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Tadeu Marroco, Chief Executive

Good morning, everyone. I'm delighted to welcome you to our 2024 Interim Results presentation. With me this morning, Soraya Benchikh, our new CFO, and Victoria Buxton, Group Head of Investors Relations.

I will begin with our transformation highlights and the progress we have made against our key areas of focus over the last 12 months. Soraya will then take you through our financial performance in more detail. I will then return to talk more about our performance outlook before we move to the Q&A session. With that, I would like to draw your attention to the disclaimers on slides two and three.

So let's begin by looking at the way forward.

Our first half performance is in line with expectations, and we are on track to deliver our full-year guidance. In the first half of this year, we have continued to transform our business. We added 1.4 million smokeless consumers, reaching 26.4 million. Smokeless now accounts for 18% of group revenue, up 1.4 percentage points versus full year '23. Our focus on Quality Growth, balancing top and bottom-line delivery, has driven a £165 million increase in New Category contribution and close to a 10 percentage point increase in our category contribution margin.

Building on this momentum, we expect another good increase in New Category contribution for the full year.

We are committed to rewarding shareholders with strong cash returns, and I'm pleased with our progress in enhancing financial flexibility, enabling the initiation of a sustainable share buy-back.

This year is a key moment in our transformation journey as we sharpen our execution, enabling us to navigate near-term market challenges and drive our sustainable transformation.

Turning to the drivers of 2024 delivery...

As we previously guided, 2024 is an investment year for BAT.

In the first half, we have invested to strengthen our U.S. business, accelerate innovation momentum, and enhance capabilities that support our strategic delivery.

This, together with lapping a tough competitor in APMEA, means we expect an acceleration in our second-half performance.

I'm encouraged that our New Category launches and our first-half U.S. investments are gaining traction.

Together with the expected unwind of U.S. wholesaler inventory movements, related to the year-on-year timing of our first half price increase, I'm confident that we are on track to deliver our full-year guidance.

This time last year, I shared a clear set of objectives to sharpen our execution and build a more modern and agile BAT.

Over the last 12 months, working together with our broader teams, we have made good progress across the six areas of focus.

We will touch on some of these highlights in more detail as we go through today's presentation.

While there is still more to do, we are making good progress. I'm confident that the choice we have made and actions we are taking are the right way forward for BAT.

With that, I will hand over to Soraya to take you through the detail of our results.

Soraya Benchikh, Chief Financial Officer

Thank you, Tadeu, and good morning everyone.

I'm Soraya Benchikh, CFO of BAT.

Before I take you through the results, I would like to introduce myself.

I'm Lebanese. Having started my career in finance at Gillette and GE, I then spent many years working at BAT across Europe, Russia, Africa, and the Middle East.

I have spent the last 12 years in general management, and my last four have been at Diageo, culminating in my role as President for Europe. Now, after two months back at BAT, I'm excited to join Tadeu and the team to work on the next stage of our transformation.

As CFO, my focus will be on supporting BAT's transformation with financial stability and effective resource allocation. This includes driving Quality Growth by balancing top and bottom-line performance and targeting investments to deliver better returns and consistent cash generation.

I will do so by prioritising understanding market trends and consumer needs, investing in innovation and R&D, streamlining operations for efficiencies, while managing organisational change effectively and aligning with our sustainability goals.

I am passionate about transformative leadership and committed to fostering creative, inclusive and empowered teams. Maintaining transparent and consistent communication with stakeholders is also key for me, and I really look forward to sharing insights into our performance and future outlook with you.

Now, moving to our first-half results.

Our reported results reflect the impact of our exit from Russia and Belarus in September last year, higher amortisation and impairment charges following the decision to start amortising the U.S. acquired Combustible brands from January 2024, and a gain recognised in respect of the partial sale of the group's investment in ITC.

Now to better understand the underlying performance of the business and present a like-for-like comparison, excluding Russia and Belarus, we will focus today on organic adjusted constant currency results unless otherwise stated.

Our Group revenue was down 0.8%. While New Category revenue grew over 7%. Profit from operations was down 0.9% and diluted EPS was up 1.3%.

While our Group results have been impacted by continued macroeconomic headwinds in the U.S., we have also made targeted investment choices. And these have included continued investment in our U.S. commercial plans with related wholesaler inventory movements, and investment in New Category launches globally in order to strengthen our portfolio and drive sustainable growth and value creation.

As you can see, our wholesaler inventory movements in the U.S. significantly impacted our first half delivery. Excluding these, our Group revenue would be flat, and profit from operations was up 0.5%.

We expect these movements to unwind in the second half and have no material impact on our full-year delivery.

Now, diving into some of the key drivers of our performance. We delivered 4.3% Combustibles price / mix, with pricing up 7.2%, offset by a negative geographic mix, mainly driven by the U.S.

In addition, we achieved a flat operating margin driven by improvement in our New Category contribution, and our continued focus on efficiencies, despite absorbing a 1.8% transactional FX headwind. Excluding the U.S., which I will discuss in more detail later, in the rest of the world, we delivered 4% revenue and 4.6% profit from operations growth, in line with our medium-term guidance. This reflects the resilience of our multi-category portfolio and the benefit of our global footprint.

