

Altria Group, Inc. Business Update
03/06/23, 9:00 am ET

Operator:

Good day and welcome to the Altria Group Business Update Call. Today's call is scheduled to last about one hour, including remarks by Altria's management and a question-and-answer session. In order to ask a question, please press star (*) followed by the number one (1) on your touchtone phone at any time. Representatives of the investment community and media on the call will be able to ask questions following the conclusion of the prepared remarks. I would now like to turn the call over to Mac Livingston, Vice President of Investor Relations for Altria Client Services. Please go ahead, sir.

Mac Livingston:

Thanks, Todd. Good morning and thank you for joining us. This morning, Billy Gifford, Altria's CEO, and Sal Mancuso, our CFO, will discuss our recent e-vapor announcements. Additional information related to these announcements can be found in our release, which are available at altria.com and in our SEC filings. Our remarks contain forward-looking and cautionary statements and projections of future results. Please review the forward-looking and cautionary statement section at the end of today's press release for various factors that could cause actual results to differ materially from projections.

Today's press release also includes reconciliations and further explanations of the non-GAAP financial measures we discussed today. As noted in our press release issued earlier today, the transaction with NJOY is subject to customary closing conditions, including reporting requirements under the Hart-Scott-Rodino Act. All references in today's remarks to tobacco consumers or consumers within a specific tobacco category refer to existing adult tobacco consumers, 21 years of age and older. With that, I'll turn the call over to Billy.

Billy Gifford:

Thank you, Mac, and good morning, everyone. Earlier today, we made an exciting announcement regarding our plans to acquire NJOY and its portfolio of e-vapor products. We

have also recently announced our decision to exit our minority investment in JUUL. Our remarks this morning will focus on why we believe these actions, meaningfully, accelerate our journey towards moving beyond smoking. I will discuss the strategic rationale of these transactions and how they enhance our compelling portfolio of smoke-free products. I'll turn it over to Sal to discuss the financial details and then we will move to a question-and-answer session.

The e-vapor category is the largest smoke-free category in the US. Last year, the category included nearly 14 million tobacco consumers, including 9½ million exclusive vapers, generated approximately \$7 billion in retail sales, and represented approximately 15% of total estimated equivalized US tobacco volumes. We continue to believe that the e-vapor category can play an important role in harm reduction, but for this to occur, the category must provide an off-ramp for smokers and not an on-ramp for underage users.

National government surveys indicate that progress has been made toward reducing underage vaping and although, current usage levels remain high, they are significantly lower than the 2019 peak. Since 2019, we, and many other stakeholders, have taken significant actions to address underage vaping. Our efforts have contributed to: the enactment of Tobacco 21 laws at the federal level and in 41 states; the inclusion of synthetic nicotine products in the US Food, Drug and Cosmetic Act; 137,000 retail stores with age validation technology installed at the registers; and 33,000 stores with embedded age and identity verification solutions in their digital apps.

We know that addressing underage use of tobacco products is critical for us to achieve our vision and we will continue these efforts as we responsibly expand the availability of smoke-free products. Since the end of 2018, we have participated in the e-vapor category through our minority investment in JUUL. As many of you know, we elected late last year to be released from the non-compete obligations related to this investment, which allowed us to pursue other e-vapor opportunities. In the five months since this election, our teams have been diligently evaluating all options to best compete in this category. As part of this analysis, we decided that it would be in the best interest of our shareholders to exit the JUUL investment given the significant, regulatory and legal challenges and uncertainties facing the company. And as we

reported last week, we exchanged our JUUL shares for access to heated tobacco IP that we can add to our product development toolkit.

During our e-vapor evaluation, we identified NJOY as an attractive business with talented employees. We believe that there are five key strategic pillars for this transaction, including that the e-vapor category can play an important role in harm reduction if supported by appropriate regulation. *NJOY ACE* is uniquely positioned relative to other pod-based products with marketing-granted orders from the FDA. NJOY has taken a responsible approach to marketing its products and has limited youth usage. Our consumer research supports our belief that *ACE* is a satisfying product for smokers and competitive vapers. Finally, we believe that our commercial resources can responsibly accelerate US smoker and vapor adoption of *ACE* in ways that NJOY could not as a standalone company.

