levers of profitability; revenue growth management, COGs reduction, and marketing spend effectiveness. Vapour margins have historically been much lower than Combustibles, THP, and Modern Oral. But we have made great progress over recent years to build a commercially sustainable model with Vuse.

Our Vapour gross margin is fast approaching Combustibles at a Group level. And in more established markets we are already delivering meaningful category contribution.

I am proud of the strong progress we are making, and I am confident that our transformation will deliver long term multicategory growth and returns.

My third area of focus is the all-important US Combustibles market. In the US we are sharpening our execution with new leadership and enhanced focus and by activating commercial plans through our broad digitally enabled revenue growth management capabilities.

RGM is a dynamic approach to revenue optimisation, powered by big data and analytics, enabling a granular view of elasticity curves. It brings together our consumer occasion driven portfolio, pack price architecture, joint customer business planning, optimised pricing, highly targeted trade activation and tailored retailer assortment strategies. Ensuring that our portfolio is well positioned to face competitive challenge and deliver profitability growth through all economic cycles.

And our commercial plans are already starting to deliver early signs of US Combustibles volume share recovery. Our volume share is up 60 basis points since January, driven by our 100 basis points increase in the important premium segment. Whilst our progress is encouraging, we will continue to implement our plans carefully and thoughtfully. As a result it will take time for this to deliver consistent Combustibles value growth and returns.

Turning to my fourth area of focus, THP, where I am determined to significantly strengthen our consumer offering. To enable this we are expanding our capability through increasing our investment in people and building new innovation hubs, including our Global Device Development Centre in China, to drive an enhanced innovation pipeline.

As a top priority we have already reengineered our internal innovation processes. In addition we are developing an agile innovation ecosystem through external partnerships and in doing so we're increasing the pace of our transformation to drive better returns.

Glo Hyper X2 Air, which is currently rolling out, is the first step in an exciting accelerated medium term Heated Tobacco pipeline.

This enhanced innovation pipeline process is enabled by our 4D model. We are well positioned to leverage across category insights and foresights, meaning we sharply define and prioritise consumer opportunities. We leverage these consumer understandings through a focused discovery phase to validate the consumer proposition. We then develop the commercial offering at an accelerated pace through out internal and external capability network, before finally leveraging our global scale and capability to fully deploy.

This dynamic model is underpinned by our revamped product lifecycle capability and portfolio management discipline, which enables us to adapt to the economic conditions and competitive environment.

Overall this means better innovation and faster development, generating higher returns on investment.

My next area of focus is to lead responsible New Category development. I am determined to manage external risks thoughtfully and transparently by increasing our engagement with regulators, policymakers, and relevant stakeholders, as well as leveraging our science.

Given this, we need to have a louder voice. We have now created a new Management Board role to drive more proactive corporate and regulatory affairs. Our activities will follow a science-based approach to regulation to drive a level playing field in our markets.

Regulation is a significant barrier to entry across New Categories, while navigating regulations is not new to BAT, we must now focus on developing a

more front footed external approach, led by our science.

Finally, my sixth focus area is to enhance our financial flexibility. We need to be more agile in the near term to make the right active choice that will deliver long term sustainable value. I am clear that we will not compromise our commitment to accelerate investment in our transformation.

And as I have set out today, I am also clear on my near-term priorities, to enable a more agile, flexible BAT where we will leverage our global portfolio to continue to grow profits and cash, deliver £1bn of efficiencies over the next three years to further fund our transformation and reduce debt to strengthen our balance sheet.

In addition we will seek and evaluate opportunities to optimise capital allocation. We have significantly increased our free cash flow generation with four consecutive years of at least 100% operating cash conversion. This has enabled us to return a total of £21bn to shareholders within this period, while also making good progress on deleverage. We remain committed to continue our 25-year track record of consistent dividend growth, rewarding our shareholders through all economic cycles. And over the next five years we are on track to generate around £40bn of free cash flow before dividends.

As we continue to execute on our transformation, our medium-term financial model for growth will evolve. And we will have more flexibility to allocate our capital to drive returns and reward shareholders by sustainably returning cash through dividends and share buybacks.

And with that I will hand over to Javad to take you through the detail of our results.

Javed Iqbal, Interim Finance Director

Thank you, Tadeu, and good morning everyone. When I started my journey with BAT 27 years ago as a management trainee in finance in Pakistan, I never thought I would get the opportunity to present BAT's financial results to all of you as Interim Finance Director.

Personally it is a very humbling and a proud moment for me, but more importantly it is a great testament to BAT's commitment to develop and grow a very diverse global talent pool. When I joined BAT, what fascinated me the most was our international footprint and truly multicultural working environment, where everyone gets an equal opportunity to learn, develop and grow in their careers.

