Orange Book

New Categories

BAT
A BETTER TOMORROW

Purpose

With the introduction of New Categories, the complexity of volume, share and financial reporting has increased substantially.

It is critical to the success of the Group's New Categories that guidelines are consistently applied and reporting is standardised across the Group.

Doing so, allows meaningful analysis to be carried out and drive resource allocation and strategic decision making.

However, compared to Combustibles, there is increased complexity because:

- Most New Categories brands are operating on the LRD model from the start. Whereas in Combustibles this model was localised to specific brands and regions, globally most New Categories markets must adhere to the strict governance procedures necessitated by the LRD model
- The variation in New Categories products is far greater than anything seen in the Combustible space. This drives the need for a greater level of detail required, hence the use of Brand Ranges
- Due to a different regulatory environment, New Categories allows much greater communication and interaction with the Consumer.
- Combustible products allow a very easy volume comparison by reporting in Stick Equivalents. As New Categories have products recorded in Pouches, Pods, Bottles and Sticks, this has increased the complexity for volume reporting and analysis
- Sales Channels for New Categories are vastly different to that of Combustibles. Whereas Traditional Retail was the major sales channel for Combustibles, New Categories can allow for sales through E-Commerce and Own Retail. To track this Channel Reporting is crucial
- Lastly BAT will be required to report Operating Segments by Product Category, including New Categories. For this, markets will need to allocate Direct and Shared costs according to globally defined allocation rules

In order to provide guidance and clarity over New Categories reporting, the Orange Book has been created. This is a brand-new collection of Volume/Financial guidelines and methodologies that apply only to New Categories.

The Orange Book is to be used in conjunction with Pink Book, Green Book, Black Book and any guidance issued by the Nicoventures Reporting Team.

In case of any confusion or discrepancy, the guidance provided for New Categories in this document supersedes any other document.

As the world of New Categories constantly evolves, this document will be updated on a regular basis. We are currently working on the following solutions for New Categories and once they are finalised, they will be made part of this document:

- Reviewing Discounting and Trade Margin Reporting
- Enhanced Channel Reporting
- Updated COS Lines for Bought-in Goods
- Savings methodology for Cost of Sales
- Share Reporting

Contents

Section 1

General Reporting Guidance

1 General Reporting Guidance

The following section details the current approach to the New Categories reporting for both internal and external purposes.

1.1 Channel Reporting

Requirements

There is an increasing Group focus on the Channels through which New Categories are sold. Because of this, Channel Reporting in BPC will be required for the **reporting of Actual / Forecast volumes and financials in markets that have > £1m of the Total NTO in Channels other than Traditional Retail.**

The scope of the Channel Reporting requirement will continuously evolve as other products and markets may be introduced in the future, depending on the relevance. **The requirement for Channel Reporting covers TaO and Non-TaO markets.**

A full Channel breakdown is required for all P&L lines from Sales Volume to External Net Turnover.

Channel splits for COS are not currently required.

The key Channels which need to be reported are:

-Traditional Retail
-NGP Shops Owned by BAT
-NGP Shops Owned by 3rd parties
-Online BAT Owned
-Online Owned by 3rd Parties

In order to report Channel Volumes and Financials, markets are required to use the **Analysis Dimension in BPC**. No further granularity below the previously stated Channels is required.

However it must be ensured that for both Actuals and Forecast, the split of the Channels are correct and there are no volumes or revenue financials remaining under the “No Analysis” category.

Please see the following page for an example of Channel Reporting in BPC.

1 General Reporting Guidance

1.1 Channel Reporting (continued)

	Traditional Retail	NGP Shops Owned by BAT	NGP Shops Owned by 3rd Parties	Online Owned by BAT	Online Owned by 3rd Parties	Total Market
MPTO11000 - Recommended retail price (RRP)	660,016,920	11,286,928	2,603,989	33,131,123	796,255	707,835,215
MPTO12000 - Consumer discounting (if legislation allows)	80,433,443		297,067	9,694,703		90,425,213
MPTO13000 - Consumer price turnover (CPTO)	**579,583,477**	**11,286,928**	**2,306,922**	**23,436,420**	**796,255**	**617,410,002**
MPTO21010 - Retailer margin standard	19,915,794	(20,763)		9,907	134,318	20,039,256
MPTO21015 - Retailer margin non-standard		4				4
MPTO21010P - Retailer margin	**19,915,794**	**(20,759)**		**9,907**	**134,318**	**20,039,260**
MPTO21020 - Wholesale margin standard	2,169,389	20,759		25		2,190,173
MPTO21025 - Wholesale margin non-standard	2,406		269,442			271,848
MPTO21020P - Wholesale margin	**2,171,795**	**20,759**	**269,442**	**25**		**2,462,021**
MPTO21030 - Distributor margin standard	1,017,023					1,017,023
MPTO21030P - Distributor margin	**1,017,023**					**1,017,023**
MPTO21000 - Trade margin	**23,104,611**	**(0)**	**269,442**	**9,932**	**134,318**	**23,518,303**
MPTO22011 - Customer price discounts	1,397,613			37,992		1,435,605
MPTO22010 - Customer price discounts & surcharges (interim)	**1,397,613**			**37,992**		**1,435,605**
MPTO22021 - Customer allowances (discounts)	(59,936)			12,371		- 47,565
MPTO22022 - Customer allowances (surcharges)				10,670		10,670
MPTO22020 - Customer allowances	**(59,936)**			**1,701**		**- 58,235**
MPTO22030 - Trade pay for performance	53,721,564		129,605			53,851,169
MPTO22040 - Early payment allowances	11,315,268		53,738			11,369,006
MPTO22050 - Method of payment allowances	7,372	(0)				7,372
MPTO22000 - Trade credits & payments	**66,381,881**	**(0)**	**183,343**	**39,693**		**66,604,917**
MPTO20000 - Total trade margin and credits & payments	**89,486,492**	**(0)**	**452,786**	**49,625**	**134,318**	**90,123,221**
MPTO30000 - Marketing investment in GTO	19,353,936	178,947		1,382,594	229,618	21,145,095
MPTO30000P - Marketing investment in GTO (interim)	**19,353,936**	**178,947**		**1,382,594**	**229,618**	**21,145,095**
MPTO41000 - Indirect VAT	4,946,031	11,833		(1,721)	26,864	4,983,007
MPTO40000 - Indirect taxes paid by trade	**4,946,031**	**11,833**		**(1,721)**	**26,864**	**4,983,007**
MPTO60010 - Other adjustments in external GTO expense/(income)	26,444,608		61,209	396,423		26,902,240
MPGT00000 - External gross turnover (GTO)	**439,352,411**	**11,096,147**	**1,792,927**	**21,609,498**	**405,455**	**474,256,438**
MPGT11000 - External direct VAT	10,408,215	47,497		712,673	105,845	11,274,230
MPGT12000 - External direct excise specific				53,091		53,091
MPGT10000 - External government levies paid by BAT	**10,408,215**	**47,497**		**765,764**	**105,845**	**11,327,321**
MPNT00000E - External net turnover	**428,944,196**	**11,048,650**	**1,792,927**	**20,843,733**	**299,610**	**462,929,116**

1 General Reporting Guidance

1.1 Channel Reporting (continued)

Actuals Channel Reporting

In order to report volumes and revenue by Channel each month in Actuals, a one-time set up must be completed in ECC.

Each existing customer in SAP will be mapped to the relevant Customer Group in its Masterdata.

Once this has been done, Actual sales will flow to the correct Channel without any other intervention.

Also, going forward any new customers must have the Customer Group entry data field completed when raising a new Masterdata request.

If there are P&L lines that require reallocation between different Channels, such as MI in GTO for example, formula libraries have been created when setting up markets for Channel Reporting.

Please contact the BPC design or the New Categories Reporting Team for assistance in this matter.

Forecast Channel Reporting

To enable the reporting of Channel financials every SOP, End Markets must use driver-based forecasts.

This means End Markets must maintain drivers for each Channel in BPC.

This can be done by copying the drivers from ECC to BPC.

The drivers will then ensure Financials are populated by Channel.

1 General Reporting Guidance

1.2 Brand Range Reporting

In 2019 Brand Ranges were introduced in the product hierarchy.

For New Categories, focus has sharpened on this level to produce meaningful and insightful analysis across the P&L.

Therefore, it is critical to ensure that financials for following Brand Ranges are reported accurately:

Vapour	
ePen 3	Starter Kits, PUKs and Consumables
ePod	Starter Kits, PUKs and Consumables
Vuse Alto	Starter Kits, PUKs and Consumables
Vuse Solo	Starter Kits, PUKs and Consumables
Vuse Vibe	Starter Kits, PUKs and Consumables
Vuse Ciro	Starter Kits, PUKs and Consumables

THP (Starter Kits)
Glo 1
Glo 2
Glo Mini
Glo Pro
Glo Nano
Glo Spirit/ Hyper
Glo Hyper 2.0
Glo Trinity

THP Consumables
Though there are currently no THP Consumable Brand Ranges, it must be ensured that the financials are allocated correctly to either the King Size Demi-Slim (KDSS) or King Size Super-Slim (KSSS) formats.

Brand Range Reporting requirements will be updated as and when new products are launched and apply to both TaO and Non-TaO markets.

Note: *For New Categories volume reporting, it remains critical to ensure that all Brand Range sales volumes are reported accurately.*

Section 2

Volume Guidelines

2 Volume Guidelines

2.1 Product Hierarchy and Volume Reporting

Product Hierarchy / NPI:

- In case any market identifies any **NPI** which is not covered by the 'planning SKUs' guidelines please contact your regional SPI New Categories lead for final instructions

Conversions:

- Sticks equivalent conversion is applied only to THP Consumables, Hybrid Consumables, HnB, and Modern Oral products
- There is no Stick equivalent conversion rate for THP Devices & Accessories, Hybrid Devices & Accessories, Vapour Consumables and Devices & Accessories, and Other Alternative Oral Products

System:

- All external sales volumes should be submitted in BPC in the same planning entity where tobacco forecast is loaded
- No external sales should be submitted into the New Categories Export entities
- Nicoventure entities should not be used to load forecast
- Internal sales loaded in the New Categories Export entities is a GBS/Finance responsibility

2 Volume Guidelines

2.1 Product Hierarchy and Volume Reporting (continued)

- **Forecast Guidelines:**

- Forecast should be on a monthly basis (as per the IBPM process)
- Forecast should be at SKU level, utilizing TaO code (above SKU planning by exception)
- Forecast of external volumes will be loaded at 1,000s of BUoM (i.e. in BPC the number 1 is equivalent to 1,000)
- Forecast should be done using up to three decimals
- All New Categories devices (ALL platforms: Vapour, Hybrid & THP) should be loaded in thousands of packs (regardless of what is inside the pack)
- New Categories Accessories, with the exception of Atomisers & Clearomisers, should be loaded in thousands of packs (regardless of what is inside the pack)
- Vapour Atomisers & Clearomisers should be loaded in thousands of makeup quantity (No. of primary devices included in a pack)
- Vapour Cartridges should be loaded in thousands of No. of Consumables in a pack
- Vapour eLiquid should be loaded in thousands of No. of 10ml Bottle equivalents
- Hybrid Pods should be loaded in thousands of No. of Consumables in a pack
- THP Consumables should be loaded in thousands of sticks
- Modern Oral should be loaded in thousands of Pouches (Consumables)

Vapour Examples:
1,000 ePen 3 Starter kit Packs includes 2 Cartridges = 1
1000 ePen3 Consumables Packs includes 2 Cartridges = 2
1,000 eTank Pro Starter kit Packs does not include Consumables = 1
1,000 eTank Pro Atomiser Packs includes 5 Atomisers each = 5
1,000 eTank Pro Clearomiser Packs = 1

THP Examples :
1,000 GLO Device Packs = 1
1,000 THP Consumables Sticks (NeoStiks) = 1
1,000 GLO Brush Packs includes 2 Brushes each = 1