Let's now walk through each of these strategic pillars beginning first with our view of the category. We remain optimistic about the future of harm reduction in the US and we continue to believe that the US e-vapor category will undergo a multi-year transition period. Over the next few years, we expect that the FDA will issue marketing determinations on currently pending PMTA applications, including those filed for tobacco-derived and synthetic nicotine products, and exercise appropriate enforcement actions against non-compliant manufacturers. Most of these expectations were highlighted in the recent Reagan-Udall Foundation report as recommendations for the FDA and we believe the agency will respond accordingly. We expect the e-vapor category to remain in flux as the FDA continues its efforts to create a market consisting solely of authorized products through its marketing determinations and enforcement actions. We estimate that over the next 10 years, total US e-vapor volumes will grow at a low single digit compounded annual growth rate. Our estimates include a range of scenarios including various regulatory outcomes from menthol and flavored e-vapor products.

Moving to our second pillar, *ACE* is currently the only pod-based product with marketing authorization from the FDA. In fact, NJOY has received six of the 23 marketing orders granted by the FDA to date for the entire e-vapor category, including pods, disposables and open

systems. NJOY's marketing orders include the *ACE* device, three *ACE* tobacco-flavored pods and two tobacco-flavored disposable products. Among competitors, it appears that PMTAs remain pending for *Vuse Alto* and JUUL awaits the results of the FDA's administrative stay order.

For our third pillar, we evaluated NJOY's marketing practices and national survey data regarding underage use of tobacco products. We believe NJOY has taken a responsible approach to marketing its products. According to the 2022 National Youth Tobacco Survey, NJOY-branded products are not included among the top usual brands among middle school and high school e-cigarette users. Additionally, NJOY is developing access restriction technology for its devices to further address underage use. This technology uses Bluetooth connectivity to authenticate the user before unlocking the device.

Fourth, our consumer research indicates that once consumers try NJOY *ACE*, it is a competitive product for both smokers and vapers. After trying the authorized non-menthol *ACE* variant, 19% of surveyed smokers and 27% of surveyed vapers indicated that they would definitely buy the product. The *ACE* results were on par with the post-trial findings for *Vuse Alto* non-menthol and better than those for JUUL non-menthol. We observed similar post-trial results for the *ACE* menthol variants when compared to *Vuse Alto* and JUUL menthol products. This encouraging research supports our belief that *ACE* is a compelling proposition.

Finally, the fifth strategic pillar of the transaction focuses on the fact that a large number of tobacco consumers are not currently aware of nor have access to *ACE*. At retail, *ACE* is currently available only in, approximately, 33,000 stores and is supported by a small sales force of fewer than 50 people. As a result, total US retail share for *ACE* pods in 2022 was only 3%. Yet, we know that *ACE* has performed better in stores where it's visibly merchandised and has consistent distribution. In the top five chain accounts where *ACE* competes with *Vuse Alto* and JUUL, the weighted average share for *ACE* is, approximately, 11%.

Based on these factors, we believe we can responsibly accelerate US smoker and competitive vaper adoption of *ACE* in ways that NJOY could not as a standalone company. We believe that tobacco consumers should have more and better choices available to them as they move down the risk continuum. We believe the strengths of our commercial resources can benefit smokers and vapers and expand competition in the stores where *ACE* has not been previously distributed or visible.