As a business leader I am always focused on creating a culture of respect and empowerment or in Tadeu's words, inclusive and collaborative. And this has helped me in having a successful track record of developing high performing teams and delivering strong and sustainable commercial results.

In my role as Interim Finance Director I'll be working with Tadeu and members of the management board to continue to drive the transformation journey of BAT. Some of the areas which will be in my primary focus are resource allocation, using tools like marketing spend effectiveness and RGM, and leveraging our digital hub capabilities and Global Business Services footprint.

We will continue to invest in technology and move further on our digital transformation, making BAT a digitally connected organisation. And of course capital allocation and a sharper focus on cash generation will always be a high priority.

Now moving to the first half results. Our first half results demonstrate continued delivery and the resilience of our business. We delivered organic revenue growth of 2.8%, with New Category revenue up nearly 27% and Combustible price mix of 6%.

Profit from operations was up 3.6%, with our operating margin up 90 basis points at current FX and 40 basis points at constant FX, driven by the investment in New Category contribution and our continuous focus on efficiencies.

Diluted EPS grew by 5.3% or 8.5% on current currency basis.

We continued to drive strong New Category revenue growth and are well on track to deliver on our £5bn revenue target by 2025. This was enabled by progressively building our consumer base, together with capturing consumption moments and growing poly usage.

Non-combustibles now represent 16.6% of Group revenue, 1.8 percentage points higher than in 2022. I will now share more details on our key category drivers, full market share across our key markets is available in the appendix.

In Vapour, we extended our value share leadership with Vuse achieving 38.3% in the key Vapour markets, up 2.4 percentage points. In the US the largest global Vapour market Vuse strengthened its number one position. Vuse share grew 5.7 percentage points to reach 47% in tracked channels and we remain confident in our PMTA submission for Vuse Alto.

We welcome the recent FDA actions with regards to illicit synthetic nicotine disposables in the US, which we estimate to be more than 50% of the total Vapour market. And we continue to engage with the stakeholders to enforce the removal of unauthorised products.

In Canada, France, the UK and Germany we maintained value share leadership in closed systems, with the modern disposable segment continuing to accelerate total category growth. This drove strong volume and revenue growth in AME.

Outside the US we continue to approach the modern disposable segment in a responsible way, with ongoing commitment to underage access prevention, take back schemes and marketing practices. We are making good progress on driving profitability in Vapour, with a positive contribution in three of the five key markets, driven by increased scale and marketing spend efficiencies.

In Tobacco Heating, glo reported revenues were up 10% or 12% on an organic basis. Continued category volume share and momentum in key AME markets, including Poland and the Czech Republic was offset by highly competitive markets in Japan and Italy. As a result glo's THP category volume share was down 110 basis points to 18.2%, while our share of the combined Combustible and THP category continued to grow.

As Tadeu highlighted, we have much more to do on strengthening our THP offering. But I am pleased to say that our newest innovation, glo Hyper X2 Air is delivering positive early results.

Our Modern Oral portfolio continued to grow, with Velo volume up 33% and revenue up 42%, driven by geographic expansion and innovation. We continue to grow our volume share of total oral, while our volume share by Modern Oral category was mainly impacted by our continued prioritisation of Vapour in the US as we await the outcome of our PMTA submission for a new Velo product.

Outside the US we maintained leadership of the Modern Oral category and I am delighted to share the Velo is now the largest oral nicotine pouch brand in Sweden.

We continue to see a significant opportunity for Modern Oral in Emerging Markets, with strong growth in Pakistan and a national rollout ahead of plan in Kenya.

Now turning to Combustibles, our volume declined by 5.8%, mainly due to significant excise increases in Pakistan, lower US industry volume, and share

loss due to our premium positioning. Cigarette price mix remains strong, up 6% with price offset mainly by geographic mix. Together this resulted in 0.2% increase in revenue.

Group volume share was up 10 basis points, driven by gains in AME, with stable share in APMEA, partially offset by the US. Group value share was down 40 basis points as the impact of our commercial plans in the US and losses in APMEA more than offset growth in AME.

We are performing very well in Combustibles outside the US, with the reintegrated portfolio, refreshed brands and sharpened execution. This demonstrates the benefit of our global footprint and our ability to deliver in these challenging environments.

Turning to regions, in AME total revenue was up 9%, driven by higher revenue from combustible, with a resilient volume performance and a favourable pricing environment, offsetting some geographic mix headwinds. Alongside continued growth across each New Category with revenues up nearly 37%.

Adjusted profit from operations was up nearly 8%, driven by improved financial performance in key markets, including Germany, Poland, Brazil, and Mexico. In APMEA total revenue was up nearly 10%, driven by a robust Combustible performance, led by pricing and Combustibles and volume growth in Bangladesh, alongside continued growth across each New Category with revenue up 15%.

Adjusted profit from operations in APMEA was up 9%, driven by strong performances in Australia, Sri Lanka, and a continued recovery in global travel retail.