2 Volume Guidelines

2.1 Product Hierarchy and Volume Reporting (continued)

Product Hierarchy Summary

Category	Category x Format	Material
Total Vapour	Vapour Consumables	Total FG Vapour LiquidBtl (to be used for Open systems Consumables / Liquid Bottles) Total FG Vapour Cartomiser (to be used for Disposables AND Closed systems Consumables / Cartridges)
	Vapour Devices & Accessories	Total FG Vapour StarterKit (to be used for Starter Kits) Total FG Vapour Device (to be used for Batteries AND PUKs) Total FG Vapour Charg. Acc (to be used for Charging Accessories) Total FG Vapour Acc Cat (to be used for Catalogue Accessories) Total FG Vapour Atomiser (to be used for Atomisers / Coils) Total FG Vapour Clearomise (to be used for Clearomisers / Tanks) Total FG Vapour Acc (to be used for Any accessories other than Charging, Atomiser, Clearomiser or Catalogue)
Total Hybrid	Hybrid Consumables	Total FG THP Pod (to be used for iFuse 1.0 Consumables / Pods) Total FG Hybrid Consum.Kit (to be used for Glo Sens Consumables / Tobacco Pods)
	Hybrid Devices & Accessories	Total FG Hybrid StarterKit (to be used for ALL Starter Kits) Total FG Hybrid Device (to be used for Batteries / PUKs) Total FG Hybrid Charg. Acc (to be used for Charging Accessories) Total FG Hybrid Acc Cat (to be used for Catalogue Accessories) Total FG Hybrid Accessory (to be used for Any accessories other than Charging or Catalogue)
Total THP	THP Consumables	Total FG THP Stick (to be used for ALL Consumables / Sticks)
	THP Devices & Accessories	Total FG THP Starter Kit (to be used for ALL Starter Kits) Total FG THP Device (to be used for Batteries / PUKs) Total FG THP Charging Acc (to be used for Charging Accessories) Total FG THP Acc Cat (to be used for Catalogue Accessories) Total FG THP Accessories (to be used for any Accessories other than Charging or Catalogue)
Total HnB	HnB Consumables	Total FG CTHP Stick (To be used for carbon tip Sticks)
Total Modern Oral Products		Total FG Oral Nicotine Pouch (to be used for Pouches without tobacco but more than zero nicotine) Total FG Oral Tobacco Pouch (to be used for Pouches with tobacco and more than zero nicotine)
Total Other Alternative Oral Products		Total FG OAP Mouth Spray Total FG OAP Gum Total FG OAP Lozenge Total FG OAP Pouch

2 Volume Guidelines

2.2 Free of Charge Reporting

For reporting related to Free of Charge activities, please refer to the table below:

Beneficiary	Objectives	Type	Revenue	Examples	Channel	Flow	Documents	External Sales Vol in BPC	P&L line
Consumer benefit	**Increase Volume Sales/ Increase Loyalty**	Promotional/ Discounted price	Reduced Revenue	- 1+1/3+1/9+1 pack free - 1 Starter Kit + 10 packs free - 1 Starter Kit @ 50% discount - EDLP - All other bundles deals	- Traditional Retail - NGP Shops Owned by BAT/3rd Party - Online Owned by BAT/3rd Party	BAT - > Customer -> Consumer	Sales Ledger: Sales invoice & Credit note to Direct Customer Purchase Ledger: Invoice from Direct/Indirect Customer	Yes - the entire quantity	Consumer Discounting
Customer/ Consumer benefit	**Increase Awareness & Trial**	Free Trial / Sampling	No Impact	Sampling through: - Social Seller - Brand Ambassador - Shop Assistant	- Retail / Distributor/Wholesaler - Own Retail - operated by 3rd party - E-commerce - 3rd party - Social Selling - 3rd party	BAT - > Customer -> Consumer	Stock transfer: No External Sales Volume or Revenue recorded	No	Retail Activation - POS and Promotional Materials (Total Cost should include Excise and Cost of Sales of the Product)
					- Own retail - operated by BAT - E-commerce - own - Social Selling - own	BAT - > Consumer			
Customer benefit	**Improve Compliance and/ or Performance**	Trade Remuneration/ Incentive	Reduced Revenue	- If sales/share targets for the year are met - Early payment or efficient method of payment (direct debit or EFT) - Promotion on behalf of BAT - Payment to Customer for carrying out EDLP - Price discounts	Retail / Distributor/Wholesaler	BAT - > Customer-> Consumer	Sales Ledger: Sales invoice & Credit note to Direct Customer Purchase Ledger: Invoice from Direct/Indirect Customer	Yes	Customer Investment (Trade Credits and Payments/ MI in GTO)

Section 3

Revenue Guidelines

3 Revenue Guidelines

3.1 Consumer Discounting

Consumer Discounting for New Categories can be split into four different types as outlined right:

Couponing

A consumer receives a £1.50 discount on a pack of Modern Oral products when presenting a valid coupon/voucher at the time of purchase.

This discount of £1.50 is a benefit that the consumer is receiving and can be charged back by Distributors/Retailers through credit notes.

A credit note provision should be created based on the estimated redemption levels.

Discounting / Promotions

BAT sells Consumables to Distributors/Retailers at full price assuming RRP is £5.49 per pack.

Retailers then sell to the consumer at a price of £5 per pack.

This represent a £0.49 Consumer Discount.

The discount is then charged back to BAT by the Distributor/ Retailer via credit notes.

Bundling

BAT sells Consumables to distributors/retailers at full price assuming RRP is £5.49 per pack.

Retailers then give away five packs of Consumables with each Device purchased.

The consumer receives an effective discount of £27.45 (5 x £5.49) which will be charged back by the distributor/retailer through credit notes.

In examples of fixed bundle offers, a credit note provision should be made at the time of sales to the distributor/retailer.

Subscriptions based discounts

A consumer enters an agreement to pay £30 a month for 6 months.

For this, they receive one device in the first month and 6 refills for each of the six months.

Usually all of these products would cost £210 in total if bought separately.

This agreement is an example of a subscription model and the discount would be £30 over the course of the agreement.

Please see the following page for guidance on how the revenue should be recognised in accordance with IFRS15.

3 Revenue Guidelines

3.2 Accounting for Subscription Models

If a Subscription model is in place, the accounting of revenue must be in line the standards set out in IFRS15.

This states that if the customer is receiving multiple products in return for their monthly subscription fee, then the transaction price (consumers subscription fee) must be allocated to each product.

The opposite example demonstrates a £27 per month contract for an epod device and 6 refills a month, lasting for 3 months.

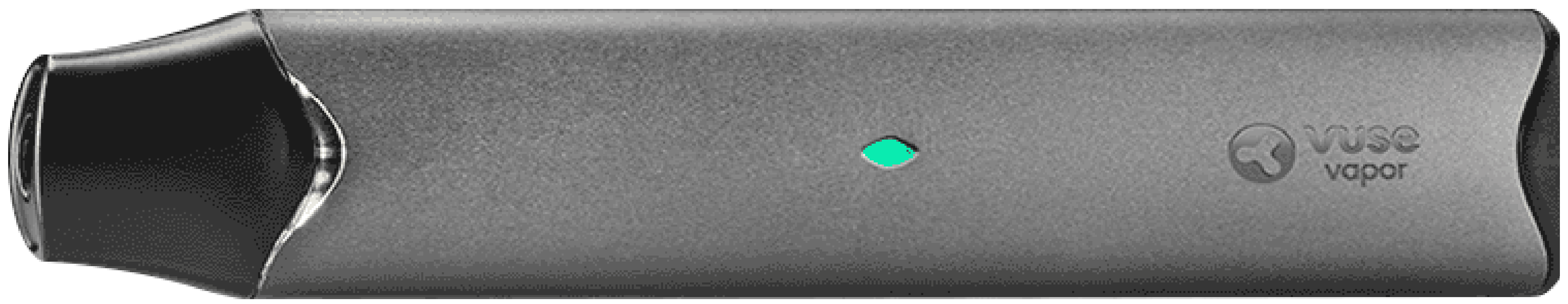
Quantity	Product	RRP	% of product of total RRP	Proportion of contract revenue	Effective discount
1	Epod Device	£19.99	16%	£12.67	-£7.32
18	Refills	£107.82	84%	£68.33	-£39.49
Total		**£127.81**	**100%**	**£81.00**	**-£46.81**

From the table you can see that based on the total bundle of goods sold to the customer, a percentage is worked out for how much each product is of the total RRP.

The total contract revenue (£27 x 3 months) is then multiplied by this percentage.

This allocates the contract revenue to each product and gives an effective discount value.

The tables on the next page illustrate the difference in the first months revenue recognition when using the IFRS15 discount allocation compared to a standard price promotion.



3 Revenue Guidelines

3.2 Accounting for Subscription Models (continued)

Month 1

Month 1 - BAU	Per Unit RRP	Total RRP	Per Unit External GTO	Total External GTO
Device	19.99	19.99	0	0
Consumable	5.99	35.94	4.5	27
Total		**55.93**		**27**

	Line Item	Value	Debit/ Credit
P&L	Sales Volume (Base UOM)	7	
	RRP	55.93	
	Discounting	28.93	
	External GTO	27.00	Credit
	Direct VAT	4.50	Debit
	External NTO	22.50	
	Cost Of Sales	19.90	Debit
BS	Cash	27.00	Debit
	Govt. Levies Payable	4.50	Credit
	Stock	19.90	Credit

Month 1 - IFRS 15	Per Unit RRP	Total RRP	Per Unit External GTO	Total External GTO
Device	19.99	19.99	12.7	12.67
Consumable	5.99	35.94	3.80	22.78
Total		**55.93**		**35.45**

	Line Item	Value	Debit/ Credit
P&L	Sales Volume (Base UOM)	7	
	RRP	55.93	
	Discounting	20.48	
	External GTO	35.45	Credit
	Direct VAT	4.50	Debit
	External NTO	30.95	
	Cost Of Sales	19.90	Debit
BS	Cash	27.00	Debit
	Govt. Levies Payable	4.50	Credit
	Stock	19.90	Credit
	Debtors	8.45	Debit

As IFRS 15 records more revenue in the first month than BAT receives from the customer, (the Subscription cost to the consumer is only ever £27 a month) an entry must be made into the balance sheet.

3 Revenue Guidelines

3.2 Accounting for Subscription Models (continued)

Months 2 & 3

For month two and three IFRS15 methodology means BAT would record less revenue than BAT receives from the customer.

Doing so each month reduces the initial balance sheet entry recorded in month one until it reduces to zero at the end of month three. The end result is still recognising the £81 total contract revenue, only the phasing changes.

Because of this phasing, pricing conditions cannot be set up in the system in order to record the correct revenue.

Month end adjustment must be made to increase revenue in the first month and reduce revenue in months two and three.

Month 2 - IFRS 15	Per Unit RRP	Total RRP	Per Unit External GTO	Total External GTO
Device				
Consumable	5.99	35.94	3.80	22.78
Total		**35.94**		**22.78**

	Line Item	Value	Debit/ Credit
P&L	Sales Volume (Base UOM)	6	
	RRP	35.94	
	Discounting	13.16	
	External GTO	22.78	Credit
	Direct VAT	4.50	Debit
	External NTO	18.28	
	Cost Of Sales	14.40	Debit
BS	Cash	27.00	Debit
	Govt. Levies Payable	4.50	Credit
	Stock	14.40	Credit
	Debtors	4.22	Credit

Month 3 - IFRS 15	Per Unit RRP	Total RRP	Per Unit External GTO	Total External GTO
Device				
Consumable	5.99	35.94	3.80	22.78
Total		**35.94**		**22.78**

	Line Item	Value	Debit/ Credit
P&L	Sales Volume (Base UOM)	6	
	RRP	35.94	
	Discounting	13.16	
	External GTO	22.78	Credit
	Direct VAT	4.50	Debit
	External NTO	18.28	
	Cost Of Sales	14.40	Debit
BS	Cash	27.00	Debit
	Govt. Levies Payable	4.50	Credit
	Stock	14.40	Credit
	Debtors	4.22	Credit

In order to make these adjustments its suggested that a sales order transaction is used, similar to Distribution Margin fee adjustments or Pay for Performance, to move postings below Gross Margin to allocated to SKUs above Gross Margin.

OTC teams in GBS will be able to assist with this.

3 Revenue Guidelines

3.2 Accounting for Subscription Models (continued)

The table opposite outlines which GLs to use for the **first month's adjustments**.

Adjustments in months after the first month will be made in the same accounts with opposite Debits/Credits to unwind the initial posting over the course of the contact.

Increase NTO (recognise more revenue than cash received from customer)	
P&L Account	**Balance Sheet Account**
(Credit)3003104200 Customer Discounts	(Debit) 1601101000 Accrued Income - External

Decrease NTO (recognise less revenue than cash received from customer)	
P&L Account	**Balance Sheet Account**
(Debit) 3003104200 Customer Discounts	(Credit) 2252141000 Deferred Income - Operating

***Please note** - Brand Range reporting requirements should still be adhered to when making any adjustments.*

The below file can be used for examples of what postings must be made each month.