Our New Category revenue growth in the first half was driven by an excellent performance from Velo in all three regions. We expect an acceleration in New Category performance in the second half, driven by the phasing of our innovation launches, which we will touch on in more detail later on in the presentation. I will now share more detail on our key category drivers. As usual, market shares for our top markets are available in the appendix.

Starting with Vapour, the fundamentals of the Vapour category are strongly positive. The total number of Vapour consumers is accelerating, and Vapour is the largest contributor to active New Category usage, capturing 65% of consumers.

Vuse revenue was up nearly 3%, delivering a continued positive category contribution.

There was strong revenue growth in Europe and APMEA, which was partly offset by the impact of illicit single-use vapour products in the U.S. and Canada. Vuse maintained global value share leadership and also remains the number one brand in the U.S.

While we are losing share in the U.S. due to the continued proliferation of illicit products, we are actively working to drive more effective regulation and enforcement at the state and federal levels.

In June, we submitted the age-gated Vuse Pro PMTA, and last week we received a Marketing Granted Order for our Vuse Alto device and tobacco flavours, confirming that the continued marketing of these products is appropriate for the protection of public health.

Outside the U.S., we maintained value share leadership in AME at 32%. Although our regional performance was impacted by the flavour ban in Quebec province in Canada, where volume has shifted to the illegal market due to lack of enforcement, our value share in Europe grew 120 basis points.

We are excited about the developing opportunity in APMEA, with our revenue growing 48%, driven by South Korea, New Zealand and Indonesia.

In Heated Products, industry growth is slowing with growing poly-usage*.

glo's revenue was down 4%, mainly impacted by price repositioning in Japan and Italy in mid '23, and veo pipeline build at the end of '23 in certain AME markets ahead of the flavour ban on tobacco consumables.

glo has started to deliver sequential category volume share improvement in key markets since December and is stabilising share, being down 20 basis points year-to-date at 16.8 versus 110 basis points in 2023.

This has been driven by the encouraging early consumer response to our new innovations, Hyper Pro and improved consumables.

As part of our innovation pipeline, Hyper Pro is an important first step into the premium HP segment. As a result, we are seeing an improving performance with our June volume share up 60 basis points in Japan and up 70 basis points in Italy versus December.

This is especially encouraging, as we also raised consumables pricing in both markets during the period. Altogether, we drove a strong improvement in total category contribution.

With the majority of Hyper Pro roll-outs completed, and veo, our tobacco-free consumables range, now launched in 19 markets and outperforming competing products, we expect an acceleration in our second-half performance.

Now, moving on to Modern Oral, the fastest growing New Category, where new markets** with no oral tradition now account for one quarter of industry volume.

In H1, revenue was up 49%, with growth across all regions and the growing category contribution. Our market share continued to grow with our volume share of Modern Oral up 30 basis points. In AME, we maintain clear leadership of the Modern Oral category, with 65% volume share, and Velo capturing the majority of the category growth.

Velo's continued performance is driven by achieving the highest consumer acquisition and conversion scores and the strongest brand power in key markets. Importantly, in AME, Velo's gross margin per mille is over two times that of combustibles, driving a strong increase in category contribution.

In the U.S., we are encouraged by results from our New York pilot featuring a refreshed Velo brand expression. In H1, we rolled out nationally, returning our U.S. performance to strong growth, with revenue up 120% and reaching 7.6% of volume share in June, up three percentage points versus December. In addition, following positive consumer testing, we started the U.S. national rollout of Grizzly Modern Oral in June.

One of my key priorities is to ensure that as we transform, we balance top and bottom-line delivery. This is demonstrated with our New Category contribution now driving our contribution margin up, whilst we continue to invest for our future growth. New Categories are now meaningfully contributing to Group results as we benefit from increased scale and efficiencies.

Building on this momentum, we expect to deliver a strong year-on-year improvement in New Category profitability in 2024.

Now, turning to Combustibles. Volumes declined by 6.9% on an organic basis. This was driven by wholesaler inventory movements in the US, 2023 market exits, and supply chain disruptions in Sudan. If we exclude these one-offs, our volume was down 4.7%.

Our volume share was up 30 basis points, driven by strong momentum and key Combustible markets such as Brazil, Bangladesh, and Pakistan.

Value share decreased by 10 basis points with the impact of our commercial actions in the U.S., more than offsetting value share gains in AME and APMEA, which delivered a combined increase of 20 basis points.

Revenue was down 2.6%, driven by the U.S., partially offset by resilient performance in a AME and APMEA, delivering combined revenue growth of 2.2%.

Now, turning to our regions. In the U.S., total revenue was down 7%, mainly driven by our Combustibles performance and the impact of illicit products on the vapour category.

As previously discussed, we have continued to actively invest in strengthening our portfolio, with the majority of our previously announced investment in commercial initiatives now completed in the first half. Tadeu will share more detail on this later on in the presentation.

Adjusted profit from operations was down 5%, driven by declining revenue, partially offset by efficiency gains, enabling us to expand our margins by 100 basis points.

Adjusting for wholesaler inventory movements, revenue was down less than 5%, and adjusted profit from operations was down 2.6%.

U.S. combustibles industry volume was down 10% or 9.5% on a sales-to-retail basis, excluding inventory movements.

Beyond secular market decline, industry volume was mostly impacted by a combination of macroeconomic headwinds and increasing poly usage*, particularly driven by the growth of the illicit single use vapes.