In the US Combustible industry volume was down 8.4% in the first half. Beyond market secular decline industry volume was pressured by a combination of macroeconomic headwinds, driving reduced average daily consumption and downtrading. Together with increased poly usage. Importantly elasticities remain stable at around 0.4%.

On top of the industry contributors, our volume performance was impacted by lower volume share as a result of our more premium skewed portfolio, lapping the benefits of SAP related inventory phasing in the comparator and the California flavour ban. As a result of our Combustible volume declined, 12.4% in the US.

As Tadeu highlighted, our commercial plans are starting to deliver early signs

of sequential volume share recovery. This is supported by the industry premium segment starting to stabilise, with our share of the premium segment growing to its highest point in three years, driven by strengthening performance from Newport and Natural American Spirit. In addition, Lucky Strike continues to perform well in the value segment and now has more than 3% share of the total market.

In Vapour Vuse continues to expand its leadership position, driving revenue up 23%, despite the challenging environment we have continued to expand our operating margin by 280 basis points, driven by further improving Vuse profitability and continued efficiency savings.

In California, the long-term impact of the flavour ban continues to evolve. Menthol products are reportedly still being sold illicitly due to lack of enforcement. And we have also seen elevated flavour volume in surrounding states, despite the industry's best effort to avoid this. Due to our menthol skew, 45% of our portfolio had to be delisted at the end of last year in California. Our Combustible volumes declined around 25% in H1 as many consumers moved to our non-flavoured variants and our new FDA authorised SKUs are performing well.

Adjusting for a 13% pre-ban rate of decline, our underlying retention rate in California, as a result of the flavour ban, has been above 85%.

Vuse has performed very strongly in California, with 100% retention, despite menthol representing 60% of volume prior to the ban. Driven the strength of our brand equity, Vuse has retained all of its pre-banned volume, as consumers switched to our tobacco pods. As a result Vuse gained 8.7 percentage point value share in tracked channels versus per-ban.

Overall nicotine consumption was broadly stable in H1 due the accelerated growth of the illicit modern disposable segment, as consumers continued to access illicit flavoured nicotine product.

We continue to believe there are more effective ways to achieve tobacco harm reduction than restricting access to flavours, that can play an important role in encouraging adults to switched to reduced risk products. At the same time we will continue to advocate for and support enforcement activities against illicit products, to help ensure that available products adhere to high consumer safety standards and support a level competitive playing field.

Returning to Group performance, operating margin expanded strongly, up 90 basis points at current rates and 40 basis points at constant rate. We absorbed headwinds of 2% from both increasing inflationary pressures and transactional

FX on profit. This was supported by our strong progress improving New Category profitability and additional efficiency savings.

Turning now to EPS, we delivered constant currency adjusted diluted EPS growth of 5.3%. This reflects our resilient operating performance and the benefit of continued strong ITC delivery, which more than offset increased net finance costs and tax.

Our cash flow conversion of 72% in the first half puts us well on track for another year of cash conversion in excess of 90%. Due to the timing of leaf purchases and MSA payments our cash flow is always second half weighted. We expected full year gross capex of £550m below adjusted depreciation and amortisation and we continue to make good progress on deleverage.

As guided earlier, this year our average cost of debt is 4.3%, which is well below the current market rates. And we continue to expect to see the impact of higher rates in our net finance cost in 2023 and moving forward. As a result we expect full year net finance cost to be around £1.9bn, subject to both FX and interest rate volatility.

Over the next five years this business is on track to generate £40bn of free cash flow before dividends, with cash conversion in excess of 90% and leverage moving towards the middle of our 2 to 3 times net debt to EBITDA corridor. This will provide greater business resilience, while continuing to support future financial agility.

As Tadeu outlined, we remain fully committed to further invest to better execute and deliver our strategy, while also rewarding shareholders throughout. We remain fully committed to our 65% dividend payout ratio over the long term and growth in sterling terms. Once our leverage target is reached, we will review how to sustainably return cash to shareholders.

With that I'll hand back over to Tadeu, thank you.

Tadeu Marroco, Chief Executive

Thank you, Javad. Looking forward we are on track to deliver our full year 2023 guidance, driven by strong New Category growth, a further reduction in New Categories losses, a resilient Combustible performance and continued efficiency savings and strong cash generation.

We expect to deliver organic revenue growth of 3 to 5% excluding Russia and Belarus and adjusted diluted mid-single figure EPS growth, reflecting an

incremental New Category investment, continued investment in the US Combustibles, higher net finance costs, a transactional FX headwind of around 2%. And this will all depend on the timing of the transfer of our business in Russia and Belarus.

Extrapolating current spot rates, we expect currency translation to be a 3% headwind on full year adjusted diluted EPS growth.