Click to View

3 Revenue Guidelines

3.3 MI in GTO Allocation

Markets are to ensure that BE: Customer Investment is reported accordingly for all Product Categories / Brands to generate an accurate MI in GTO reflected in NTO. As guiding principles:

- If a contract clearly states the investment breakdown by Product Category and/or Brand, then the MI must be reported accordingly, using the relevant WBS
- In cases whereby a single contract covers multiple Product Categories / Brands, markets are advised to reflect the MI between different Product Categories / Brands based on:
  - Share of space used (e.g. Assortment and Listing Fees or;
  - Duration of the promotion or;
  - Any other criteria that generates an appropriate reflection of spend

Allocation from below to above NTO should be based on GTO of each SKU within the Brand specified in the WBS. This is required for both Actuals and Forecast reporting going forward.

Markets and GBS teams are required to ensure that no other allocation method is used.

An example is shown on the right.

Step 1: Cost posted against WBS

Costs			
WBS No	Customer Investment Costs	Brand House	Product Type
4AUCAB/VYPE.LBS$U\TO#P25	150,000	9985	ZFG413000

Step 2: Assessment of GTO of each SKU

COPA Data			
SKU	Brand	Material Group	External GTO
1	9985	ZFG130000	1000
2	9985	ZFG130000	2000
3	9985	ZFG130000	-500
Consider only SKU's with +ve GTO. Ignore any -ve GTP			

Step 3: Posting above NTO based on GTO

Allocation		
SKU	Brand	MI in GTO
1	9985	50,000
2	9985	100,000

Section 4

Cost of Sales Reporting Guidelines

4 Cost of Sales Reporting Guidelines

4.1 New Categories - Product Costing

Internally manufactured – e.g.
THP Consumables, Modern Oral & Hybrid Consumables

Internally manufactured products are required to undergo a full product costing cycle in SAP so that purchased material cost and associated manufacturing overheads are assessed into each SKU in the same fashion as with Combustibles and Traditional Oral Products.

In cases where manufacturing cost and other associated overheads are different from FMC, the producing factory needs to have separate activity type rates for all New categories so that overheads are properly allocated to respective materials.

New categories should also follow the normal Product Costing budgeting & forecasting cycle for SOP4 and 10. The Transfer Price policy for internally manufactured New Category products should be the same as FMC products i.e. Cost + standard mark-up unless agreed otherwise.

Externally Purchased – e.g.
THP, Vapour & Hybrid Devices

In addition to the cost of the device paid to the external manufacturer, the following additional additive costs may be incurred:

- Depreciation related to centrally held assets are to be reported under MPCO21090 - Other cost of sales (in stock)
- Logistics costs to be reported under MPCO21060 - Freight, insurance, warehousing and other (in stock)
- Import Duties to be reported under MPCO21050 - Finished good import duties

4 Cost of Sales Reporting Guidelines

4.2 Cost Centre Assessment

The example opposite illustrates how Manufacturing Cost is allocated across different product types using Activity Types.

Productive OH Cost Center	Productive CC (Head Count)	Allocation is based on HC	Activity type	£ per unit	SKU (Prod Volume)	£ in Product Cost
Factory Manager 100,000	PMD (4)	20,000	P100	40 / KG	CRT 1 (200 KG)	8,000
					CRT 2 (300 KG)	12,000
	SMD (8)	40,000	S100	10 / TH	SMD 1 (800 TH)	8,000
					SMD 2 (2000 TH)	20,000
					SMD 3 (1200 TH)	12,000
	THP (4)	20,000	N102	20 / TH	THP 1 (500 TH)	10,000
					THP 2 (200 TH)	4,000
					THP 3 (300 TH)	6,000
	Oral PMD (2)	10,000	X100	50 / KG	Oral PMD 1 (100 KG)	5,000
					Oral PMD 2 (100 KG)	5,000
	Oral SMD (2)	10,000	Y100	12.5 / TH	Oral SMD 1 (100 TH)	1,250
					Oral SMD 2 (500 TH)	6,250
					Oral SMD 2 (500 TH)	2,500

4 Cost of Sales Reporting Guidelines

4.3 New Categories - BPC Cost of Sales Reporting

For Externally Bought in Goods, total CoS per unit is impacted due to reasons such as write-offs, NRV, UPiS, etc.

Therefore, it is important that specific Management P&L accounts are utilised to identify these costs, with the remainder providing a cost per unit which can be utilised for analysis.

Right is a list of the specific Management P&L accounts which should be used for reporting – please ensure that these are being utilised correctly at a Brand Range level.

Account	Description	Cost Example
MPCO10000 - Externally bought-in cost of sales	Should be used for Purchase Cost/Ex Works Cost Only	40
MPCO21010 - Leaf		
MPCO21020 - Wrapping materials		
MPCO21030 - Manufacturing costs	Should be used for Purchase Cost/Ex Works Cost and; Should be used to Depreciation allocation only	10
MPCO21090 - Other cost of sales (in stock)	Should be used for Purchase Cost/Ex Works Cost and; Should be used to Depreciation allocation only	10
MPCO21050 - Finished good import duties	Should be used for Import Duties Cost Only	10
MPCO21060 - Freight, insurance, warehousing and other (in stock)	Should be used for Freight/Logistics Cost Only	15
MPCO32200 - Royalties internal expense/(income) - innovation	Excluded from COS/Unit Analysis	5
MPCO22020 - Other adjustments in cost of sales (not in stock)		
MPCO32300 - Royalties internal expense/(income) - technology		
MPCO32100 - Royalties internal expense/(income) - brand		
MPCO22910 - Adjustment for unrealised profit in stock expense/(income)		
MPCO21095 - FX hedging impact (in stock)		-5
MPCO22900 - Cost of sales intercompany elimination adjustment		
MPCO21040 - Intercompany margin (mark-up)		
MPCO22010 - Primary supply chain expenses (not in stock): FIW not TP	Excluded from Analysis. Should be used for Write Offs/ NRV Adjustments/ Write Backs etc.	40

Vol	10
Total Cost	**125**
COS/Unit	**12.5**
In Scope Cost	85
COS/Unit (with only in scope/green lines)	8.5

4 Cost of Sales Reporting Guidelines

4.4 Management View Reporting - Externally Bought in

The purchase price paid to the external supplier by the BAT entity who has purchased the product directly from the supplier (e.g. Nicoventures) recognises this cost under **MPCO10000 – Externally Bought-In Cost of Sales.**

However, the same cost in the end market is recognised under MPCO21090 – Other Cost of Sales (in stock).

This is because the internal sale of the externally bought in device from e.g. Nicoventures Trading to the end markets is recognised in SAP as an Internally Bought In item (COPA value field – VV046) which in BPC is mapped to account MPCO21090 – Other Cost of Sales in stock.

Figure: Externally Bought-In BPC Mapping

Management Account	Cost Compoinent Description	COPA Value Field	Value Field Description
MPC021090	Other cost of sales)in stock)	VV046	G: Int Bought in
		VV066	G: Otha COS

Figure: Externally Bought-In Example

Entity → / Intercompany →	Nicoventures (Purchasing Entity) Internal Sales	Selling Entity (Domestic End Market) External Sales
External Volume in TH	10	
Internal Volume in TH		10
External Net Turnover		**300,000**
Internal Net Turnover	**670,000**	
Externally Bought in	500,000	
Manufacturing costs	50,000	50,000
Finished Goods Import Duties	20,000	20,000
Other Cost of Sales (in stock)		500,000
Inter-company mark-up		80,000
Primary Supply Chain Cost (not in Stock & not in Transfer Price)	20,000	
Total Cost of Sales	**590,000**	**650,000**
Gross Margin	**80,000**	**(350,000)**

← The externally bought in Cost of Sales is reported as Other Cost of Sales in the end market

4 Cost of Sales Reporting Guidelines

4.5 BPC eliminations

The table on the right demonstrates how internal transactions are eliminated per BPC consolidation logic.

The elimination is performed at a level in the entity hierarchy where the buying and the selling entity meet.

In other words, the sale from Manufacturing to Commercial within a given market is eliminated within the management view of the market; whereas a sale from one market to another within a given region is eliminated within the management view of that region.

Figure: Elimination Example

Entity →	Manufacturing Entity	Commercial Entity	Elimination Entity	Market View
Intercompany →	Sale to Domestic (I_DOMESTIC)	External Sales (I_NONE)	BPC Elimination	Total Intercompany
External Volume		200		200
Internal Volume	200		(200)	0
External Net Turnover		**2,000**		**2,000**
Internal Net Turnover	**1,000**		**(1,000)**	0
Leaf	300	300	(300)	300
Wrapping materials	300	300	(300)	300
Manufacturing costs	150	150	(150)	150
Inter-company mark-up		250		250
COS Inter-company elimination			(250)	(250)
Total Cost of Sales	**750**	**1,000**	**(1000)**	**750**
Gross Margin	**250**	**1,000**	**0**	**1,250**

4 Cost of Sales Reporting Guidelines

4.6 External view of Cost of Sales for Export Markets

The simplest way to exclude the impact of Export Sales is to calculate Cost of Sales as right:

Cost of Sales

=

External Net Turnover

−

Gross Margin (of the market)

+

Gross Margin made on the internal sale

Figure: Cost of Sales for Export Markets Example

Entity →	Manufacturing Entity		Elimination Entity	Domestic	Market View
Intercompany →	Sale to Domestic (I_DOMESTIC)	Sale to Export (I_EXPORT)	BPC Elimination	External Sales (I_NONE)	Total Intercompany
External Volume				200	200
Internal Volume	200	100	(200)		100
External Net Turnover				**2,000**	**2,000(a)**
Internal Net Turnover	**1,000**	**500**	**(1,000)**		**500**
Leaf	300	150	(300)	300	450
Wrapping materials	300	150	(300)	300	450
Manufacturing costs	150	75	(150)	150	225
Inter-company mark-up				250	250
COS Inter-company elimination			(250)		(250)
Total Cost of Sales	**750**	**375**	**(1,000)**	**1,000**	**1,125**
Gross Margin	**250**	**125(c)**	**0**	**1,000**	**1,375(b)**
				External view of Cost of Sales	**750(a-b+c)**

4 Cost of Sales Reporting Guidelines

4.7 Calculations of Cost of Sales for Group Reporting

The above calculation for Cost of Sales unfortunately cannot be used for the Cost of Sales Variance Analysis reporting because of the need to reconcile the summation of markets to the Total Group Cost of Sales number reported on the P&L.

For this reason, the Cost of Sales in the BPC Variance Analysis report is calculated as the following:

Cost of Sales

=

External Net Turnover

–

Gross Margin

The only difference with this approach to the one mentioned above is the treatment of the *Export Margin* made on intercompany sales. In this scenario the *Export Margin* is retained within the management view of the market. The movement on *Export Margin* should be treated as a *Net Price* movement in the Cost of Sales Variance Analysis, the BPC report is defaulted to work this way.

Additionally, please note on the Cost of Sales Variance Analysis, Internal Royalties are also excluded since this is a non-controllable item for the end market.

Figure: Cost of Sales for Calculations Example

Entity →	Manufacturing Entity		Elimination Entity	Domestic	Market View
Intercompany →	Sale to Domestic (I_DOMESTIC)	Sale to Export (I_EXPORT)	BPC Elimination	External Sales (I_NONE)	Total Intercompany
External Volume				200	200
Internal Volume	200	100	(200)		100
External Net Turnover				**2,000**	**2,000(a)**
Internal Net Turnover	**1,000**	**500**	**(1,000)**		**500**
Leaf	300	150	(300)	300	450
Wrapping materials	300	150	(300)	300	450
Manufacturing costs	150	75	(150)	150	225
Inter-company mark-up				250	250
COS Inter-company elimination			(250)		(250)
Total Cost of Sales	**750**	**375**	**(1,000)**	**1,000**	**1,125**
Gross Margin	**250**	**125**	**0**	**1,000**	**1,375(b)**
Cost of Sales for Group Reporting					**625(a-b)**

4 Cost of Sales Reporting Guidelines

4.8 Royalties

The following now applies to royalties on New Category products as of the 1st of January 2020:

LRD markets

- No royalties payable on New Categories brands (Vype, Vuse, Neo, Sens and Glo). NVT now owns the relevant IP
- 1.5% technology royalty payable on Modern Oral (Velo, Lyft and Epok) to Company Code SE15 by NVT; and
- 10% royalty on Combustible Strategic Brands such as Kent, licensed to NVT from BAT Exports Limited (GBDZ) for use on THP and Hybrid Consumables

Licence markets

- 10% royalty (split into 5% brand and 5% technology) payable to NVT on New Categories brands (Vype, Vuse, Neo, Sens and Glo)
- 10% royalty (split into 5% trademark royalty and 5% technology royalty) payable to NVT on Modern Oral brands (Lyft, Epok and Velo). NVT will then on pay a 1.5% technology royalty to Company Code SE15 for historic technology
- 10% royalty payable to NVT on Combustible Strategic Brands, who will then pay on to GBDZ.