We have an industry-leading sales force of 1,600 employees located across the country. Our sales force has significant retail coverage, servicing over 200,000 US retail stores and decades of experience supporting the responsible retailing of tobacco products. We have dedicated personnel supporting the top 340 retail accounts and the top wholesalers in the country. Additionally, we collect and analyze tobacco transactions from, approximately, 125,000 stores. Our teams use this data and our extensive adult tobacco consumer database to responsibly connect with smokers in a variety of ways and help them along their transition toward smoke-free products. We believe adding NJOY's FDA-authorized products into this system will benefit consumers across the country and, of course, we will use our existing tools to limit the appeal of *ACE* to unintended audiences, especially youth.

As a result of the transaction, Altria will have a compelling portfolio of products and technology across the three largest smoke-free categories. In e-vapor, we will fully own the only FDA-authorized, pod-based e-vapor product today. In oral tobacco, we own the largest brand, *Copenhagen*. Own 100% global rights to *on!*, the fastest-growing nicotine pouch brand in the US last year and we have differentiated new products in development. And in heated tobacco, we have the majority-owned joint venture with JT Group for the US commercialization of the next-generation *Ploom* device and *Marlboro* heated tobacco sticks. We have full ownership of an exciting heated tobacco capsule technology which we will discuss further at our Investor Day.

We also have strong external relationships, including the potential global partnership with JT. We believe the smoke-free portfolio combined with the significant cash flows from our leading US combustible brands and substantial internal capability positions us well to achieve our vision

to responsibly lead the transition of adult smokers to a smoke-free future. We're excited about the path ahead and believe that our actions will benefit tobacco consumers, our businesses, our shareholders and society.

I'll now turn it over to Sal to discuss the financial details of the transaction.

Sal Mancuso:

Thanks, Billy. We agreed to purchase NJOY for, approximately, \$2.7 billion in cash payable at closing. We expect the transaction to be accretive to cash flow within two years of closing and accretive to adjusted diluted earnings per share within three years of closing. The difference in timing between cash and earnings accretion relates to estimated amortization charges. We also expect the return on invested capital for the transaction to exceed our weighted average cost of capital within three to four years of closing. The transaction terms also include additional \$500 million in contingent cash payments related to non-tobacco-flavored PMTA filings. The payments are only triggered if a marketing authorization is issued by the FDA. These contingent payments and the estimated market performance associated with additional authorized products are not included in our accretion estimates.

We are fortunate to have multiple sources of funding for this transaction. Our core businesses continue to be highly cash generative and we have strong access to the credit markets and committed short-term bank financing. Additionally, we entered into a \$2.7 billion transition agreement last year with Philip Morris International for the IQOS system. We received \$1 billion from PMI in the fourth quarter of last year and we expect to receive a payment of \$1.7 billion plus interest by July 2023.

Finally, we reaffirm our guidance to deliver 2023 full-year adjusted diluted EPS in a range of \$4.98 to \$5.13. This range represents an adjusted diluted EPS growth rate of 3% to 6% from a \$4.84 base in 2022. This guidance range does not include the potential financial impacts of the transaction. We also reaffirm our expectation to complete our \$1 billion share repurchase

program by the end of this year. Additionally, following the exchange of our JUUL shares, all tax losses related to the investment are realizable.

Let's now open the question-and-answer period. Joining Billy and me for Q&A this morning is Murray Garnick, our General Counsel and Head of Regulatory Affairs. While the calls are being compiled, I'll remind you that further details on the NJOY and JUUL announcements can be found in our releases and SEC filings. Operator, do we have any questions?

Operator:

Yes, sir. At this time, we do have some questions. Again, as a reminder, if you would like to ask a question, please press the star and one on your touchtone phone at this time. Investors, analysts and media representatives are now invited to participate in the question-and-answer session. We'll take questions from the investment community first. Our first question comes from Vivian Azer with TD Cowen.

Vivien Azer:

Hi. Thank you. Good morning.

Billy Gifford:

Good morning, Vivien.

Vivien Azer:

Good morning. So, the brand is clearly subscale which drives the three-year outlook I'm sure for EPS accretion, but I was wondering could you comment at all on the diverse margin profile or the economics around the portfolio, if that's possible. Thanks.