So in summary I'm pleased with our resilient delivery in the first half and the renewed sense of energy in the business and I'm confident we are on track for our full year guidance. I'm particularly proud of our ability to perform and transform simultaneously, while consistently rewarding our shareholders through growing cash returns.

I am clear that there is much more to do and together with my management team we are energised to deliver on our focused areas outlined today, in order to accelerate our transformation.

Finally, I want to take this opportunity to thank everyone in BAT for their continued strong support and for delivering these results. I'm excited about the opportunities ahead and I'm confident that we will deliver long term good stakeholder value.

We will now be joined on stage by Victoria for the question and answer session.

Victoria Buxton, Group Head of Investor Relations

Thank you, Tadeu. And good morning everybody. If you joined us via the webcast, you can type your questions directly into the online question box, or if you've joined by the call you can press *1 on your telephone keypad.

While we wait for questions from the phone line Tadeu, I can see that we have already got one for you. Given your 30-year career at BAT and four years as Finance Director, what will be different now you're Chief Executive?

Tadeu Marroco, Chief Executive

Well, first of all I would like to start by saying that I'm very honoured to have been appointed Chief Executive. And as you could see, and I have outlined in my presentation there is a lot of – a single set of strengths in BAT already. And I have been always clear since I took over as CEO that we have the right

strategy.

So we cannot ignore the fact that the world out there has changed substantially, the landscape we operate in is much more complex, the macroeconomics are much more challenging, and this will require a sharpened execution. So one of my focus areas, clear focus areas is how we take much more measures in terms of doing resource allocation across geographies, across categories, that is why the market architype is a very powerful example.

I addressed some of my key focuses, immediate actions which relate to increasing our resilience in our US Combustible business from the economic cycle point of view, but on the regulatory cycle view as well.

So innovation – we have started to change the way we innovate in the Group, we want to improve that substantially and then address the gaps that we have around THP. And for sure return investment is and will be a major focus for us moving forward when we make those calls in terms of execution.

So the second leg is related to – I would like for the Group to be much more outward looking. We need to have a more sustainable engaging agenda with stakeholders, policyholders, regulators, policymakers in order to make sure that we have an informative debate about the landscape where we operate. We referred to that in the presentation. We have to create a level playing field and there is a lot of desire from many governments to improve in some elements of the New Categories that we agree with. And it is a question for us to have the right discussions.

I would like to sharpen up the narrative of BAT and be much more outspoken out there and being on the front foot means that I have created a new role in the Management Board in corporate affairs, exactly to give me the backing to be able to do that. And to you know articulate the whole organisation towards that goal.

And thirdly it is about the culture, I genuinely have progressed in the Group with you know trying to promote a much more collaborative and inclusive culture and that is what I want to see everywhere in BAT. I really believe that this can be very powerful. And I have already early signs that I think that the vast majority of the BAT employees agree with me. So that would be my third area of focus.

Victoria Buxton, Group Head of Investor Relations

Thank you Tadeu. So we'll now go over to the phone lines, so I'll pass back over

to the operator.

Telephone Operator

Thank you. Richard Felton from Goldman Sachs, please go ahead.

Richard Felton, sell-side analyst, Goldman Sachs

Thanks, morning everyone. My first question is going to be on the US Combustibles market. So Tadeu you've referenced early signs of improvement for your business there, but it still remains under quite a lot of pressure. So my question is you've changed leadership of that business about a month ago. What do you think David is going to be doing differently to improve performance going forward for the US Combustibles business?

Then my second question, also in the US but on your Vapour business, where volume declined by 6.5% in the first half. Now I'm sure that is a result that you and the team are not satisfied by. So how do you think about restoring volume growth for US Vapour? And I guess within that how do you think about the balance between margin and volume growth for that part of the business specifically? Thank you.

Tadeu Marroco, Chief Executive

Okay, thank you Richard. Look, I'm really excited to have David come in as a new CEO of Reynolds. David came with a massive experience on the Combustibles side. He was the Head of Marketing looking after the GDB's, the global drive brands that we have in the group for many years, four or five years before he moved on. And he's driving today one of the key areas within Europe. And under his leadership he was able to put us in a very leading position in Vapour in the key markets in Europe and also Modern Oral.

So David brings a mix of experience which is quite unique, not just in Combustibles but also in New Categories and his style of management pretty much talks in the way I see the company moving forward. So I'm very excited to have him there and I think that he will do, together with the Reynolds team, a fantastic job.

As you point out the situation in the US is difficult because at the end, we had the secular decline and elasticity, normal declines, that was exacerbated by the macros. The macros are a combination basically of the incentives that came in at federal state level that was withdrawn after post COVID. And at the same time with massive inflationary pressures that put a lot of pressure in terms of consumer purchase power. And us being skewed in the premium segment we're suffering most. And this for sure there was some other elements to explain our volume decline like the SAP rollout. But in essence we were exposed to a segment that was struggling given the circumstance that we were facing in the US.