Combustibles volume declined by 13.7% ahead of industry decline, mainly driven by wholesaler inventory movements. If we exclude the deep discount segment where we are not present, industry decline was nearly 11%, in line with our volume decline when adjusted for inventory movements, at 11.4%.

While our volume share is down year-to-date by 10 basis points and value share is down 30 basis points, I am pleased that our commercial plans are delivering signs of volume and value share recovery. Our volume share is up 10 basis points since the last half year, driven by a 90 basis point increase in the premium segment.

In addition, we have started to recover value share with a 20 basis point decline since last half year, led by a 20 basis point increase in our premium share, reaching our highest level in four years.

Driven by this progress and adjusted for inventory moves, our Combustibles contribution has recovered versus the last half year.

Now looking outside the U.S... AME is a truly multi-category region. Smokeless products now represent 25% of regional revenues in markets where we are present, and over 50% of revenue in 11 markets.

This drove continued strong regional delivery. Revenues grew 5%, driven by higher revenue from Combustibles, reflecting a resilient volume performance and pricing, alongside continued New Category revenue growth driven by an excellent Modern Oral performance, which was up 47%. Excluding Canada, vapour revenues in AME were up

15%. Adjusted profit from operations was up 5%, as we continue to offset the impact of inflation with continued efficiency gains.

In APMEA, we saw resilient performance against a very strong prior year comparator. Total revenue was up 2% with combustibles revenue up 1% driven by good pricing, partly offset by the decline, the industry decline in Australia and supply chain disruptions in Sudan.

Vapour and Modern Oral revenue were both up strongly, driven by geographic expansion and continued progress in emerging markets. HP revenue was impacted by our price repositioning in Japan last year.

Smokeless products now represent 18% of regional revenue in markets where we are present.

And adjusted profit from operations was up 4%, driven by strong pricing and continued efficiency gains.

Now returning to our Group performance. Our operating margin was flat as we successfully offset high single figure inflation and a nearly 2% transactional effects headwind with improving New Category profitability and continued efficiency gains.

Inflation was mainly related to leaf, which we expect to ease in the second half.

Turning now to EPS, we delivered organic, constant currency adjusted diluted EPS, up 1.3%. Our performance benefited from lower net finance costs, tax, and share count, which was partially offset by our reduced share of ITC profits. Our underlying tax rate was 24.4%, and we continue to expect a rate of around 25% for the full year with existing tax rates.

BAT is a highly cash generative company. Our cash flow conversion of 78% in the first half puts us well on track for another year of cash conversion in excess of 90%, enabled by our continuous improvement mindset and further resource optimisation.

Due to the timing of leaf purchases and MSA payments, our cash flow is always second-half weighted. We now expect full year gross capex of around £600 million, below adjusted depreciation and amortisation. This is above our previous guidance of £550 million, as we expand production capacity in the fast-growing Modern Oral category.

We're making good progress on deleverage and expect to be within our narrow target range of 2 to 2.5 times at year end.

We have seen some in the interest rate environment with lower rates and tightening credit spreads. This, together with the cash we received from the ITC asset sale, has resulted in lower than expected net finance costs.

As a result, we now expect full year net finance costs to be around £1.7 billion, subject to both effects and interest rate volatility.

As we continue our transformation journey, we are focused on the importance of disciplined capital allocation and strong shareholder returns. We are committed to a progressive dividend, and we are making good progress on de-leverage.

We are committed to a sustainable share buyback, and in March, we reinitiated a share buy-back, starting with £700 million in 2024 and £900 million next year, enabled by the monetisation of a portion of our ITC stake.

Looking forward, we are making targeted investment choices to drive our medium-term sustainable growth algorithm.

As expected, our first-half performance was impacted by continued macroeconomic pressures and investment in our commercial actions.

We are confident that our second-half will accelerate, and we remain on track to deliver low single digit organic revenue and adjusted profit from operations growth, including a 2% transactional FX headwind for the full year.

Extrapolating current spot rates, we anticipate currency translation to be a 4% headwind on full year adjusted profit from operations growth.

Now beyond 2024, we expect to progressively improve our delivery to 3 to 5% organic revenue growth and mid single digit adjusted profit from operations growth on an organic constant currency basis by 2026.

Now, with that, I will hand back to Tadeu. Thank you.

Tadeu Marroco, Chief Executive

Thank you, Soraya.

I would now like to spend a few moments outlining the opportunity and pathway ahead for BAT, and why we are confident we can deliver an acceleration in our second-half performance.

There are four clear accelerators that we expect to drive our second-half delivery, improving U.S. performance, innovations in all three New Categories, driving double digit revenue growth for the full year.

In addition, we are lapping a softer comparator in APMEA and expect a continued strong performance in AME.

As a result, we remain confident in delivering our guidance for 2024.

Looking at the U.S. premium segment, we can see a clear correlation between consumer sentiment and premium segment volume trends.

Historic macro-economic shocks have had a significant impact on consumer sentiment, and this in turn has driven accelerated declining in premium volumes.

However, over time, as consumer confidence levels improve, premium volume decline typically stabilise, returning to a more normalised level.

Although the U.S. market continues to evolve, we believe this further supports our outlook for improving U.S. delivery over the medium-term.