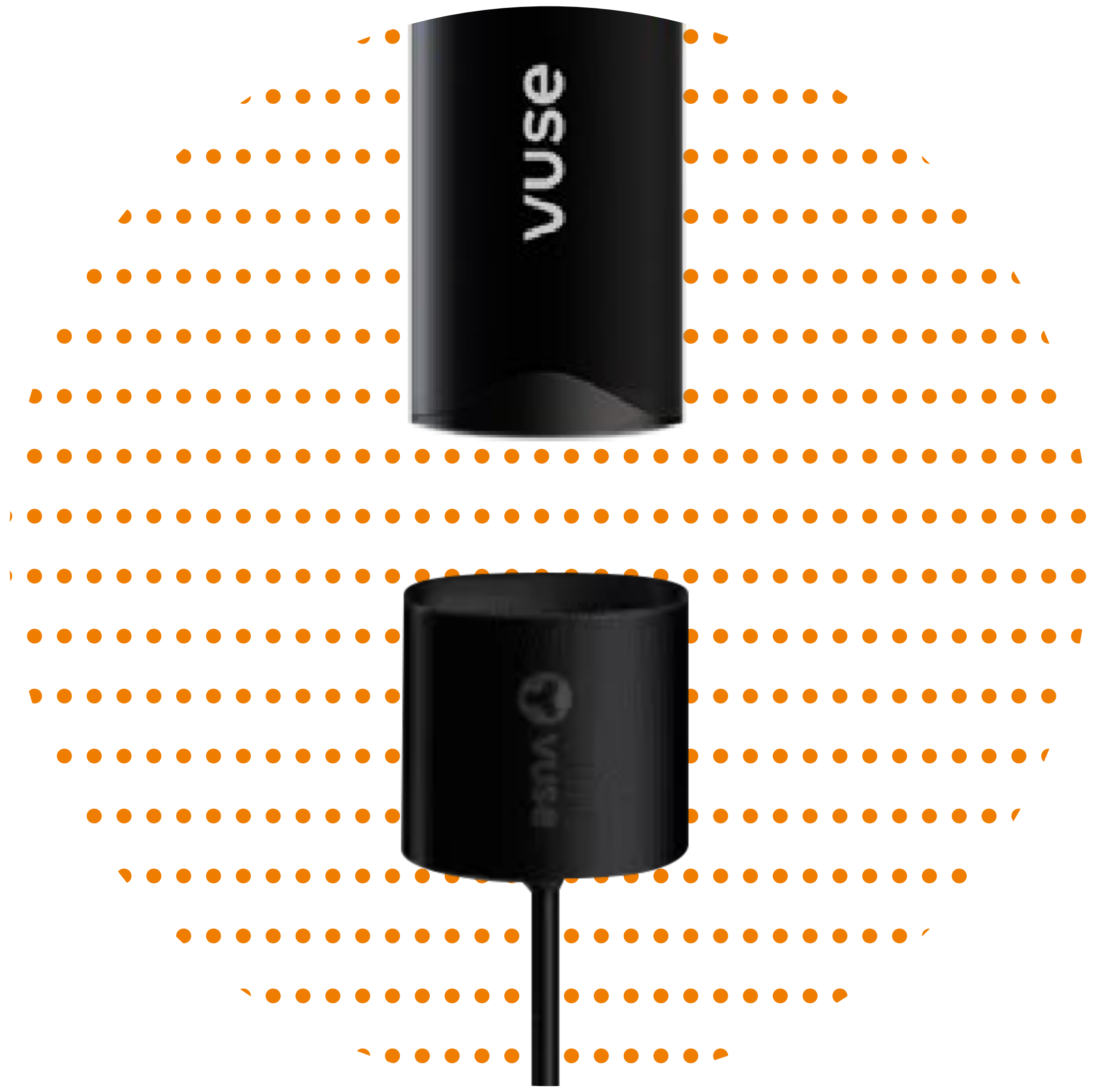
Waivers

- Standard waivers will apply in cases of brand migration for example (VYPE to VUSE)
- For THP Sticks (Kent, Kool, Dunhill) there is no waiver applicable neither for trademark royalty, nor innovation & technology royalty (the only exception will be where the combustible strategic brand was not launched before in that market)

For a full list of LRD/Licence markets, please contact the NVT Corporate Finance team.

Please note that the waiver only applies to the umbrella brand (e.g. Vype) and hence there is no waiver for launches or brand variants e.g. E-Stick Max does not receive a waiver if other Vype products exist in the market.

Any waivers must be approved by the Regional Exceptions Committee



4 Cost of Sales Reporting Guidelines

4.9 UPiS calculation

BPC performs an elimination adjustment for Unrealised Profit in Stock for those markets that have enabled the functionality.

The accounting entries on the P&L would look as follows if we make the following assumptions:

- Manufacturing entity sells 200 Stk to Domestic
- Domestic has no opening stock position
- Domestic sells only 100 Stk externally
- Transfer Price of £5/mille; Cost to Manufacturing of £3.75/mille; Gross Margin on internal sales £1.25/mille

Since only half the stock has been sold externally, the market would need to put through an adjustment for £125 (100 Stk unsold * £1.25 internal margin) in their books to eliminate the intercompany margin that is in stock.

Dr: P&L £125

Cr: Inventory £125

Figure: UPiS Example

Entity → / Intercompany →	Manufacturing Entity Sale to Domestic (I_DOMESTIC)	Elimination Entity BPC Elimination	Domestic External Sales (I_NONE)	Market View Total Intercompany
External Volume			100	100
Internal Volume	200	(200)		-
External Net Turnover			**1,000**	**1,000**
Internal Net Turnover	**1,000**	**(1,000)**		**-**
Leaf	300	(300)	150	150
Wrapping materials	300	(300)	150	150
Manufacturing costs	150	(150)	75	75
Inter-company mark-up			125	125
COS Inter-company elimination		(250)		(250)
Adjustment for Unrealised Profit in Stock		125		125
Total Cost of Sales	**750**	**(875)**	**500**	**375**
Gross Margin	**250**	**(125)**	**500**	**625**

4 Cost of Sales Reporting Guidelines

4.10 Cost of Sales Variance Analysis

The purpose of this section is to provide guidance on the methodology used for Cost of Sales variance analysis for New Categories. This can be split into two types of COSVARs;

1. For Products that have volume reported in Thousand Stick Equivalent: THP Consumables and Modern Oral
2. For Products that have volume reported in Units of Measure: Vapour (Starter Kits/PUKs and Consumables) and THP Starter Kits

THP Consumables and Modern Oral

The approach is identical to the one used for Combustibles. The report is run at per mille basis. Standardised reports are generated from BPC using:

- Automated for Price, Over/ Under Absorption and Mix (Portfolio and Geo)
- Manual input supplementary schedules in BPC for Savings, Spec, Regulation, Transactional FX and Others

The system generated Waterfall can be used by Markets, Areas, Regions and Central teams to present at various forums. The Waterfall calculations are run excluding Internal Royalties, even though Royalties impact will be still visible for completeness.

The different components of the Waterfall are:

1. **Net Price:** The Gross Pricing Impact will be calculated as:

   (CoS/Mille in YR2
   –
   CoS/Mille in YR1)
   X
   Sales Vol in YR2.

   CoS/Mille calculations exclude Internal Royalties.

   Gross Pricing Impact is only required for mathematical completion for Variance analysis.

   The Net Pricing Impact in the Waterfall will be the residual amount after deducting Under/ Over Absorption, Savings, Spec, Regulation, Transactional FX and Others.

2. **Under/Over Absorption:** BPC report calculates the Under/Over Absorption based on the following methodology:

   (Sales Vol in YR1
   –
   Sales Vol in YR2)
   X
   70% of Manufacturing Cost / Mille in YR1.

   Production Overheads are approximately 70% of the total Manufacturing Cost, hence 70% of the Manufacturing Cost captured the fixed apportionment.

   Sales volumes allows Under/ Over Absorption to be allocated to the relevant markets regardless of whether they are Import or Export Markets.

3. **Savings;** The BPC Waterfall will automatically populate the number based on the manual input in BPC Savings Report schedule.

   Therefore, it is essential that Regional OF teams ensure PSTT matches BPC at quarterly reporting cycles– to reinforce this point, technical options will be reviewed to ensure that BPC is populated directly from PSTT.

4 Cost of Sales Reporting Guidelines

4.10 Cost of Sales Variance Analysis (continued)

4. **Portfolio and Geo Mix:** Mix is divided into Portfolio and Geo Mix, rather than being shown as one category.

   The calculation is run at a Brand Variant level, calculated as:

   (YR2 Volume – Expected YR2 Volume @ YR1 Mix)
   x
   (Brand Variant YR1 COS/Mille – Market Average YR1 COS/Mille)

   Geo Mix is for above Market level Entities.

   Minimum comparison entity will be Market for Area, Region and Group.

   The methodology is:

   Σ:
   (YR2 Volume of Market – Expected YR2 Volume of Market @ YR1 Mix)
   x
   (Market YR1 COS/Mille – Above Market Unit Average YR1 COS/Mille)

5. **Spec, Regulation and Transactional FX:** BPC Waterfall will automatically populate the number based on the supplementary input schedules in BPC.

6. **Others:** Others should only be used to capture exceptional items such as accounting treatment changes.

   Markets/Areas need to get approval from Regional and Global Operations Finance before reporting under Others.

4 Cost of Sales Reporting Guidelines

4.10 Cost of Sales Variance Analysis (continued)

Vapour (Starter Kits/PUKs and Consumables) and THP Starter Kits

The report is run at per unit (UOM) basis. Standardised reports are generated from BPC using:

- Automated for Price and Mix (Portfolio and Geo)
- Manual input supplementary schedules in BPC for Savings, Spec, Regulation, Transactional FX and Others. Input will be required at Brand Range level

The system generated Waterfall can be used by Markets, Areas, Regions and Central teams to present at various forums.

The Waterfall calculations are run excluding Internal Royalties, Write Offs, Inter-Co adjustments and NRV adjustments.

To ensure this, COSVAR will be run for the following MGMT P&L lines only:

MPCO10000 - Externally bought-in cost of sales
MPCO21010 - Leaf
MPCO21020 - Wrapping materials
MPCO21030 - Manufacturing costs
MPCO21090 - Other cost of sales (in stock)
MPCO21050 - Finished good import duties
MPCO21060 - Freight, insurance, warehousing and other (in stock)

The different components of the Waterfall are:

1. **Net Price:** The Gross Pricing Impact will be calculated as:

   (CoS/Unit in YR2
   –
   CoS/Unit in YR1)
   X
   Sales Vol in YR2. CoS/Unit.

   Gross Pricing Impact is only required for mathematical completion for Variance analysis.

   The Net Pricing Impact in the Waterfall will be the residual amount after deducting Savings, Spec, Regulation, Transactional FX and Others.

2. **Savings;** The BPC Waterfall will automatically populate the number based on the manual input in BPC Savings Report schedule.

   Therefore, it is essential that Regional OF teams ensure PSTT matches BPC at quarterly reporting cycles– to reinforce this point, technical options will be reviewed to ensure that BPC is populated directly from PSTT.

4 Cost of Sales Reporting Guidelines

4.10 Cost of Sales Variance Analysis (continued)

3. **Portfolio and Geo Mix:** Mix is divided into Portfolio and Geo Mix, rather than being shown as one category.

   The calculation is run at a Brand Variant level, calculated as:

   [(YR2 Volume – Expected YR2 Volume @ YR1 Mix)
   x
   (Brand Variant YR1 COS/Unit – Market Average YR1 COS/Unit)]

   Geo Mix is for above Market level Entities.

   Minimum comparison entity will be Market for Area, Region and Group.

   The methodology is:

   Σ:
   [(YR2 Volume of Market – Expected YR2 Volume of Market @ YR1 Mix)
   x
   (Market YR1 COS/Unit– Above Market Unit Average YR1 COS/Unit)]

4. **Spec, Regulation and Transactional FX:** BPC Waterfall will automatically populate the number based on the supplementary input schedules in BPC.

5. **Others:** Others should only be used to capture exceptional items such as accounting treatment changes.

   Markets/Areas need to get approval from Regional and Global Operations Finance before reporting under Others.