The good news is that we are seeing for the first-time early signs of stabilisation of the premium segment, so at industry level which is very positive for us. And also the actions, the commercial plans that we have put in place has already started showing up. The improvement that we have seen is quite encouraging from January to now in terms of our market share improvement in Newport in particular. But also Natural American Spirits and the premium segment as a whole and the Group as a whole.

So for sure those economic cycles come and go. What we want to ensure is that when this one finishes, we come out of this much stronger when we came in and that's exactly why we are working with all these commercial plans across our brands. And I think that David will be a great additive for what we need to put in place in the US. So that's about David in the US.

The US Vapour market, you're absolutely right, it is quite frustrating to be honest. You see the whole increase in these unauthorised products, synthetic nicotine products. We believe that they are well ahead of 50% of the Vapour markets today in the US, way ahead of that. And this for sure is putting pressure on the overall consumption of the tracked channels when you see the reduction as a group, as an industry, 15% so BAT performed better than we had a reduction of 106. But you see that this is just as a consequence of this exponential growth of this disposable nicotine device.

If you add that to the mix, it's a completely different ballgame and you will be nowhere near the 15% reduction that we are seeing because we are seeing a lot of traction of smokers actually using these types of products.

What is encouraging is that the latest movement from the FDA in terms of trying to issue for example MDOs for some of those manufacturers and being very explicit that they are illicit products. And even raising now penalty fines so we'll be supporting this initiative from the FDA for sure. There is a massive wide space for every single percentage point that they are able to reduce. And we are quite I would say optimistic that this will materialise. Because we know that a lot of the problems that we have in Vapour in terms of youth access is coming from the use of these type of products naturally. So I think that there would be a lot of mobilisation from different agencies in order to tackle the problem in the US and we'll be willing to see this happen, okay.

Richard Felton, sell-side analyst, Goldman Sachs

Thank you very much.

Telephone Operator

Gaurav Jain, Barclays please go ahead.

Gaurav Jain, sell-side analyst, Barclays

Hi, good morning Tadeu, good morning, Javed. Three questions from me if I'm allowed. The first one is, you know the definition of leverage that you have, and I think a lot of investors are very confused about what is the 2x to 3x net debt to EBITDA, like is it the way you are reporting adjusted net debt to EBITDA? Or we need to make various adjustments like remove Canada, EBITDA net cash then put in restructuring charges, remove debt, add in hybrid. So, you know how should we interpret that 2x to 3x corridor?

Tadeu Marroco, Chief Executive

You want to take this one?

Javed Iqbal, Interim Finance Director

So yes, so I think this is how we are reporting them right now, so this is how they're reported in our numbers, and we are moving towards the mid of the corridor of 2 to 3 of net debt to EBITDA as they're reported in our numbers. And as you see they made good progress from above 3 last year to now reaching 2.6 in the middle of the year so we remain on track moving towards that target. So it is as there reported in our numbers, not with that adjustment.

Gaurav Jain, sell-side analyst, Barclays

So thank you.

Javed Iqbal, Interim Finance Director

No please go to the second question?

Gaurav Jain, sell-side analyst, Barclays

The second question, you know the e-cigarette growth which is happening in the US and a lot of marketing moving towards disposable that you are highlighting. In your view like including disposable to legal everything, how much has the e-cigarette market in the US grown one is '23 over one is '22?

Tadeu Marroco, Chief Executive

Well it's very difficult to have a full assessment to valuation in the US because you know that's most of these products are sold in non-tracked channels. They are independent stores mainly, vapour stores for example. They are e-

commerce, you still can buy these products in the US via e-commerce. So it's very difficult to have a view on that.

But if you think for example that the valuation of the Vapour market in the US is around 5bn or it's even slightly higher than that. The vast majority, like I said more than 50% should be now clearly occupied by these products.

Gaurav Jain, sell-side analyst, Barclays

Thank you. And the third question just one on this ITC – the spinoff which has been announced and you will own about 18 or 19% spinoff company, will be looking to monetise that stake or you will remain invested in that company?

Tadeu Marroco, Chief Executive

Yeah Gaurav, look we were made aware actually yesterday about the decision of the ITC Board to propose these structures of realising - keeping 40% of shareholders of the hotels and giving the other 6% for the current shareholders. We will know more details about that in the Board meeting that will be held in mid-August and then we're going to make a decision around that. And as we move along, we will make a call in terms of what we, you know, decided to do specifically after making the decision in terms of this shareholding that you are referring to.

Gaurav Jain, sell-side analyst, Barclays

Sure, thank you so much.

Telephone Operator

Nik Oliver of UBS, please go ahead.

Nik Oliver, sell-side analyst, UBS

Thank you Tadeu. Two from me, just one on the US, you talked about the sequential improvement which is nice to see. But as we looking forward do you still think down 4 to 5 is the right algorithm for the US market in total?