A key feature of our industry in recent years has been the strength of the deep discount segment as consumers looked to make the dollars stretch further. We are now starting to see deep discount volume growth slow dramatically, with market share remaining broadly flat since the third quarter of last year.

At the same time, the branded value segment has grown volume share, with BAT increasing its segment share, led by Lucky Strike.

While we have not assumed the macro improvement in our full-year guidance, we believe this early indication of low-end consumer recovered could provide a tailwind in the medium-term.

I want to share some more colour on the portfolio actions we have taken, and why we are confident this will drive an improving performance moving forward.

In premium, we have invested in Newport soft-pack in key investment states, creating a ladder portfolio, which has driven a recovery Newport's share of the total premium segment.

This has enabled us drive a 30% reduction in smokers switching out of the Newport brand family, resulting in an 80% reduction in low-end growth in the 19 states where Newport soft-pack has been deployed.

Taking a step back, we have a balanced portfolio of brands across all price points.

Through our commercial initiatives, we have driven consistent value share gains in both the premium segments with Natural American Spirit, and in the branded value segment, with Lucky Strike.

Natural American Spirit's distinctive brand positioning in the super premium segment benefits from a highly loyal consumer base.

While Lucky Strike, relaunched three years ago, remains the fastest growing cigarette brand in the market.

A key element of our commercial investment has been expanding our contracted distribution universe over the last 12 months to reach 88% coverage.

This has significantly improved our competitive position by offering more of our retailer partners increased salesforce support.

This has driven a 2.3 percentage points increase in volume share in these newly contracted outlets with share gains across our brands. In addition, this has led to a 1.6% decline in the deeper discount segment in these outlets.

Altogether, with these previously announced commercial initiatives now in place, we are confident that our actions will drive a better second-half performance in the U.S. and further strengthen our portfolio over the medium to long term.

Turning to regulation… We continue to advocate for more appropriate regulation and enforcement of New Categories, especially in the U.S. Vapour.

During the first-half, we saw an increase in enforcement action from the FDA, with increasing fines, import refusals and seizures.

In addition, the U.S. Justice Department and FDA recently announced the creation of a task force, designed to harness the enforcement capabilities of multiple federal agencies to combat illicit products.

However, the success of legal products is dependent on the FDA doing more to tackle illicit vapour. To support this, we continue to advocate for the publication of a PMTA list, which would provide clarity to all market participants.

I'm pleased that just last week, the U.S. International Trade Commission announced it will investigate our patent infringement complaint against the manufacturers, distributors, and retailers of single use illicit products. In addition, the ITC continues its investigation of our complaint against the unfair import of these illicit products.

Clearly, the pressure for enforcement is building. However, much more needs to be done to drive a meaningful impact over the medium-term.

At the state level, Vapour directory or enforcement legislation has now been passed in 13 states, meaning, once implemented, 31% of the tracked vapour industry volume will be covered by state directories. In Louisiana, the first state to implement a vapour directory, with significant enforcement in October 2023, we are starting to see illicit product volume decline, with Vuse Alto capturing the majority of the volume flow back into the legal segment.

As a blueprint, Louisiana is a powerful example of what can be achieved. However, it's important to note that the scope of Vapour directories and regulation differs materially by states, and that much more needs to be done to ensure effective enforcement of these regulations.

Turning now to Heated Products…. As Soraya shared, we are starting to see a turnaround in glo performance driven by Hyper Pro. With the majority of our launches now in place in the first half, we are confident we can build on this momentum through the rest of the year.

The step change in performance is clear. With volume share gains in key HP markets, Japan, Italy, and Poland.

Our Pro device has a premium price position, and the launch of our reed consumables has enabled us to take price increase in key markets.

Importantly, since December, our value share in these key markets is now growing faster than our volume share, reflecting the strength of our innovations and commercial actions.

So what has driven this turnaround? I have been very transparent that we needed to do more to strength our HP performance, and this all begins with better products.

Leveraging our consumer-insights, glo Hyper Pro and consumables are resonating strongly with consumers across key attributes, such as brand equity and perception. This is also driving an increasing in average daily consumption amongst glo consumers.

These launches are the first step in our enhanced innovation pipeline for Heated Products, and that a significant driver in the progress we are making to improve glo's category contribution.

In Vapour, we have started to roll out exciting innovations with significant launch plans for the second half. Vuse Go 2.0, our newest single-use vapour delivers improved sensorials with superior heating technology. Importantly, this is our first device with the removable battery, which together with a device lock, directly addresses key sustainability and safety concerns.

We continue to upgrade our rechargeables experience with our new Vuse Go Reload device, which pairs with our improved Vuse flavours.

Vuse Go Reload provides the flexibility and convenience of single-use products with a rechargeable device.

And earlier this month, in the U.S., we entered the emerging zero nicotine space with the launch of Sensa.

Putting all this together, we are confident these innovations can drive an improved Vuse performance in the second half.

In Modern Oral, we are re-invigorating our U.S. portfolio. I'm delighted by the performance of our refreshed Velo brand expression in our New York pilot, which has driven volume share up 7.2 percentage points to June, versus pre-pilot levels reaching 16.5%. As a result of the success, earlier this year we commenced a national rollout of refreshed Velo.