Billy Gifford:

Thanks for the question, Vivien. I think when you think about it from a pricing perspective in the marketplace, it's similarly priced to other competitive brands in the marketplace and you'd touched on it's a small company. So they had just under right at 50 sales force employees and I

think when you think about it, it's really a uniquely-positioned asset. They took very careful and responsible approach to how they approach the marketplace. They were really thoughtful in making sure that the science that was necessary to get PMTA approval, so in a sense, you have certainty there from a standpoint of it speaks to the quality of employees at NJOY. It's very competitive. You saw the research results. Once you get a consumer to try it, even competitive vapers, it's a preferable product, especially, related to the JUUL devices. With it being cash accretive over two years, that really shows you that we believe that we can really use our strengths of responsible distribution and visibility at retail to really drive the value enhancers as we move through time.

Vivien Azer:

Okay. That's helpful. Just for my follow-up, I wanted to touch on the JUUL announcement from Friday, if that's okay. For the heated tobacco IP that you guys are getting access to, is that exclusive?

Billy Gifford:

Yes. There are two types of IP that are related in that transaction. One is, if you think about it specific to the heat-not-burn category, we get sole non-exclusive licensing to that and then there were some IP included in that that was, I would say, used broader in more different types of devices. We have the non-exclusive right to use that in a heat-not-burn space.

Vivien Azer:

Got it. Thank you so much.

Billy Gifford:

Thank you.

Operator:

Thank you. Our next question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog:

Thank you. Good morning. I guess, a key question for me this morning is what gives you guys the confidence that you're going to be successful with NJOY to, I guess, justify the investment you've made? I'm hoping just to hear a little bit more in terms of what is differentiated about NJOY other than the PMTA. Then you touched on this in the markets where NJOY has the distribution. You highlighted that it has done well, so where do you think it's sourced share from and then just ultimately curious if you think you need to reposition the brand in any way?

Billy Gifford:

Yes. That's a lot of questions packed into one, Bonnie. I'll try to unpack them, but if I miss one, feel free to follow up. I think when you think about it, you're right. Where it is visible and we believe we can improve the visibility even in those stores, but where it's visible, it competes very vigorously. I think from a sourcing standpoint, it sources exactly where you would anticipate it would and that's from adult smokers who are looking for a smoke-free alternative as well as competitive vapers.

As far as repositioning, we're pleased with the quality of the product. We saw some early comments where there were rumors in the marketplace where we don't think that the national share represents the quality of the product and we believe that really plays, if you will, to the strengths that we can bring to it. That we have extensive relationship with retailers that our sales force has built over decades and we're able to bring that strength to the table and really have consumers that haven't had access to this product that has been FDA-authorized now have access and have it in their considerations of that.

Bonnie Herzog:

Okay. Then just maybe a second question on the JUUL announcement from last week. You touched on this, again, the opportunity with the heated tobacco IP, but just curious, do you guys have plans to distribute this internationally or is this primarily to leverage it in the US? Just a little bit more color on that would be helpful. Thanks.

Billy Gifford:

I just want to clarify with you, Bonnie, are you referring to NJOY or the heat-not-burn IP?

Bonnie Herzog:

Oh, sorry, the heat-not-burn IP, the JUUL.

Billy Gifford:

Yes. When you think about that, we saw it as very interesting technology. It allows us to put it in the toolkit of our product developers and so we would have the ability with that licensing to use it anywhere around the world. Our focus, of course, would be the US because that's the biggest opportunity we see in products.

Bonnie Herzog:

Just a quick clarification on that, so do you have plans at some point to start selling, distributing internationally and if so, how do you plan to tackle that?

Billy Gifford:

Yes, I think when you think about the heat-not-burn space, just to remind you where we're at, but I know you so well, Bonnie, is that we have the JT for *Ploom* in the US. We have the capsule technology that we're excited to unveil at Investor Day. We would have global rights to that and then these licenses give us global rights to that IP.