And then secondly, more Group level, we're used to kind of modelling BAT a high single digit constant FX company. Obviously more recently it's been lower giving investments in NGPs and Ukraine, etc. but as we go forwards, should high single digit constant FX EPS still be the right algorithm?

Tadeu Marroco, Chief Executive

Okay, look on the US, the first question was ...

Javed Iqbal, Interim Finance Director

Industry volume.

Tadeu Marroco, Chief Executive

Industry volume and now it could evolve. Look, the US for sure that's the macros like I said is cyclical by nature no, and the good thing about the US is the elasticity is still very benign at 0.4. And you would imagine that once the economy starts recovering these elements of macros that we have pointed out during our presentation, is basically gone. This would bring us back to the likes of 5%.

Now if it's more 4 to 5, 5 to 6, this will depend a lot in terms of the poly users moving forwards. But I would say that at this point in time there is nothing major to suggest that we cannot hold at that level 5% on a normal circumstance without economic pressures. Given the fact that the elasticity is still very benign like I said which means that there is still a lot of pricing for the US so the secular plus the elasticity would probably lead you to this level, that would be around that more or less depending on the poly users that we see moving forward.

Now in terms of the future of – for all and the future for the Group, what we are facing is very challenging times. And this was one of the reasons why we highlighted this in the presentation today, the net finance costs we have today is much lower than what we are seeing in the markets. So we had all this maturity commencing the next coming years and this will mean higher net finance costs, this is as simple as that. Which means that the kickers on the EPS will be not be counted on net finance cost, if anything if will probably be a drag. So we have to take those things into consideration when you start talking about short term high single digit type of figures.

The other thing in the short term that we need to bear in mind is that despite the fact that the macro-economic pressures has faced down substantially. There is still a big impact coming next year the back of leaf, because some of the leaf costs that we see this year, most of it impacts the P&L of next year because of the nature of it, it goes on your balance sheet and then starts on your P&L months later.

So we will have to face this pressure and as I said also in my presentation, we don't think that the fix in the US that we want in Combustibles would be a

quick one. This would take some time and we'll do it properly because we want to create a more resilient portfolio for the sake of generating stable value over time.

Now, saying all that we cannot ignore the fact that we have a massive cash generative company. BAT is doing extremely well in New Categories. We are reducing the loss on a very accelerated base, hence our comments about this will not be linear because this will depend a lot in terms of our plans for geo expansion, markets that can open, new platforms that we launch. But one thing is very clear, the direction of travel is very clear, this will be accretive for the results of the Group, it has been since '21, there is nothing to prevent us to continuing being that way moving forward.

And our Combustibles business outside the US is performing extremely well. So without the difficulty in the west our price mix is still 6% so there is a very, very, very strong company in our hands moving forward. And the point that we try to make today for all of you is how resilient is this company. We are having, you know, difficult times in the Combustibles business, in the US specifically. And this is more than offset by the performance that we are having now in the other categories rather than Combustibles, as well in the other geographies.

So when all those things get aligned, we'll be in a much stronger position. So I hope that I give you kind of a perspective, I don't want to make commitments of this is the short term and we understand where we are in the short term. But the future is important to give some more a prospect for you moving forwards.

Nik Oliver, sell-side analyst, UBS

Really clear, thank you Tadeu, that was great.

Telephone Operator

Jacob de Klerk from Redburn, please go ahead.

Jacob de Klerk, sell-side analyst, Redburn

Thanks Tadeu, thanks for taking my question on the additional details. I just have a couple of questions on your New Category performance. The overall traditional oral category not just BAT's portfolio of brands in the US, seems to be affected by the growth in Modern Oral nicotine pouches. Is this a fair assessment to make on the overall oral market in the US, and do you see this trend continuing?

And then just secondly, all three New Categories are growing revenue strongly. Can you maybe give us a sense of the performance that's mainly coming from new market rollouts, like success of Modern Oral in Pakistan or are existing markets driving most of it, in the US?

Tadeu Marroco, Chief Executive

Yes, Modern Oral in the US is performing in line with other traditional oral markets that we see across the world. The likes of Sweden and Norway we are seeing Modern Oral gaining traction in terms of total oral consumption. And the difference is that in the US the average daily consumption is really low. It's been 1 to 2 pouches as opposed to 6, 7 pouch that you see in the Nordics for example. And this has to do with the product itself. The product has a level of moisture that is not really satisfying consumers as we can see outside.

One of the difficult steps we have as BAT in our own offer in the US is the fact that we couldn't bring this product that we have in Europe, this excellent, leading product that we have Europe, to the US yet. We have applied for PMTA, we're waiting for the outcome of the PMTA in order to be able to launch this product in the market. And I think that once this type of product which the US we will see a bigger traction, let's put it that way, in that particular market.