Utilising our consumer insights, we continue to innovate to broaden our offering and appeal to both Traditional Oral consumers through Grizzly Modern Oral, and internationally by enhancing our flavours ranges.

As you can see, we have exciting new innovations in markets in each new category, to drive our second half acceleration.

I am encouraged that our New Category launches and our first-half commercial investments to strength our U.S. Combustibles portfolio are gaining traction, which together with the unwinding of U.S. wholesaler inventory movements, I'm confident will drive an acceleration of our Group performance in the second half.

As a result, we are on track to deliver our full-year guidance.

In conclusion, 2024 is an investment year for BAT. We are sharpening our execution to navigate near-term market challenges and set the business up for a stronger future.

We will continue to reward shareholders throughout our transformation, driven by consistent cash flows, disciplined capital allocation, and strong shareholder returns.

While there is more to do, our focus on Quality Growth is building momentum, and I'm confident this is the right approach to ensure we deliver long-term growth and value creation.

Thank you for listening.

We'll 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 everyone. If you've joined us via the webcast, you can type your questions directly into the online question box, or if you joined the call you can press *1 on your telephone keypad. Tadeu and Soraya will be very happy to take your questions and I will now hand over to the conference call operator.

Operator

Thank you. And our first question today comes from Rashad Kawan from Morgan Stanley. Please go ahead..

Rashad Kawan, sell-side analyst, Morgan Stanley

Hey, good morning, Tadeu and Soraya. Thanks for taking my questions and congrats on the results. A couple from me both on the U.S. please on the combustibles market. If I compare slide 21, where you laid out the impacts to the market, what you have in the full year, the key deterioration is coming from higher elasticities. Is that purely from increased poly-usage you think, or is it just less volume of smokers are cutting back given the pricing environment and weak sentiment overall? I guess have you seen a material change in consumer elasticity in U.S. combustibles?

And then my second question is on modern oral again in the U.S. I mean, the acceleration we're seeing is a bit of a surprise to be honest, given you still don't have your more superior obviously European product in the U.S. Is it just about the brand refresh you've done? Are you benefiting a little bit from the shortages by one of your peers there? Any more colour on what's going on in U.S. Modern Oral? Thanks, thanks again.

Tadeu Marroco, Chief Executive

Okay Rashad. Look on the U.S. combustibles, we are not seeing a massive deterioration in terms of elasticity in the cigarettes. What is impacting us in the industry as a whole is a combination of a very difficult macro environment. Remember that we came from the pandemic times off a lot of support from state federal level to consumers that was really reversed completely was taken out completely, and at the same time the consumer got hit by very high levels of inflation and very high levels of interest rates as well, and put mostly low income consumers and a lot of stress financially.

So this clearly has an impact and this has reflected in consumer sentiment. That's why we show in our presentation the correlation. Now, the other obvious driver for that is the proliferation of the illegal single-use vapour products in the U.S. And the category continues to grow despite the fact that the legal part of it is actually reducing now, is all the growth is more than compensating the reduction the legal side and going into those illicit, and this is putting more pressure on that.

So these are the major drivers that why we are seeing this high single-digit industry decline in the U.S. It's good to note that we are seeing some first green shoots in terms of the macro economics. The inflation is coming down, wages inflation is catching up and narrowing the gap with the overall inflation. We are seeing a small uptick in consumer sentiment more recently, and this, combined with a potential Fed move in terms of reduced interest rates by end of the year, could all be positive more towards 2025/2026.

Now your question about poly-users is the right one, because in the end we are seeing more poly-user dynamics in the U.S. market. So remember that before the pandemic we used to see secular decline in the U.S. around 4 to 5%. I think that these high-end of the range now will be as soon as things stabilise on the macroeconomic side become the low end of the range, a new range around 5 to 7%.

I would say that is the best guess that I have moving forward, when things start to stabilising. And we see at least a minimal level of enforcement on the illegal product.

Now the Modern Oral question you are referring to. Look, I think that most of the drivers of the improvement have had to do with our new expression of the brand. Because we pilot since Q3 last year in New York, and we were already seeing some traction there, before seeing any type of distribution issues with competitors in the market.

So, obviously this more recently case probably is also helping to drive some growth in our offer. But you have to remember that we were already growing New York at the end of last year. And that's the reason why we decided to do the national rollout in the first quarter of this year. And for sure, we have now Grizzly also in a new offer, it's early days because we saw a lot of consumers of Grizzly actually moving our interest in this new emerging segments and we are trying to contemplate this within a very strong brand power which is Grizzly in the U.S.

Rashad Kawan, sell-side analyst, Morgan Stanley

Thank you very much.

Operator

Thank you. And we now move on to a question from Gaurav Jain from Barclays. Please go ahead.

Gaurav Jain, sell-side analyst, Barclays

Hi, good morning. I have three questions. The first one is for Soraya. So if I look at your FX guidance, there is a 4% headwind and that has been a structural issue with BAT given your presence in so many emerging markets. It was an issue for a lot of other FMCG companies, and we are now hearing from several companies including Philip Morris, Unilever, Coke, that they're targeting dollar EPS growth or a pound EPS growth. Is that something which BAT would also like to move to that, instead of just a constant currency EPS growth, actually try to have meaningful pound EPS growth?