4 Cost of Sales Reporting Guidelines

4.10 Cost of Sales Variance Analysis (continued)

Reporting Timelines

The below table outlines the reporting timelines and requirements for New Categories Cost of Sales for CY and CY+1

Month	Responsibility	Forum
Feb GPC: Central Ops Fin team to provide Savings Update only	**Central NC Ops Fin**	**GPC**
Mar: Transfer Prices issued for Externally Bought in Goods, THP Consumables and Modern Oral	**Central NC Ops Fin and NVT Finance**	**NA**
Apr: SOP4: Fully loaded COGS updated in BPC	**GBS/ End Markets**	**NA**
Apr: SOP4 COSVARs for specific Brand Ranges	**Market/DRBU/Regional Ops Fin**	**OpComm**
June GPC: Central Ops Fin team to provide Savings Update only	**NC Ops Fin**	**GPC**
Jul– Sep: Central Ops Fin Team to finalise Savings and Landed Costs for SOP10	**NC Ops Fin**	**NA**
Sep GPC: Central Ops Fin team to provide Landed Cost Update only	**NC Ops Fin**	**GPC**
Sep: Transfer Prices issued for Externally Bought in Goods, THP Consumables and Modern Oral	**Central NC Ops Fin and NVT Finance**	**NA**
Oct SOP10: Fully loaded COGS updated in BPC	**GBS/ End Markets**	**NA**
Oct: SOP10: COSVARs for specific Brand Ranges	**Market/DRBU/Regional Ops Fin**	**OpComm**

GPC= Global Productivity Committee

Section 5

Marketing Investment Reporting

5 Marketing Investment Reporting

5.1 New Categories WBS Structure

The New Categories WBS structure has been updated to facilitate system-based allocations of Marketing Investment to specific Channels.

The new structure also allows Marketing Investment to be allocated directly to key Brand Ranges. Both of these changes will allow greater analysis on Channel Profitability and Marketing spend effectiveness which are key for the Group to achieve its long term aims in New Categories.

The new structure should be used for Actuals and Forecasting reporting from 2021 onwards and replaces the previous requirement for Touch Point Reporting, which is no longer required.

What has changed?

There are two main changes and they are applicable to both BSE and BTE structures.

Old ✕	New
BSE: ATCAB/VYPE.BPN$A**OH**	BSE: ATCAB/VYPE.BPN$1**01**
BTE: XPCCCI/GGGG.FFF$R**TE**	BTE: XPCCCI/GGGG.FFF$1**01**

- Level 3 changes highlighted in **orange**, will be used to allocated BSE/BTE against specific channels. In case the spend cannot be split against individual channels or is not specific to an individual channel (e.g. Creative Production, Agency), it should be reported against number 1 (All Channels). For New Categories, it is mandatory that markets must select a number 1-6 depending on the Channel.

Numeric Identifier in WBS	Channel
1	All Channels
2	Traditional Retail/ General Stores
3	Online Owned by BAT
4	Online Owned by 3rd Parties
5	NGP Shops Owned by BAT
6	NGP Shops Owned by 3rd Parties

- Level 4 changes highlighted in **bold** and **black** above, will be used to allocated BSE/BTE for specific Brand Ranges for Vapour. It is mandatory that for Modern Oral, THP, Hybrid and Other Alternative Oral Products, “00” is used to represent No Brand Range. Only the numbers in the table below are to be used for all of New Categories.

Numeric Identifier in WBS	Brand Range ID mapping	Brand Range Description
00	00000	No Brand Range
01	00144	ePen 3
02	00156	ePen
03	00170	Vuse Alto
04	00243	Vype ePod
05	00281	Vuse ePod

- **Please note level 5 remains freely definable for each EM as does the section of the new WBS structure highlighted in orange below.**

New
BSE: ATCAB/VYPE.BPN$1\01
BTE: XPCCCI/GGGG.FFF$1\01

Section 6

Segmental Reporting

6 Segmental Reporting

In accordance with IFRS 8 – Operating Segments, BAT currently reports revenue and APFO based on the geographical segments of our four regions.

The core principle of IFRS 8 is that an entity shall disclose information to enable users of the financial statements to evaluate the nature and financial impacts of the business activities in which it engages, and the economic environment in which it operates.

The key requirement of IFRS 8 is that the reportable segments (i.e. the segments disclosed externally as part of the Q2 and Q4 results) must be based on what is reported internally to the Chief Operating Decision Maker (CODM).

The CODM is a person, group of people or function responsible for allocating resources and assessing the performance of operating segments.

For BAT, the CODM is the Management board.

Therefore, going forward BAT will be reporting New Categories external sales and P&L up to Category Contribution (Brand Margin – RTM Overheads – R&D Costs) internally and externally.

The MGMT P&L will be updated to per next page (2019 Reported Results).

6 Segmental Reporting

Fig: 2019 Reported Results

	Regional View						Product Category View			
	AmSSA	APME	ENA	US	Centre	TOTAL	Combustibles & Other	Traditional Oral	New Categories	TOTAL
***Reported Revenue**	**4,491**	**5,157**	**6,118**	**9,916**	**0**	**25,683**	**23,433**	**1,036**	**1,214**	**25,683**
Cost of Sales	1,459	1,937	2,607	3,407	-603	**8,807**	7,830	202	774	**8,807**
Gross Margin	**3,023**	**3,210**	**3,498**	**6,489**	**657**	**16,876**	**15,602**	**834**	**440**	**16,876**
Brand Exp	162	432	432	296	54	**1,375**	662	24	689	**1,375**
Brand Margin	**2,861**	**2,777**	**3,066**	**6,193**	**603**	**15,501**	**14,940**	**810**	**-249**	**15,501**
NBE: RTM Overheads	418	264	360	251	1	**1,293**	1,154	23	116	**1,293**
Research and Development Expenditure	0	1	0	124	118	**244**	72	9	163	**244**
***Category Contribution**	**2,444**	**2,512**	**2,705**	**5,818**	**484**	**13,964**	**13,715**	**778**	**-528**	**13,964**
NBE: Marketing Overheads						**923**				**923**
Market Contribution						**13,041**				**13,041**
Admin Overheads and OIE						**2,009**				**2,009**
***APFO**						**11,032**				**11,032**

*Reported Revenue (NTO), Category Contribution and APFO only will be reported externally for each Segment. Other lines included in the table above are for internal visibility only

6 Segmental Reporting

6.1 Category Contribution: Cost allocation between New Categories and Combustibles

The purpose of this section is to summarise the Group's approach to accounting for shared and dedicated costs for Marketing and Admin Overehads, R&D and OIE in terms of allocation to respective Material Groups (Combustibles, New Categories etc).

As an example, dedicated costs would include employee expenses for Trade Representatives covering New Categories only. Shared costs would include a Head of Marketing Finance who would split their time between Traditional and New Categories.

Allocation rules are required to split Shared Costs between different categories.

Approach to be followed

Based on the guidance aligned with Global Commercial Finance, as well as Tax, Statutory Reporting, Strauss and BOC teams, the guidelines in the table opposite are now in place:

Markets will need to create dedicated New Categories cost centres (if not already set up) to enable the correct reporting.

Material Group related to New Categories' product must be assigned to each New Categories' cost centre.

<table>
<tr><th>P&L Line</th><th>Direct Cost Allocation</th><th>Shared Cost Allocation</th></tr>
<tr><td>Above NTO lines</td><td>Automatically allocated at SKU level</td><td>N/A</td></tr>
<tr><td>MI in GTO</td><td>Automatically allocated based on WBS</td><td>N/A</td></tr>
<tr><td>Cost of Sales</td><td>Automatically allocated at SKU level and Cost Centres</td><td>Shared Cost to be allocated based on NTO proportion ONLY if the TOTAL New Categories NTO is more than 10% of Market NTO. In the case where a market has more than one New Category products (THP, Vapour, Modern Oral), cost should be allocated if the total NTO of combined New Categories exceed 10% of Market NTO.
e.g. If a market has 3% THP NTO, 5% Vapour NTO and 4% Modern Oral NTO, it needs to allocate shared costs to New Categories as combined NTO is more than 10%. Shared Costs should be proportioned between different Products based on their NTO. So, 3% of Shared Costs should go to THP, 5% to Vapour and 4% of Modern Oral.</td></tr>
<tr><td>Brand Expenditure</td><td>Automatically allocated based on WBS</td><td>N/A</td></tr>
<tr><td>NBE: RTM Overheads</td><td rowspan="5">To be allocated if 100% dedicated to New Categories</td><td rowspan="5">Shared Cost to be allocated based on NTO proportion ONLY if the TOTAL New Categories NTO is more than 10% of Market NTO. In the case where a market has more than one New Category products (THP, Vapour, Modern Oral), cost should be allocated if the total NTO of combined New Categories exceed 10% of Market NTO.
e.g. If a market has 3% THP NTO, 5% Vapour NTO and 4% Modern Oral NTO, it needs to allocate shared costs to New Categories as combined NTO is more than 10%. Shared Costs should be proportioned between different Products based on their NTO. So, 3% of Shared Costs should go to THP, 5% to Vapour and 4% of Modern Oral.</td></tr>
<tr><td>R&D Expenditure</td></tr>
<tr><td>*NBE: Marketing Overheads</td></tr>
<tr><td>*Admin Overheads</td></tr>
<tr><td>*OIE</td></tr>
</table>

6 Segmental Reporting

6.2 Total Investments

Due to the New Categories importance to the group, it is critical that the Investments made into this category can be consistently tracked and analysed.

To assist with this, it has been agreed that the items in the table opposite will be included in New Categories Total Investment going forward:

P&L Item	Details
Non-Volume Driven Investment (a)	
MI in GTO on Consumables	MI in GTO allocated to THP/Vapour Consumables and MO Pouches
Marketing Investment	All MI allocated to New Categories
R&D	R&D costs across the group associated with New Categories
Volume Driven Investment (b)	
Consumer Discounting on Cons.	Consumer Discounting related to THP/Vapour Consumables and MO Pouches.
GM Loss on Devices	GM losses relating to THP/Vapour Devices
Total Investment (a+b)	

As shown left, Total Investments can be split between those that move with sales volume changes such as consumer discounting or those which are unrelated to sales volume changes such as the Group spend in R&D.

Section 7

Competitor Reporting

7 Competitor Reporting

Competitor reporting is required for SOP3 and SOP9 under the current IBPM cycle.

Detailed guidance is issued for each cycle. Below are the minimum requirements for Competitor Reporting.

In addition to BPC reporting, SP&I might request additional PowerPoint and Excel templates with more detail.

Manufacturers to Input (volume and financials):
PMI
PM US
JT
Imperial
KT&G
Swedish Match (just for Oral)
JUUL (just for Vapour)
Others (where relevant)
Illicit Trade

Material Group:	
THP	Consumables, Starter Kits
Hybrid	Consumables, Starter Kits
Vapour	Cartomizers, Liquid bottles, Open system Starter Kit, Closed system Starter Kit
Modern Oral	Tobacco pouches, Nicotine pouches, Nicotine-free pouches

The input should be considered where key competitor size and market share are significant and relevant for BAT's operations in the market.

7 Competitor Reporting

7.1.1 Volume Inputs

- **Tobacco Heating Product (THP) Consumables Sales Volume**

THP consumables shipments estimates should be reported.

The input should be made in thousands sticks. This input should be aligned with commercial finance and reported in BPC by SPI.

- **Hybrid Consumables Sales Volume**

Hybrid consumables shipments estimates should be reported.

The input should be made in thousands of pods.

This input should be aligned with commercial finance and reported in BPC by SPI.

Formula to estimate competitors' volumes (TH Pods) – example –:

Competitor 1:	Competitor 1:
Number of packs	2500 packs
x	x
pods per pack	2 pods per pack
x	x
conversion rate specific to the manufacturer	3.50
=	=
sticks equivalent / 6.67	17,500 sticks equivalent / 6.67
=	=
number of BAT equivalent Pods **(load in TH)**	2,623.68 BAT equivalent pods **(load in TH 2.62368)**

- **Vapour Consumables (Cartomizers and Liquid Bottles) Sales Volume**

Vapour Consumables shipments estimates should be reported.

Cartomizers volume input should be made in thousands and Liquid Bottles volume input should be made in 10ml bottles equivalent in thousands.

This input should be aligned with commercial finance and reported in BPC by SPI.

- **Tobacco Heating Product (THP), Hybrid and Vapour Starter Kits/PUKs Sales Volume**

THP/Hybrid/Vapour starter kits and PUKs shipments estimates should be reported.

Starter kits and PUKs volume input should be made in number of devices/packs (net sales) and in thousands. Only for Vapour Starter kits and PUKs, volume input should be captures for Open and Closed systems.

PUKs in case of competitor volume are covered under relevant starter kit material groups.