So it's definitely one area of focus for us and we feel very confident with our offer outside when we can be able to use it in the US itself. So that's one.

Starting with Modern Oral to answer your question. This is a fantastic performance. We have a fantastic product in our hands, we have just reached the all-time high leadership in the share in Sweden. And Sweden was dominated by our competitor for more than 100 years as you know, it's a very traditional oral markets and Velo took leadership of the whole, not Modern Oral, the whole oral tobacco segment in Sweden in terms of share.

And this has been reflected wherever we are in terms of leadership. So we are leading in several markets and the other thing that we are seeing is that even markets where there is no oral traditional, this product is gaining traction. Here in the UK for example and that was no tradition at all, the incidence of Modern Oral is getting close to 2%, was 1.5, it's getting traction now.

And we are seeing this phenomenon happening in other markets. For example in Poland we start with this product like two years ago and now we have volumes that are really getting to a significant level. And the beauty about these products is the margin as you probably saw in my presentation, are even higher than cigarettes. So it's a product that has not even tobacco in it, so the risk profile is really low. And it can be a way to implement tobacco

harm reduction as we see in Sweden. Sweden used to have an incidence of Combustibles of 30% in the '70s. Today like I said in my presentations about to be the first EU smoke free market at the back of promoting traditional oral with incidence of cancer reducing dramatically over this period of time.

And the margins that we make in oral are higher than the ones we make in cigarettes. So this is a win, win for everyone and that's exactly the model, the powerful model that we have.

So Modern Oral is a combination of us expanding geographically and they're still doing quite well in the markets that we're established.

Vapour we have rolled out our Vuse Go, our modern disposable. We decide to enter this sub category because we clearly see a lot of smokers migrating towards this type of product.

Vapour is the level of conversion of cigarette smokers to vapour is similar to THP. And if anything in the markets where Vapour and THP are present we see a higher retention in Vapour than we see in THP, the markets where both of them are present. So it's a category gaining more and more traction.

I'm very pleased with the performance that we are making in terms of the margins, so the margin performance comes at the back of for sure the scale of it. But also the fact that we are now with a leading brand able to renegotiate trade margins and reducing it for example and also taking price. So the revenue improvement that you see is a consequence of expansion but also us working on the margin side of Vapour that is now getting close to 6%. And you have places already like France where if you take the gross margin equivalent of cigarettes, we make more money selling Vuse than we do selling our own products of cigarettes in France. In the US we have margins already equivalent to promo in cigarettes. So we are really, really happy with the performance we are making there.

And THP is the category where we are highlighting of one area of focus for us in terms of the need to strengthen our offers. I think that glo Hyper 2 goes in the right direction. Is it a game changer, it's not a game changer, it's an improvement because it addresses some of the issues or pain points that we had within our offer, having a more sleek, and tiny and very light device. But there are some more exciting ideas coming along in the next few months ahead okay.

Jacob de Klerk, sell-side analyst, Redburn

Thanks you very much.

Telephone Operator

Jonathan Leinster from Societe Generale, please go ahead.

Jonathan Leinster, sell-side analyst, Société Générale

Hi, good morning gentlemen. Yes, a few questions if I may. First of all given the recent nationalisation of some of some of the companies that were planning to transfer assets in Russia. Has that changed your plans in any way with regards to your potential transfer in Russia?

Tadeu Marroco, Chief Executive

Okay I'm going to jump on this one. Look we are determined to leave the country; we have said that last year. As you can imagine it's a very, very complex situation to deal with. And we are following all international and local laws, and this mean all the procedures that the authorities locally in Russia have defined. And also with a close look to sanctions for sure. But I cannot comment much on that at this moment in time. It would be inappropriate for me to make further comments on that.

Jonathan Leinster, sell-side analyst, Société Générale

Okay, secondly on the US cigarette side. I mean price has clearly decelerated a bit, is that primarily driven by differences in pricing structure or is that driven by the sort of mix shift towards Lucky Strike or a combination of the two?

Tadeu Marroco, Chief Executive

Yes, we are putting in place commercial plans in the US. We are using our revenue growth management tool as an area of insight for us. So we can be very granular in terms of how we make our brand more competitive in different geographies within the US. We can go – it's now to counsel on key accounts and all that, and this is the pricing element that you see is the reflection of those commercial plans in place.

We also have taken some initiatives in terms of laddering some of our brands to make it more resilient in terms of these economic cycles. And this all reflects in the top line that you are seeing.

Jonathan Leinster, sell-side analyst, Société Générale

But has the growth of Lucky Strike as a sort of pseudo discount, has that had

quite a big impact on it?