Soraya Benchikh, Chief Financial Officer

Sorry, Gaurav, apologies I didn't hear the last part of the question. If I understand correctly... Are we confident that we can drive EPS growth on constant terms? Was that the question? And current terms.

Gaurav Jain, sell-side analyst, Barclays

No, look, I think clearly you have a guidance that you can grow EPS on a constant currency basis. But, I mean it has been a struggle to drive pound EPS growth. That is because FX has been a structural headwind, and we are seeing some of your peers, including Philip Morris, now talk of hard currency EPS growth. So, is that something which BAT should also do? Is what I'm trying to understand. And maybe Tadeu, you can also chime in there.

Soraya Benchikh, Chief Financial Officer

Yes, I am confident, Gaurav, that we can drive EPS growth on current terms. Do you want to add something to it?

Tadeu Marroco, Chief Executive

Gaurav, look, remember that our numbers we have read transactional FX on this, no? Some of these companies you are referring to, they come with constant numbers that actually exclude transaction, which makes a very deep, even bigger distance between constant and current, let's put it that way. So for sure, in years like the ones that we are facing now, with a lot of the valuations coming mainly emerging markets, it's difficult to imagine that you can offset all that. But like Soraya said, in the medium-term on a current base, we should be able to deliver that.

Gaurav Jain, sell-side analyst, Barclays

Sure, thank you. The second question I had is on your NGP revenue and volume and how it has panned out in one edge... heated tobacco volumes organically are down, and they were down in Japan as well, and you had a lot of price repositioning in 2H23, and your e-cigarette business is also down. So, do you think it makes sense to direct more of the investments into e-cigarettes and away from heated tobacco? Otherwise both the segments are down?

Tadeu Marroco, Chief Executive

Look, the situation in AME is impacted and we refer to that in our presentation by some stock movements that we have done end of last year to prepare for the flavour ban in tobacco heated product, because we have to in some markets start selling few our non-tobacco flavour product. And if you adjust for that AME, I think that had a revenue of 2%, a volume of 7%, the volume will be double-digits adjusted for that.

So I'm very pleased actually with the progress that we are making. You go to a place like Poland for example, we have around 34% market share in the category, and in difficult place like Italy, we start seeing some improvements. The same happening in Japan.

You have to remember that last year, and I was very clear and transparent about that when I came as a CFO, I said we don't have a really competitive THP product, and we are focusing in improving our competitiveness in that segment.

We managed to sign an IP agreement with PMI earlier in the year, and we also managed to get in place a product that is well superior. You saw some of the statistics that I present today. And if you consider that penetration of these devices on average just 15%, all these improvements that you saw in my slide about average daily consumption, conversion, retention, this will just grow from now until the end of the year. Not to mention the other platforms that we are now building our pipeline.

So I think the answer, yes, we should be investing. I think that we are lapping in a difficult period mainly because of lack of competitiveness, but I'm quite confident that we start to have turned our competitive position in THP.

Gaurav Jain, sell-side analyst, Barclays

Sure. Thank you so much. And my last question is on e-cigarettes. Clearly very nice to hear that you have received the PMTA. Could you just remind us what's your PMTA pipeline now on e-cigarettes in the US and clearly Vuse, it's doing pretty well internationally. So how should we think about future PMTAs?

Tadeu Marroco, Chief Executive

PMTAs, what we have already approved is basically the tobacco flavours of Alto, Vuse, Ciro and Solo. As you know, is the largest combined PMTAs received the U.S. so far. We are disputing, as you know, the menthol version, why we still keep selling. Because we believe that we have the data that is necessary for the FDA to take into consideration. So we receive the stay, and we are hopeful that this can be reviewed in future.

We have just submitted last month the PMTA for our age-gated device. This includes not just flavour but also some fruit flavours as well, and menthol, as part of this. And this is the most pressing PMTAs I have to say, that we are now expecting.

We are very hopeful that given the fact that is an age-verified, with age-verification technology, FDA can, as they said, expedite the approval of this PMTA, because this will be probably one, two, that they'll be considering trying to bring back flavours that is so critical to move adult smokers out of cigarettes towards vapour in a responsible way.

Gaurav Jain, sell-side analyst, Barclays

Thank you so much.

Operator

Thank you. And as a brief reminder, that it's *1 for your questions over the telephone today. And up next we have Richard Felton from Goldman Sachs. Please go ahead.

Richard Felton, sell-side analyst, Goldman Sachs

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

My first question is on vapour outside of the US, where I think volume was down almost 10% in H1. Is there any colour or detail you can share on the drivers of that, and whether those drivers are one-off in nature, or there's more structural headwinds that we should be aware of?

Then my second question, also on new categories. Look, I'd really like to understand how you are thinking about growing revenue versus improving profitability from here. Because if I take a step back, and reflect on your performance over the last few years, you've missed your guidance on revenue, but profitability has improved much better than you had been previously guiding for.

Looking forward, how do you think about managing your P&L for that part of the business? And how do you balance investing in further growth, but also improving margin? Thank you.

Tadeu Marroco, Chief Executive

Okay, so I will take the second question. In regards to your vapour question, outside the US, is pretty much impacted by Canada. This is basically Quebec that introduce a new legislation limiting the amount of ML, for 2 ml, and the banning all flavours other than tobacco, and without any enforcement.