7 Competitor Reporting

7.1.1 Volume Inputs (Continued)

- **Modern Oral Sales Volume**

Modern Oral shipments estimates should be reported. Modern Oral volume input should be made in thousands of Pouches and needs to be captured amongst **the three Modern Oral material groups** separately as appropriate.

This input should be aligned with Commercial Finance and reported in BPC by SPI.

7.1.2 Financial Inputs

- **NTO excluding MI in GTO**
- **Marketing investment in GTO**
- **Cost of Sales - Including Royalties**
- **Marketing Investment**

  All relevant product categories Marketing Investment estimates should be reported, split into Brand Expenditure and Non-Brand Expenditure

- **Category Contribution**
  GM less Marketing Investment

7.1.3 Adjusted Operating Profit

Section 8

Capex Reporting

8 Capex Reporting

8.1 Capex Reporting

In order to assist with resource allocation decisions, Ops Capex for New Categories must be reported correctly against the Modern Oral, Vapour, THP and Hybrid product categories in Actuals and Forecasts.

In addition to recording CAPEX by product category, further classification is required.

One of the following subcategories should be used, with classifications based on the driver or cause for the purchase of the asset:

- Growth
- Innovation
- Profit Protection
- Productivity
- Footprint
- Compliance & Legal

Please visit the Green Book for detailed descriptions of each of these subcategories.

Section 9

NVT Business Model

9 NVT Business Model

9 NVT Business Model

The New Categories business is centred in the UK and has employees with responsibility for the key areas of the business covering Marketing, Legal and External Affairs, Finance, R&D, Operations and Supply Chain.

To reflect this, the principal company for the global New Categories business is Nicoventures Trading Limited (NVT), a UK company. The business model for how New Categories operates and interacts within the Group was agreed in 2015.

The key principles of the business model are:

- The New Categories Strategy (including marketing strategy and planning), Brand and Product Development and Supply Chain are the responsibility of NVT.
- All New Categories IP (Vype, Vuse, Neo, Sens and Glo) is owned by NVT. Combustible Strategic Brands are licenced to NVT from BAT Exports Limited for use on THP or Hybrid Consumables.
- NVT to sell to BAT End Markets (EM) under the Limited Risk Distributor (LRD) model. Under this scenario, the key financial and commercial risks are borne and managed and controlled by NVT who is rewarded appropriately. It also reflects the significant investment, substance and senior headcount built up within the UK for New Categories over the last 5 years.
- NVT to set End Market Budgets which includes Key Performance Targets, Pricing and Marketing Plans, this will require EMs to make recommendations to NVT which will be considered and approved as part of the budget process.
- The general principle is that EMs will earn a targeted operating margin of 4%, this is based on external benchmarks.
- The default NGP business model for EMs is to be an LRD of NVT, however operation of an LRD in an EM may not be always to be possible due to legal, fiscal or regulatory reasons. In such instances NVT appoints the EM as a Full Risk Distributor.
- As appropriate, NVT will engage the use of other group entities for support services e.g. GSD or supply chain service centres and contract manufacturing for consumables. These relationships will evolve as the business matures.

The primary business models are:

Limited Risk Distributor

The standard model for the most of EMs, this model follows the principles outlined in the New Categories strategy. Key feature is that EM will only retain a small margin representing the profit generated for distribution services rendered with the remaining risk or reward being borne by NVT.

Cost Plus

For markets that have a legal, fiscal or regulatory reason why they cannot adopt a limited risk distribution model.

The two most common reason for this is the presence of a factory in the market that is supplying some or all the goods or if the local government does not recognise LRD models.

In this case locally produced goods are purchased directly from the factory if applicable and other goods are supplied by NVT on a cost-plus basis. A Royalty is payable to NVT.

Full Risk Distribution

This is where NVT sells direct to a third-party distributor in the market.

Depending on the market a local BAT entity may be used to provide Marketing Services to NVT.

NVT subsumes the full risk and reward of distribution in these markets.

9 NVT Business Model

9.1 NVT Transfer Pricing

Transfer pricing is the price at which internally procured or produced goods move around the group to ensure compliance with local and global tax legislation. As per the New Categories business model the principal of the New Categories business is based in the UK due to operations performed centrally as the risk and rewards of the operating model lies with the principal entity.

Therefore, the aim of the Transfer Price (TP) in LRD models is to leave a target operating margin within the domestic entity (4% in standard LRD model). To achieve this, the TP process differs from the traditional combustibles cost plus model in that pricing is driven by the local external revenue received into domestic entity (distributor) and subsequent operating margin as opposed to the cost of the SKU e.g.

This means the calculation of transfer pricing is more complex and requires the calculation of the full P&L of the domestic distributor market (domestic) to establish the transfer price, as the transfer price is adjusted depending on the difference between the forecast MGMT P&L and the target margin e.g.

	NTO	COGS	Cost Plus TP	LRD TP
SKU 1	10	6	6.6	9.6
SKU 2	10	4	4.4	9.6
SKU 3	15	4	4.4	14.4

SKU 1 & 2 under traditional **Cost Plus** model will have different TPs due to different COGS but under LRD will always have the same TP as the NTO is the same.

SKU 2 & 3 will have different TPs driven by higher external NTO despite the COGS being the same, whereas under **Cost Plus** the TP would have been the same.

Domestic P&L	FCST P&L	TP adj
NTO	100	100
COGS	60	76
GM	40	24
Overhead allocation	20	20
Operating margin	20	4
Target 4%	4	4
Difference	16	0

TP increased by 16 to adjust Operating Margin

Although driven by the domestic P&L the change in TP causes a change in both NVT and domestic market P&L from a statutory and profit centre basis, however from a MGMT and group perspective this change is neutral as the impact is equal and opposite.

For the example in the table to the left, the 16 increase in COGS for the domestic P&L is offset by an increase of 16 in NTO for NVT. Upon consolidation these transactions will eliminate to nil.

Due to the additional complexity and time burden a full SKU P&L (including overheads), SKUs will be grouped by category and brand for the purposes of establishing the TP.

Therefore, a TP will be established for each category (Devices, Consumables and Accessories) within a brand group (THP, Vapour and Hybrid).

The same pricing will be applied to all SKUs within the group, with the aim of delivering the target operating margin at a total company level. The TPs will be reviewed quarterly against the target and adjusted where required.

9 NVT Business Model

9.1 NVT Transfer Pricing (continued)

The adjustment required to meet the Target Operating Margin will be applied to the remaining forecast volume where possible to minimise the need for true ups at the end of the year. See example opposite:

1. New forecast is produced and no longer aligns to target operating margin percentage

	FCST P&L	SOP 4	
Volume	10	10	
NTO	**100**	**90**	
COGS	76	76	
GM	**24**	**14**	
Overhead allocation	20	20	
Operating Margin	**4**	**-6**	
Target 4%	4	3.6	Target Operating Margin aligned to new forecast
Difference	0	-9.6	Forecast P&L not aligned

2. Balance to go (BTG) P&L reviewed and adjusted for difference between forecast operating margin and target operating margin

	HY Act	FCST BTG	Adj BTG	
Volume	5	5	5	
NTO	**40**	**50**	**50**	
COGS	38	38	28.4	Difference split across HY1 and HY2 but adjustment for FY must be applied to BTG
GM	**2**	**12**	**21.6**	
Overhead allocation	11	9	9	
Operating Margin	**-9**	**3**	**12.6**	
Target 4%	1.6	2	2	
Difference	-10.6	1	10.6	

3. Adjusted forecast aligned to target operating margin

	FCST P&L	SOP 4	
Volume	10	10	
NTO	**100**	**90**	
COGS	76	66.4	
GM	**24**	**23.6**	
Overhead allocation	20	20	
Operating Margin	**4**	**3.6**	Operating margin aligned to target
Target 4%	4	3.6	
Difference	0	0	

9 NVT Business Model

9.1 NVT Transfer Pricing (continued)

Where significant forecast changes occur e.g. tax/duty or MI boosts and there is insufficient volume remaining in the year to adjust the transfer price and LRD true up payment or receipt will be enacted between the export entity and the distributor.

This will tend to happen in November with adjustment at December if required and then a final adjustment when the distributor files its statutory accounts in the next financial year.

It therefore becomes very important that P&R teams include volumes at the correct unit of measure (UoM) at an SKU level as it will impact the calculations made for transfer pricing and volume to go.

In order to correctly calculate NTO, any Marketing Investment in GTO is required to be allocated across Brand and product categories to avoid distorting the NTO (and therefore TP calculation).

If no direct allocation can be determined, marketing investment in GTO should be allocated on a gross GTO percentage.

As the LRD model requires a target operating margin to be achieved, then the forecast needs to consider an allocation of non-brand expenditure and overheads.

Due to the difficulties in forecasting to a particular SKU or category, non-specific costs will be allocated to categories on the basis of percentage of NTO.

Where the new TP for a SKU will result in a negative margin, to minimise the risk of under payment of import duties the SKU TP will be adjusted to COGS value with no intercompany margin.

Calculated TP will then be shared with the market for review. Once aligned new TPs will be loaded into the system by GBS team and applied from the agreed date.

The review of TPs will be performed as follows:

1. **Transfer prices will be updated on 01 June current year based on SOP4 financials and will be valid from 01 June onwards till the end of the year**

2. **Transfer prices will be updated on 01 January the following year based on the financials submitted in SOP10 and will be valid from 01 January till the next update**

A mid-year transfer pricing review exercise might occur for some markets in August if there are material differences.

Those transfer process will become active from 01 September current year till the next update. If such review is required, the markets will be notified in advance.

Transfer pricing will be issued in the currency stated in the LRD contract which should be the domestic currency of the end market unless for legal, fiscal or regulatory reason an alternate currency has been approved by the NVT Head of Corporate Finance and agreed with Treasury/LEX that a currency is undeliverable or other regulatory restrictions.

If New Categories has not been launched and no contract or Letter of Intent exists please assume currency is the local currency of the end markets.

9 NVT Business Model

9.2 NVT Governance

This section outlines the relevant governance guidelines when operating under the NVT model:

New Market Launches

If it is decided to enter a new market under the NVT model, the below check list must be followed and completed:

Click to View

NVT SoDA

The details of what level of approval is required at different monetary values can be found in the NVT SoDA below:

Click to View

Full Risk Distribution

In some circumstances, NVT can sell directly to external distributors under an "external sales model".

This can be due to no BAT entity existing in the end market, or due to various legal, fiscal or regulatory reasons.

If there is case for operating under the NVT "external sales model", the requirements and key contacts for enabling this can be found in the below presentation:

Click to View

NVT Write-Off Process

Any write-offs or stock returns/ destructions should be approved by the relevant persons as set out in the NVT SoDA. If an NVT board note is required due to the value of the write-off, an example can be supplied by the NVT finance team on request.

The below template should be completed when seeking the relevant approval:

Click to View

Section 10

Marketing Governance Framework

10 Marketing Governance Framework

This section covers the details of the Global Marketing Governance Framework and the relevant sections for New Categories.

10.1 Brand Migrations

Thresholds	DRBU / Regional Noting	GlobalNoting
1. Strategic Portfolio migrations: Annual Gross Margin of current brand is >£20m 2. Non-Strategic Portfolio migrations: Annual Gross Margin of current brand is >£10m	Regional Exceptions Committee or RAI President as applicable	Chief Marketing Officer
1. Strategic Portfolio migrations: Annual Gross Margin of current brand is >£5m <20m 2. Non-Strategic Portfolio migrations: Annual Gross Margin of current brand is >£5m <10m	Regional Exceptions Committee or RAI President as applicable	N/A
1. Strategic Portfolio migrations: Annual Gross Margin of current brand is <£5m 2. Non-Strategic Portfolio migrations: Annual Gross Margin of current brand is <£5m	DRBU S&OP	N/A

Notes:

- *Strategic Portfolio refers to:*
  1) Combustibles: Dunhill, Kent, Lucky Strike, Pall Mall, Rothmans, Newport, Camel and Natural American Spirit.
  2) New Categories: Vuse, Vype, Glo, Lyft, Velo, Epok, Neo, Kent, Dunhill, Kool, Nuo, Kickup, Skruf
  3) Traditional Oral : - Grizzly and Camel

- *Strategic Portfolio migrations refer to: Strategic brands to be migrated to other Strategic brands or any Non-Strategic brand to be migrated to a Strategic brand*

- *Non-Strategic Portfolio migrations refer to: Strategic brands to be migrated to a Non-Strategic brand or any Non-Strategic brand to be migrated to other Non-Strategic brand*

- *All thresholds refer to Annual gross margin of current brand*

- *BATUKE/WECT/NVT approval is required for brands which fall under an LRD arrangement*

For external and group reporting, the entirety of New Categories NTO will be reported as strategic NTO whether the NTO is related to the New Categories strategic portfolio or not.