Bonnie Herzog:

Okay, so in a few years. Appreciate it. Thank you.

Billy Gifford:

Thank you.

Operator:

Thank you. Our next question comes from Pamela Kaufman with Morgan Stanley.

Pamela Kaufman:

Hi. Good morning and congrats on the acquisition. I just wanted to dig into the assumption that you're making behind your accretion expectations for NJOY. Can you share your outlook for market share? What are you assuming for volume and profitability? Then does your accretion consider accelerated cigarette volume declines as you work to drive NJOY growth?

Billy Gifford:

Yes, that's a lot of details you're asking for there, Pamela. I think we try to provide extensive details in the release. From an acquisition model where we quoted the cash accretion within two years, you can think about that as that was built on the tobacco-only scenario even though we ran various scenarios on that. From a discount perspective, the discount rate we use was significantly higher than what we see as our weighted average cost of capital. We built all those assumptions in. What I don't want to do is unveil every single detail from a competitive standpoint of "this would be our approach to market" and "this is how we would approach the market" and we'll unveil that as we – we first have to get it to final close and then be able to launch in the marketplace.

Pamela Kaufman:

Okay, understood. Then just on the decision to exit the JUUL stake, was there a reason why you had to do this before acquiring NJOY? I guess, why not retain the JUUL upside optionality? Was that driven by potential antitrust concerns stemming from owning JUUL and buying NJOY or was it more about locking in the capital loss on JUUL?

Murray Garnick:

Hi, this is Murray. Look, as you know, we made the decision to compete in the e-vapor market when we terminated our non-compete with JUUL months ago. Exiting our minority interest in JUUL was simply the culmination of that process that we started months ago. And when we examined our options in the e-vapor market, we were incredibly impressed by NJOY and its people and it made no sense really to acquire NJOY while owning 35% of its competitor and so we exited that market. We now think that this transaction with NJOY is virtually a textbook case

of a transaction that is pro-competitive, so we look very much forward to that and closing this transaction.

Pamela Kaufman:

Thank you.

Operator:

As a reminder, if you would like to ask a question, please press star, one at this time. You can remove yourself from the queue by pressing star, two. Our next question will come from Priya Ohri-Gupta with Barclays.

Priya Ohri-Gupta:

[Audio Gap] the question and congratulations for the transaction. I have one administrative question around the short-term bank financing that you have in place. Is that a term loan or is it a bridge? I guess, would the expectation be to utilize that in order to have prepayable debt short-term or something that you could potentially refinance? Then I have another follow-up.

Sal Mancuso:

Well, Priya, you're right to point out that we do have committed short-term financing in the form of a bridge loan. What I would tell you is that we have multiple sources of funding as we stated in our opening remarks, right? They include our core businesses which are highly cash generative, a strong access to the credit markets to committed short-term financing you and I just spoke about and then of course, we have the PMI transition agreement which pays us \$2.7 billion, \$1 billion which we've received already and \$1.7 billion plus interest that we expect to receive in July of 2023. We're excited to have that optionality and of course, market conditions will determine the direction we go in at the time of closing.

Priya Ohri-Gupta:

Great. That's helpful and then do you have any sort of guidance you would give us in terms of the expected closing and then how quickly thereafter would you be able to utilize the sales force

to start getting NJOY into more retail locations? Because it seems like that's sort of the big gap that you guys can fill through expanded distributions, so if you would give us some context around that and how that flows into your cash accretion guidance for two years, that would be helpful. Thank you.

Murray Garnick:

Hi, this is Murray. Let me address the first part of the question. We have to go and obtain HSR clearance before we can close. We plan to file for HSR clearance within the next 40 days and then we'll be working with the FTC and hopefully, close as soon as possible.

Billy Gifford:

Yes, and then subsequent to that, certainly, prior to closing, we would have no services that we would give NJOY, but after closing, we would bring the full resources of Altria, so our sales force, our regulatory team, our government affairs team, all of that would be available subsequent to close.