So what we saw in the following day was these proliferations of all these illegal products bringing back big tanks full of flavours. And for sure, there is no level playing field. And that's the consequence that you are seeing there in Canada.

So in a way, it's a one-off until the regulators wake up and try to enforce properly, or review the regulatory element to that. That's why, when you see the second pillar of our strategy, it's all about tobacco harm reduction. It's about having evidence, science evidence, points of discussion with key stakeholders, regulates the policymakers to avoid this type of very misleading regulations, should be put in place without proper enforcement.

So if you strip out Canada, in reality, AME as a region grew 15% revenue. And this without any impact. Of all these products that I show in my slides, the Vuse Go 2.0, the Vuse Go Reload. These are all reaching the market now in May, has not any time in terms of the shares or performance that you saw in the performance these early today. And the other markets that we are quite excited about, markets like New Zealand, that has now moved to a more well-sounded regulatory environment, and is allowing us to properly compete in the market.

And we are gaining a lot of traction with our offers in New Zealand. And also Korea, that is quite exciting. We are already market leaders in a very short period of time in Korea. And we also have prospects or markets like Indonesia. So overall, it's basically in summary, a consequence of the regulatory impact in Canada.

Soraya Benchikh, Chief Financial Officer

Okay, I'll take the second question. In terms of balancing revenue growth and margin expansion, as you might recall, I mentioned that our priority is really to balance top and bottom line growth. And we are really looking to do this by continuing to invest, but more so targeting our investments in all the categories that have momentum, but also where there is more value, be it in categories or geographies.

So with targeting investment, what you will see is we'll continue to balance both top and bottom line. And this is evidenced by the fact that in the first half we showed that we've increased a category contribution by more than, I think it was around 167 million.

And that's expanded category contribution by 10 margin points, 10 percentage. So as we go forward, and into the full year, we'll continue our targeted investments.

And as Tadeu mentioned, we are very second-half leaning, in terms of innovations coming to market. So we will have quite a lot of investment in the second half, but you will continue to see our category contribution increase year-on-year. And this will be a really big priority for us going forward, to target our investments and increase our margins.

Richard Felton, sell-side analyst, Goldman Sachs

Great, thank you. Very clear.

Operator

Thank you. And from UBS, we have Faham Baig with our next question. Please, go ahead.

Faham Baig, sell-side analyst, UBS

Good morning, team. A couple from me as well, please. Could I go back to the increased poly-usage that you're seeing? I think one of your competitors mentioned that the consumer conversion rates on Vapour are lower than that scene in Heated Tobacco. I just wanted to get your perspective on what you're seeing on the conversion rates between the two categories, and how you generally see the prospects of the two categories.

And the second question goes back on to U.S. vapour. I know you've previously quantified the growth of the overall category, and the impact on cigarette volumes, if you could just remind us on that. And by when do you assume that the increased enforcement efforts by the FDA could negatively impact the development of these disposable products?

And if you can touch on this, you've highlighted some benefits in Louisiana as well, what about the other two states that have implemented the registries, Oklahoma and Alabama? Maybe what you're seeing there would help as well.

Tadeu Marroco, Chief Executive

Yeah, okay. On the poly-users, I think that we mentioned, we give some statistics about vapour compared with THP, in a conference that we participated last year. We don't see massive material change amongst those two categories, in what conversion is related. So we don't agree with this comment about one has a much stronger conversion than others, in the first place.

And it's good to remember that vapour is 65% of consumption in this new space of non-combustibles, to start with. And it's growing fast as well. Different from THP, which is, if anything, is lowering down as a category, mostly because of the phenomenon of poly users, that is not just because of vapour, but now a very accelerated growth in terms of Modern Oral.

In terms of U.S. vapour, what we quoted before is a number around 2% of decline that is linked directly with the proliferation of these illegal products. If anything, we haven't seen any type of reduction in terms of growth. I cannot be here in a position to say all these headlines that you read has reflected positively in the market, because we don't see this to be the case.

Actually, the slightly loss of share that we had in vapour, it was exactly for these illegal products in the track channels mostly. So they still continue to grow. It's very difficult to answer a question of when we expect to see enforcement, because we were expecting to see a conclusion of the PMTA of vapour process from the FDA perspective end of June, well originally it was end of December last year, and now move to end of June.

So we still haven't seen that. That's why in my presentation, was making reference to the need of the FDA to really conclude this process, and be able to clearly publicly state what is allowed, what is not allowed. This can help tremendously, enforcement, at least on these tracked channels that we are continue to see growing, the participation of illegal vapours.

Now, Louisiana is the state of the art in terms of regulation. So we are seeing a big progress in terms of reduction of illegal products there, and which has benefit substantially views, as a major beneficiary with the reduction on the illegal products. And the other two, not at the same level, because as I mentioned, they are not the same type of regulations.

But it's a good start point, because what you could do is to improve the regulation as soon as you start that. But in the other two states, although there are some reduction, not at the same level of Louisiana, because Louisiana is a more complete, because they have just introduced also an excise. They use this to fund, bring proper enforcement in the legislation. And they have, if you see the details around the legislation, it's much more, I would say, comprehensive than the other two states.

<u>Faham Baig, sell-side analyst, UBS</u>

Thanks, Tadeu.