10 Marketing Governance Framework

10..2 RTM Model Changes

Thresholds	DRBU/Regional Noting	Global Noting
CPTO impacted in year 1 is >£350m	Regional Exceptions Committee or RAI President as applicable	Chief Marketing Officer
CPTO impacted in year 1 is >£50m < £350m	Regional Exceptions Committee or RAI President as applicable	N/A
CPTO impacted in year 1 is <£50m	DRBU S&OP	

Notes:

- *Route to Market Model changes only refer to changes to the way a market is served such as through distributor or in-house DSS, pre-sales etc*
- *Impacted CPTO is defined as total current annualised CPTO generated by the existing market under current RTM model prior to any change. Year 1 is the year of the change implementation, irrespective of when it happens during the year*

10 Marketing Governance Framework

10..3 NPI – New Categories

NPI refers to New brand launch, new product line extension, pack/product modification or upgrade or LEP/LEPP
This section considers Business case Category (THP/Vapour/MO) already existing in market.

Innovation Category: Thresholds	CAP 1, 2 & 3 NPV or	Opex (Yr 1) or	Total Capex	Noting From
All Projects (Global/Regional/Local)	> £50m	> £35m	> £10m	Monthly OpCom Process (GS&I -> Monthly OpCom)
	> £25m	> £20m	> £5m	MEX Forum
	> £10m	> £5m	> £2m	New Category Executive Committee
Regional/Local Projects	> £5m	> £2m	> £2m	Regional Exceptions Committee Or RAI President as applicable
Local Projects	< £5m	< £2m	< £2m	DRBU S&OP

Notes:

- *Global Projects refers to projects triggered by central marketing teams. Any Global project below above thresholds does not require business case*
- *local project below regional thresholds fall under DRBU's governance; A Decision to create a business case or not, should be noted at DRBU's S&OP*
- *Opex for All projects refers to all MI & Overheads costs (Consumer and Customer BE, NBE, Overheads and Adjusting Items related to the project)*
- *Operations capex > £2m requires supply chain validation by the Capex Investment Committee (CIC)*
- *All business cases should have a 3-year horizon*
- *This Section does not cover (actives ingredients expansion) which should be treated within NC GeoX governance*
- *Projects noted at NC Executive committee or OpCom, PIR is required 6 months after noting date. PIR of any regional/local projects could be requested at discretion of the forum noting the BC. PIR accountability is with BC owner*
- *BATUKE/WECT/NVT approval is required for brands which fall under an LRD arrangement*
- *Nothing in this Marketing Governance Framework limits or derogates from, Group governance referral requirements under the SoDA and/or any Regional and/ or Functional equivalents established under it, or any requirement for Corporate approval within a Group Company*

10 Marketing Governance Framework

10.4 GeoX – New Categories

This section relates to the introduction of any new Category (THP/Vapour/MO) for the first time in market.
Also covers NC categories expansion into existing market. (e.g. Market A launching Vaping while currently operating with THP)

Innovation Category: Thresholds	CAP 1, 2 & 3 NPV or	Opex (Yr 1) or	Total Capex	Noting From
All Projects (Global/Regional/Local)	> £50m	> £35m	> £10m	Quarterly OpCom Process (GS&I -> Quarterly OpCom)
	> £25m	> £20m	> £5m	MEX Forum
	< £25m	< £20m	< £5m	New Category Executive Committee & Regional Exceptions Committee Or RAI President as applicable (for Regional/Local)

Notes:

- *All New Market Launches will require a business case (with a 5-year horizon) to be prepared regardless of their thresholds*
- *Global Projects refers to projects triggered by Central Marketing teams*
- *Opex for All projects refers to all MI & Overheads costs (Consumer and Customer BE, NBE, Overheads and Adjusting Items related to the project)*
- *In the case a new market rollout only involves a temporary (<1 year) City Test, a simplified financial assessment form should be prepared and noted as per above-mentioned thresholds. A City Test should not involve any product spec change or Capex; if it does, a full 5 yr BC should be prepared and noted as per any new market launch*
- *In case a City Test is expanded, a full 5 yr BC should be prepared and noted as per any new market launch*
- *Capex > £2m requires noting by the Capex Investment Committee (CIC)*
- *Projects noted at NC Executive committee or OpCom, PIR is required 6 months after noting date. PIR of any regional/local projects could be requested at discretion of the forum noting the BC. PIR accountability is with BC owner*
- *BATUKE/WECT/NVT approval is required for brands which fall under an LRD arrangement*

Nothing in this Marketing Governance Framework limits or derogates from, Group governance referral requirements under the SoDA and/or any Regional and/or Functional equivalents established under it, or any requirement for Corporate approval within a Group Company.

10 Marketing Governance Framework

10.5 Pricing – New Categories

	DRBU	Regional	Global
NTO >£10m	Proposed by DRBU P&E Committee	Supported by Regional Director/ RAI President, Regional Finance Controller and Regional Marketing Manager	Noted by Global Head of New Categories Global Finance Controller New Categories
NTO >£5m-£10m	Proposed by DRBU P&E Committee	Noted by Regional/RAI Director, Regional Finance Controller and Regional Marketing Manager	Inform the NC Executive Committee
NTO <£5m	Notes by DRBU P&E Committee	Inform the Regional Director, Regional Finance Controller and Regional Marketing Manager	N/A

Notes:

- *Pricing noting including increase, decrease or even holding price in the event of competitive price movements*
- *Thresholds represent annualised NTO impact of a price change (post-price change vs pre-price change impact), irrespective of price change been budgeted or not*
- *Any long term (> 3 months) discounting activity is also subject to this pricing governance framework. Thresholds represent annualised NTO impact of a price change (post-price change vs pre-price change impact)*
- *For any short term (<3 months) discounting activity, thresholds will be applied to the financial impact for the discounting period only*
- *Budgeted activities refer to activities included as part of the Group Budget cycle. This refers to check in point in November where Management Board and Main Board will be requested to endorse Group targets for following financial year with reference to SOP10 Current Year + 1 forecast*
- *New categories include THP, Vapour, Modern Oral, devices, consumables, accessories*
- *BATUKE/WECT/NVT approval is required for brands which fall under an LRD arrangement*

Nothing in this Marketing Governance Framework limits or derogates from, Group governance referral requirements under the SoDA and/or any Regional and/or Functional equivalents established under it, or any requirement for Corporate approval within a Group Company

Section 11
Definitions

11 Definitions

0

121 Activation
(CEG)

Measures the costs of activities related to consumer communication via face-to-face interaction and conversation about product information to drive trial and to capture consumer data for ongoing engagement.

121 engagement includes brand ambassador/hostess (in retail, HoReCa or festivals/events) or Trade Marketing Representative (TMR). This includes costs for recruitment, remuneration and management of outsourced brand ambassadors/hostesses and any related operating and service costs, including agency fees, as well as costs for the training of a brand ambassador/hostess or TMR.

This does not include the costs of branded promotional or merchandising materials that are used within retail or entertainment activation channels as well as cost of free product, competitions (costs and prizes) and other incentives.

A

Assortment & Listing Fees
(CEG)

All payments related to assure and guarantee the assortment of products in controlled outlets, as well as payments to retailers to list new products.

Such costs normally include listing fees and/or single facing fee (payments to retailers for display/space within their store), rental of vending machine shaft space and maintenance costs of own vending machines (less any rental income received).

11 Definitions

B

BE
Consumer Focused Investment

Measures the costs that are directly attributable to supporting brands in the market via consumer facing activities. These include costs related to Creative Development and Production, Consumer Research, Media Advertising and promotional activities across all brand activation touchpoints.

BE – Consumer Focused Investment **CEGs**:
- Creative Development
- Creative Production
- Branded Packaging and Product Development
- Branded Research
- Media Advertising & Sponsorship
- Retail Activation - POS and Promotional Materials
- Retail Activation - Permanent In-Store Furniture
- 121 Activation
- Entertainment Activation
- Digital Activation
- Direct to Consumer Activation
- Flagship Stores
- Other Consumer Focused Investment

BE
Customer Investment

Measures the marketing costs directly attributable to the Trade which are paid to the customer.

BE – Customer Investment **CEGs**:
- Retail Activation: Advertising Space within Retailer
- Customer Retail Activation: Permanent In-Store Furniture
- Assortment & Listing Fees
- Trade Engagement
- Price Compliance
- Customer Allowances (Indirect)
- Trade Pay for Performance (Indirect)
- Other Customer Investment

Brand Expenditure
(BE)

Measures the marketing costs directly attributable to support a brand in a market. Brand expenditure is made up of: BE – Consumer Focused Investment and BE – Customer Investment.

Branded Packaging & Product Development
(CEG)

Measures the brand specific costs of Packaging and Product development. This includes brand specific costs of developing new blends, variants, pack styles, monitoring current specification and quality and cylinder development.

This excludes amounts paid to agencies for Creative Development, including packaging design, as well as non-brand specific long-term product development costs which should be reported under Admin Overheads.

11 Definitions

B

Branded Research (CEG)

Measures all the brand specific costs of consumer-focused research. Covers either quantitative or qualitative specific consumer and trade research methodologies and tools that are targeted and/or identifiable to a specific brand including NPI and innovation/mix testing (4Suite tools, new launch toolkit and communication testing (e.g. LINK, Campaign Deployment Test)) and product testing (e.g. Product Space Discovery, Product Encounter Sessions, Branded Product Test).

This excludes all non-branded specific marketing research as Retail Audit, TRACK, Segmentation and Pricing, Illicit Trade Monitoring, CBC, Social Media Listening, etc.

C

Consumer Discounting

Comprises ongoing long-term reductions, at the retail or wholesale level, which are for the benefit of the consumer.

They are, in reality, a 'permanent' reduction in the official price as perceived by the consumer.

This may be due to situations where discounting is a strategic part of the marketing mix of a particular brand or where the overall industry is very much discount focused and in which few products are sold at their full price.

Consumer discounting activities include Couponing, variable price reductions and buy down programmes. The costs consist of the price reduction itself.

Note: *Only markets whereby it is legal to carry out consumer discounting should report such costs.*

Consumer Engagement and Activation

For markets setting up an Activation team, all BAT HC costs attributable to the Direct to Consumer engagement touchpoints and campaign planning should be captured under Consumer Engagement and Activation sub-function.

These relate to areas such as Activation strategy and deployment, Digital Marketing, Social Media, eCommerce, CRM, Consumer Care / Helpline, own retail, Social Selling, 121 and events, Out of Home and PR, in-store activation, and campaign planning.

Do not report here: TM&D (field and office), Brand, SP&I (including SP&I roles linked to digital marketing).

For markets that won't be setting up a dedicated activation team, they will continue with some existing D2C activities (e.g. HoReCa) and that will go under TM&D.

Consumer Engagement and Activation is split into Office based and Field based. Field based only applies in the situations where Brand Ambassadors and Social Sellers are BAT HC, in which case all their costs should be captured in NBE, Marketing Overheads as per defined CC hierarchy.

11 Definitions

C

Consumer Price Turnover (CPTO)

Measures the actual price paid by the consumer for the Company's brands/products. The actual price paid by consumers multiplied by the total domestic volume of the company. Where the market price is stable, this is a relatively simple computation. It must be calculated as follows: (Volume in No. of sticks/no. of sticks per pack) x actual consumers price.

Example 1:		
Volume		400
No. Sticks / Pack		20
Actual Consumers Price / Pack		10
RRP Total	**400 / 20 x 10**	**200**

In other cases, the price must reflect the sum of the price paid by most consumers (e.g. discounted prices, carton prices, stick prices, etc.) e.g.:
No. of sticks sold as sticks x Stick price + (No. of sticks sold as packs with discounts) ÷ (No. of sticks per pack) x (recommended sales price – relevant rebate).

Example 2: No. / Sticks / Pack 20		
Volume	RRP / Pack	Actual Price / Pack
100	10	2 (per stick in this case)
100	10	8 (discount 20%)
100	10	10
100	10	0 (free sample product to consumers)
Calculation:	100 x 2	200
	100 / 20 x 8	40
	100 / 20 x 10	50
	100 / 20 x 0	0
	200 + 40 + 50 + 0	**290**

In cases where consumer prices vary by regions within the market a volume weighted average should be used for calculation purposes.

Cost of Sales

Measures the cost of sales of our brands. It includes cost of own manufacture (leaf, wrapping materials, process-related conversion costs, support related conversion costs and other production overheads), product bought from external suppliers for resale, external royalties and primary supply-chain costs.