Tadeu Marroco, Chief Executive

I would say it is an element of that for sure. Lucky Strike we are very pleased with the performance of Lucky Strike, one of the most successful launches in the US ever, has just reached above 3% of our total market share in the US. And for sure the mix, you know, it would be very different from the ones of Newport and Natural American Spirit. But I would say most of the impact on the price is coming from the commercial plans that we are putting in to improve our competitiveness on the more important premium segments that were where we were suffering most.

Jonathan Leinster, sell-side analyst, Société Générale

Right. And just on the vaping side, again price mix very strong in the period. Is that reflected I mean as we hear it, is that reflection again of actual underlying strong price, particularly within Europe and some of the other regions. Is it just a difference with the sort of mix with the sort of introduction of the disposables, has that caused a sort of price mix that will apparently shift off quite rapidly with the introduction of those disposable vapes?

Tadeu Marroco, Chief Executive

All the decisions in pricing Vapour in the US take into consideration a number of things. The revenue growth is also being applied in Vapour so for example we consider the price of Mods which is not cheap in the US but the way. We consider the price of cigarettes; we consider our main competitor pricing as well in the tracked channels. The fact that we have our pods that has more than double the liquid of our main second competitor in the US is another factor.

So we put all those things in consideration and the elasticity and understand the consumers. We have been working in different types of product architecture in terms of our packs with one pod, two pods, four pods, more recently even above that like six pods. And then with all that we have the consolidated view of the price mix you have seen in our results. But there is no one single element to point out, it's a combination of all those different elements. You know, we'll be keeping this for sure under review and taking immediate action to that.

Jonathan Leinster, sell-side analyst, Société Générale

Actually I was wondering outside the USA really because clearly that's where you launched the sort of the disposable vapes. I was just wondering whether

that had because a sort of quite a shift in mix and a higher value in the sort of areas where disposable vapes have been launched, which is obviously outside the USA?

Javed Iqbal, Interim Finance Director

So that's what I was trying to add that the Vuse performance as a brand, has a strong brand performance and that is why the growth of the revenue in pricing is driven by both the elements which is the Vuse closed system and the Vuse Go which is the disposable part of the brand. So the overall brand pricing is being driven positively and mainly driven by both the elements.

So you can't - outside the US so that's why I wanted to tackle the point of outside the US, that outside the US we still see a strong growth in pricing which is mainly driven by the strong brand momentum in both these things in the closed systems and also in the introduction and expansion of Vuse Go.

Jonathan Leinster, sell-side analyst, Société Générale

Okay, thank you very much.

Telephone Operator

Thank you, I'd like to hand the call back over to Victoria for any web questions.

Victoria Buxton, Group Head of Investor Relations

Thank you. So we'll now go back to the web where we've received a question. I think this is for you Javed. Your Combustibles volumes were down 5.7% versus the industry down 3.2. Why has BAT underperformed the industry?

Javed Iqbal, Interim Finance Director

So I think this one is very simple. Two points. One is the biggest impact that's coming from the highly driven, excise driven price increases in Pakistan so excise driven, volume decline in Pakistan. And then also the overall industry decline in the US.

But if I just take Pakistan for example, if you deduct Pakistan out of industry and BAT volumes, we are looking at volume decline of 2% where BAT actually starts doing better. And given our very strong presence in Pakistan that is why you see a strong decline. But these are the two elements, the rest is very minor changes. But these are the two things, excise driven volume in Pakistan and also overall industry decline in US.

Tadeu Marroco, Chief Executive

I think it is important just to add to what Javed is saying that we don't adjust the volumes to the markets where we are phasing out the likes of for example Egypt which is still part of that. And if you consider that for example together with Russia that we don't manage basically and this would be 1% out of the 5.7, so what is left is basically what Javed has explained in those two markets.

Victoria Buxton, Group Head of Investor Relations

Thank you. Well we don't appear to have any further questions on the web. If there are any outstanding questions, please don't hesitate to contact the IR team. But with that I'm now going to hand back to Tadeu for closing comments.

Tadeu Marroco, Chief Executive

Okay, so thank you for joining us today and for your participation in our Q&A session. As you can see, we have delivered a resilient performance in the first half. I'm delighted that we are on track for our full year guidance. And I hope you can all see the renewed sense of energy across the organisation which I feel around me every day.

So while there is much more to do, I'm confident that together we will accelerate our transformation to deliver long term more stakeholder value.

We look forward to updating you again in December at our pre closed trading update. Thank you very much.

END

Footnotes:

* Based on the weight of evidence and assuming a complete switch from cigarette smoking. These products are not risk free and are addictive. Our products as sold in the U.S., including Vuse, Velo, Grizzly, Kodiak, and Camel Snus, are subject to FDA regulation and no reduced-risk claims will be made as to these products without agency clearance.

** Refers to a transitional period for smokers towards complete switching to potentially risk reduced nicotine products during which period such smokers reduce cigarette consumption and choose to consume one or more New Category nicotine products.