<u>Operator</u>

Thank you. And we now take a question from a Damian McNeela of Deutsche Bank. Please, go ahead.

<u>Damian McNeela, sell-side analyst, Deutsche Bank</u>

Hi, good morning, everybody. Two from me, please. Just firstly, just on the U.S. Combustibles business, you've indicated that contracted coverage has moved from 82%

to 88%. I'm just wondering what a reasonable level of coverage would be for the U.S.? And how long it would take you to get there? And then just more generally on how happy you are with the progress that's been made in the commercial organisation in the U.S., and whether there's any more that can be done to drive an improvement in performance there?

And then the second question is just on, Soraya indicated an incremental 50 million going into Modern Oral capacity. I was just wondering if you could give us an indication of how much headroom those investments gave you going forwards, please?

Tadeu Marroco, Chief Executive

Okay, yeah, on the coverage, it's always an assessment of the investment and the return that we get on those retailers. We are coming to a point that we are very satisfied where we are. That's why I'm always referring to most of the commercial plans has been already concluded.

We did that at the back of increasing our sales force by 150 new reps. And so we expand our sales force in order to do that. We also invest heavily, even more on terms of data analytics, revenue growth management systems in general. And these are part of the commercial plans, together with laddering, and price adjustment, so on. So we are pretty much there, in terms of what we need to do. You saw some of the improvements that we have been achieving recently, in terms of volume sharing, in terms of value sharing, in terms of premium segment.

And so I think that we are in a very strong position now to benefit from when the market start to improve from the macro-economic level, and from the enforcement levels on the illicit products. But it's important to notice that nicotine consumption in U.S. is still pretty stable. The problem is that it's growing, where we are not able to participate nowadays, because these illegal vapour markets are accounting to, and I mentioned this before, more than 60% of the vapour category, which means around £60 billion of revenue, that will be up for grab as soon as we have some minimum enforcement in that space.

Not to mention the emergence of Modern Oral as well, as a category, that we are now, despite the fact that we don't have our winning products, that is still in the U.S. Quite subject to PMTA approval as you know, we are being able to start making some inroads to the product that we have currently, after some adjustments that we have done more recently.

Modern Oral is a category that is growing everywhere. And you probably notice in our comment that 25% already of the markets are outside, or in place of the industry, are in place where there was no oral tradition before.

And this materialising massive growth and BAT with our product Velo, is being able to absorb more than 7% of this growth happening in AME outside the U.S. So we are really, really well-positioned, and having a truly powerful brand that consumer loves, and being very well-activated, and hopefully together with some improvements, we are doing the U.S. And mostly, when we'd really be able to have this product in the U.S., this would be a fantastic opportunity for the group moving forward. I will leave for Soraya to answer about the capex.

Soraya Benchikh, Chief Financial Officer

In terms of the capex, yes, we're always enhancing. As you can see, the trajectory of Modern Oral has been very impressive. On the first half alone, we grew 47%. So we're always looking to further invest to enhance capacity, both be it for the US and in Europe. So we've revised our capex investment this year from 550 to 600 million.

Damian McNeela, sell-side analyst, Deutsche Bank

Okay, thank you.

Operator

Thank you. And with that I'd like to hand the call back over to you, Victoria, for any questions via the webcast?

Victoria Buxton, Group Head of Investor Relations

Thank you. We do have a couple of questions from the web. Soraya, this one's probably for you.

"How much of the raw material increase was leaf costs, versus FX? And how much do you expect this to unwind over the next six months, and over the next year?"

Soraya Benchikh, Chief Financial Officer

Okay. We had significant increase in leaf costs. I think it was the raw materials was around nine to 10%, and the leaf was around 14%. This is coming down sharply in the second half, and we expect most of it to unwind by next year. But it has been a drag on the overall operating margin, or the gross margin, in terms of combustibles, which hopefully will be an upside for us next year.

Victoria Buxton, Group Head of Investor Relations

Next question is, "Will the FIIGLO payments impact our buy-back plans next year?"

Soraya Benchikh, Chief Financial Officer

Okay, so the FIIGLO payments, which is £0.8 billion over four years. These, the amounts yearly have been well-known to us, and they have been fully taken into account in our forecast when we actually announced our buy-back resulting from the sale of our ITC stake.

And we committed to £700 million, which we started in March, and we will be doing the buy-back of the remaining £900 million, to make up the £1.6 billion from the ITC stakes.

Victoria Buxton, Group Head of Investor Relations

So apologies, we don't appear to have any more questions from the web. If you didn't manage to ask a question, then please don't hesitate to contact the IR team, and we'd be delighted to help you.

So I'll now hand back to Tadeu for some closing remarks.

Tadeu Marroco, Chief Executive

Okay, thank you for listening today, and for your questions. I hope you can all see this is a key moment in our transformation journey. I'm confident that the targeted investment choices we are making are the right decisions to deliver long-term growth and value creation.

I look forward to keeping you updated on our progress, and I hope to see many of you at our Capital Markets Day, being held at our Innovation Centre in Southampton on the 16th of October.

Here you have the opportunity to see first-hand how our teams are focused on reducing the health impact of our business, and enabling BAT to deliver long-term sustainable value for all our stakeholders. Thank you very much.

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

** New Modern Oral markets outside the U.S. and Scandinavia.