Please refer to the Green Book for detailed guidance.

11 Definitions

C

Creative Development (CEG)

Measures the costs associated with the development and adaptation of creative concepts, campaigns and manifestos that engage the consumer and drive brand awareness as supported by the global ecosystem of creative and activation agencies.

This covers activity-based and retainer fees paid to agencies for creative development, brand strategy and activation planning as well as account management of creative and strategic activity.

It also includes payments to agencies for creative development within digital and media advertising channels as well as specialist creative services such as packaging design.

It does not include fees for creative production services, amounts paid to media suppliers for the placement of advertising materials or costs associated with marketing and/or consumer research.

Creative Production (CEG)

Measures the costs associated with the production and delivery of advertising and communication materials based on approved Creative Development.

This covers fees paid to marketing implementation agencies for the production and adaptation of creative assets for use in media advertising (including broadcast, print and internet) and other activation touchpoints. It does not include payments for Creative Development, media placement or branded promotional or merchandising materials used within retail or entertainment activation channels.

CRM

Consumer Relationship Management (CRM) is a strategic software which support the management of end-to-end interactions and relationships with our consumers to grow long-term value for BAT.

It covers a broad set of applications designed to help businesses manage many of the following business processes: customer data, customer interaction, access business information, sales automation, track leads, customer support, hypercare etc.

Customer Allowances (Indirect) (CEG)

As per 'Customer Allowances', however only trade payments (through the Purchase ledger in the form of an invoice received from the customer) will be reported against 'Customer Allowances (Indirect)' within BE – Customer Investment.

This specifically relates to Indirect customers of BAT (i.e. a customer of a customer).

11 Definitions

C

Customer Retail Activation – Permanent In-Store Furniture (CEG)

Only by exception, there may be circumstances where, under specific contract terms, certain elements of these costs meet the definition of an incentive (e.g. where costs are intrinsically linked to the sales in a contract) and as such must be reclassified as a deduction from revenue.

Please contact BAT Group Accounts to discuss further and determine if any reclassification is necessary.

If the exceptional criteria are met, then all payments related to Permanent In-Store Furniture (e.g. backwalls) which advertise and communicate BAT products with consumers, with the intention of stimulating buying actions can be included within this CEG.

This include the cost of production, installation, and maintenance of the permanent furniture.

D

Digital Activation (CEG)

Measures the costs of activities related to consumer communication leveraging internet and technology to drive ongoing consumer engagement through a targeted, two-way interactive platform.

This includes all costs related to the development of branded platforms, online shopping and eCRM database related to eCommerce and costs for digital engagement touchpoints such as consumer database management.

This does not include costs associated to development of branded content and/or Creative Development and Production of content or assets used in digital media or payments for media placement related to internet advertising.

Direct to Consumer Activation (CEG)

Measures the costs related to direct selling, conversion and hypercare engagements with consumers without any intermediaries (e.g. retailers) such as social selling and careline (call centre) activities. Costs include Social Seller & Careline staff salaries, bonuses, expenses, commission, FOC devices / consumables for trials (if impacting MI), training & recruitment, IT related costs (e.g. mobile phones / tablets) and agency fees.

This does not include costs related to 121, retail, entertainment, digital activation, own retail or flagship stores.

11 Definitions

E

E Commerce (ISSC) (CEG)

All costs associated with the picking and packing of eCommerce orders should be reflected in this CEG. This includes warehouse costs, delivery costs, overhead costs, as well as any other specific ISSC costs.

Entertainment Activation (CEG)

Measures the cost of brand building and activation activities occurring at places of entertainment where people congregate and spend significant time together, e.g. HoReCa outlets, events (own or partnership) or festivals.

This includes third party fee, branded furniture, display units or signage, branded merchandising or promotional materials (such as T-shirts, lighters, ashtrays) as well as any expenses related to the production of a festival or event, including smoking lounges.

This does not include any 121 Activation costs for brand ambassadors/hostesses used with the entertainment channel or any branded furniture or promotional materials used in the retail channel.

F

Flagship Stores (CEG)

BAT managed retail stores or outlets whereby the main function is to carry out brand building activities (generating awareness, encouraging trial, etc.) that typically support one particular brand (e.g. Glo/Vype).

All operating costs associated with the flagship store should be captured within this cost element, including: third-party staff related costs, rent, and utilities. The depreciation for Flagship stores should be captured within Retail Outlets under NBE.

Note: *Outlets whereby the main function is to sell our products directly to the consumer (thereby a retail channel and captured within 'Retail Outlets' in NBE).*

M

Market Contribution

Measures the profitability of a market. The difference between an End Market's external net turnover and the total costs directly associated with the End Market. Some marketing and trade marketing support costs (e.g. salaries of Brand Managers, Sales Force Reps, and internal SSC costs) cannot be attributed directly to individual brands and hence these should be accounted for at the market level. Calculated as Brand Margin less Non-Brand Expenditure.

Marketing Overheads

Costs of the marketing organisation - all marketing sub functions including NBE: Route to Market Overheads and NBE: Marketing Overheads.

11 Definitions

M

Media Advertising & Sponsorship (CEG)

Measures the costs related to “above the line” (ATL) advertising across the media elements used for brand communication as well as commercial sponsorship agreements.

This includes the costs of advertising in broadcast media (e.g. TV, radio), print publications (e.g. newspapers, magazines), out of home media (e.g. billboards, stadiums) and internet advertising (e.g. paid search advertising, search engine optimisation) and should include the amounts paid to media suppliers for the placement of the materials as well as any associated agency commissions.

This does not include costs associated with a) the Creative Development and Production of content or assets used for media advertising, b) digital activation activities such as use of platforms on websites, mobile applications or social media or c) entertainment events partnerships.

Marketing Investment in Gross Turnover (MI in GTO)

Discounts granted to customers for using efficient methods of payments, e.g. direct debits.

Not to be applied for methods of payment that are without alternative or used by all customers anyway.

This applies for all retailer, wholesaler & distributor.

N

NBE: Route to Market Overheads

NBE: Route to Market Overheads can also be referred to as ‘Back Margin RTM Costs’. This measures the total expenditure of the costs centres within Non-Brand Expenditure which relate to RTM and therefore TCI.

The cost centres included are:

- Internal Secondary Supply Chain
- TM&D DSS Field Force
- TM&D Non DSS Field Force
- RTM - Marketing Security
- BAT Retail Outlets
- E-Commerce (ISSC)

11 Definitions

N

NBE: Marketing Overheads

Costs of the marketing organisation - all marketing sub functions.

The cost centres included are:
- Function Management
- Consumer Engagement and Activation
- Brand Marketing
- Trade Marketing & Distribution - office based
- Marketing Finance
- Planning & Insights
- Marketing IT
- Marketing LEX
- Marketing HR

Non-Brand Expenditure

Measures any expenditure that is not brand specific. This represents the sum of non-branded support expenditure and non-branded sales and internal SSC costs.

Non-Branded Packaging & Product Development

Measures the non-brand specific costs of packaging and product development.

This includes costs of developing new blends, variants, monitoring current specification and quality that are not directly attributable to a specific brand.

This excludes non-brand specific long-term product development costs which should be reported under Admin Overheads.

O

Other Consumer Focused Investment (CEG)

Measures all other brand specific costs related to consumer-focused activities. This category should not exceed 5% of total Consumer Focused Investment.

Other Customer Investment (CEG)

Measures all other customer investment specific costs related to customer-focused activities. This category should not exceed 5% of total Customer Investment.

11 Definitions

P

Price Compliance (CEG)

All payments made to Retailers to encourage/ensure that the RRP is the price which consumers pay. Such initiatives which the Retailers may carry out on our behalf, and therefore be paid as a reward of, include:

- RRP compliance
- Everyday Low Price (EDLP) schemes
- Price Gap compliance
- Price Ceiling compliance

R

Reallocation – BE to Above NTO

This cost element group will be utilised to 're-class' as per IFRS15 the total aggregated amount of the Brand Expenditure: Customer Investment into Marketing Investment in GTO.

Research and Development

Costs related to the use of analytical techniques, specialised laboratory technology and expertise to test our products to ensure high standards of consumer safety and product quality.

For New Categories these tests can include:

- Testing everything from how consumers use a product to the content of the vapour it produces
- Biological impact of the vapour on cells in laboratory tests
- The likely impact of the availability of New Categories products on consumer health
- Mapping existing technologies and establishing where the needs are to develop new ones

In addition to the above costs, any other associated costs with Research and Development expenditure such as Function Management, IT, HR and Finance will also be included in R&D costs when analysing New Categories Investment.

Retail Activation – Advertising Space in Retailer (CEG)

All payments made to the customer (predominantly retailers but could also be wholesalers) for the space used in their outlets to communicate/activate BAT products.

Examples of payments for advertising space within Retailer include:

- Payment for the space of counter/shelf (or other places within the outlets) which BAT can place temporary promotional materials to highlight, announce or communicate a product or offer to consumers;

- Payment for the space within an outlet which a brand ambassador can carry out promotional activities

Note: *This does not include costs of branded merchandising or promotional materials – these costs are reported in 'Retail Activation – POS & Promotional Materials'.*

11 Definitions

R

Retail Activation – Permanent In-Store Furniture (CEG)

All payments related to Permanent In-Store Furniture (e.g. backwalls) which advertise and communicate BAT products with consumers, with the intention of stimulating buying actions.

This include the cost of production, installation, and maintenance of the permanent furniture.

Does not include: temporary and semi-permanent furniture – these costs should be reported against Retail Activation – POS & Promotional Materials

Notes:

- *Based on Group policy all Marketing Merchandising is required to be expensed (not capitalised), there should be no merchandising depreciation included here.*
- *By exception, there may be circumstances where, under specific contract terms, certain elements of these costs meet the definition of an incentive (e.g. where costs are intrinsically linked to the sales in a contract) and as such must be reclassified as a deduction from revenue. Please contact BAT Group Accounts to discuss further and determine if any reclassification is necessary.*

Retail Activation – POS & Promotional Materials (CEG)

Measures the costs of branded merchandising or promotional materials (excluding permanent in-store furniture) related to advertising and communicating with adult tobacco shoppers to highlight, announce or communicate a product or offer to consumers in retail outlets and obtain or enhance product presence at retail point of sale.

This includes the cost of production, installation and maintenance of temporary or semi-permanent point of sale materials (POSM) comprising printed POSM (e.g. posters, visuals) and non-printed POSM (e.g. counter displays, cash trays, shelf solutions). This also includes promotional materials and free goods or merchandise whether smoking related (e.g. BAT products, lighters, ashtrays) or not smoking related (e.g. apparel, electronics, stationery).

This does not include costs related to permanent in-store furniture or payments for advertising space within retail and excludes amounts paid to agencies for creative development and production of brand communication content or assets.

Retail Outlets

All NBE costs which are associated with BAT own/leased Retail outlets (including Flagship stores). Costs can include depreciation, rent, fixtures and fittings, utilities, employment costs, etc. Such retail outlets will be predominately in relation to New Categories.

Recommended Retail Price (RRP)

Recommended Retail Price (RRP) is a guideline price for a product given out by the government authorities, manufacturer or distributor to define a maximum price to be paid for the unit. This is then multiplied by the total domestic sales volume of the company, to arrive at the Total RRP.

Calculated as follows: (Volume in No. of sticks/no. of sticks per pack) x RRP		
Example:		
Volume		400
No. Sticks / Pack		20
RRP / Pack		15
RRP Total	**400 / 20 x 15**	**300**

Note: *In a market where no consumer discounting/promotional activity takes place, RRP will equal CPTO*

11 Definitions

T

Trade Engagement Programmes (CEG)

Cash and non-cash investments that incentivise selected customers to build a strategic relationship (e.g. B2B Programmes) that generates tangible benefits for BAT.

Examples of this type of customer investment include:
- Relationship building reward scheme (e.g. combination of business planning support, training, personal rewards, loyalty etc.)
- Out of Stock prevention
- Product Quality Assurance
- Data sharing (e.g. scanning data received from Retailers)
- Responsible retailing programme: such as AIT (anti-illicit trade) programmes and YSP (youth smoking prevention) programmes
- Retailer Advocacy
- Any other form of trade investment customer-specific that incentivise engagement with the trade. This applies for retailer, wholesaler & Distributors

Trade Pay for Performance (Indirect) (CEG)

As per 'Trade Pay for Performance', however only trade payments (through the Purchase Ledger in the form of an invoice received from the customer) will be reported against 'Trade Pay for Performance (Indirect)'.

This specifically relates to Indirect customers of BAT (i.e. a customer of a customer).

End