Priya Ohri-Gupta:

Okay. Thank you so much.

Operator:

Thank you. Our next question comes from Pallav Mittal with Barclays.

Pallav Mittal:

Thank you. This is Pallav Mittal from Barclays on behalf of Gaurav Jain. I have a few questions. Firstly, there have been issues around leaky pods with NJOY, so are you planning to use the same product or are there any plans to apply for a PMTA for a new product and go live with that in the market?

Billy Gifford:

Yes. Appreciate the question. I think when you think about the consumer research we did, that didn't come up as an issue. I think all products in the marketplace have some slight leakage, but nothing of significance and we didn't see that as a huge issue with the consumer feedback we had in the consumer research. I think when you think about the authorization that's been granted, we would certainly keep the product in place, but as you saw on the release, this – now, we would be excited to have this new platform and the IP related to it in our product development and innovation system and that would allow us to build off of that, if you will, base IP for future iterations as we progress into the future.

Pallav Mittal:

Sure, and also the e-cigarette market in Europe currently is dominated by disposables, so do you have plans to go international with NJOY?

Billy Gifford:

Certainly, that's an opportunity. It's something that we're excited to be able to go explore, but it's too early to get into those details now.

Pallav Mittal:

Sure. Thank you.

Operator:

Thank you. Our next question comes from Chris Growe with Stifel.

Chris Growe:

Hi, good morning.

Billy Gifford:

Good morning, Chris.

Chris Growe:

Hi. Just two questions, and the first one, I've had a lot of questions from investors around, obviously, the losses created through the divestiture of the JUUL stake. Now, that you have that loss available to you, just to what degree that changes or maybe accelerates your viewpoint on that ABI stake, if I could start there, Billy? I have one more question, follow up on that?

Sal Mancuso:

Good morning, Chris. This is Sal. I'll take that. The way to think about the loss on the JUUL investment is the tax losses are about \$12.5 billion and the way I think about that is the original investment netted against the value of the heat-not-burn IP that we are receiving. Of course, the ability to use those tax losses depends on a variety of factors. I have nothing new to report on the ABI asset. As you know, it's an asset. It's a financial investment that we hold on our balance sheet, so any future plans, of course, we will communicate those to you, but nothing new to report on that.

Chris Growe:

Okay, and then just one question, Billy, for you in relation to NJOY. If you look over the last five to seven years in the development of e-vapor category, there's been a number of brands that have been leaders and then seemingly lose that leadership position. I guess, I just want to understand, and this goes a bit to Bonnie's earlier question, but just what makes this product unique and just in a world where there's very limited loyalty among consumers, can you develop that with NJOY? Just [talking] about its taste or the characteristics of the product that make it appealing for consumers that would allow it to sustain a leadership role in this category. Thank you.

Billy Gifford:

Yes, I think, Chris, through time, you're going to see loyalty in these new spaces that we experience in the tobacco category. When you see the consumer, they're trying various products. They're looking for products that satisfy their unmet needs and desires and once they find a satisfying product, it's up to us to build a brand around that. I think when you look at NJOY, and

I'd reference you back to the consumer research, it was both smokers looking to transition and how they rank the products in the marketplace as well as existing vapers, people that have already converted and their preference there. I think you see that we believe this is a strong asset because not only does it bring certainty around the authorization, but the consumer is telling us they have preference for this product over some of the other products in the marketplace. That's the way we think about it and are extremely excited to, again, have that base IP, have a product ready in the marketplace, but then be able to develop on it as we move forward.

Chris Growe:

Okay. Thank you.

Operator:

Thank you. We will now open the floor for members of media. Our next question will come from Jennifer Maloney with the Wall Street Journal.

Jennifer Maloney:

Good morning.

Billy Gifford:

Good morning, Jennifer.

Jennifer Maloney:

I was wondering if you could share the lessons that you'd take away from the investment in JUUL.

Billy Gifford:

Yes, I think when you think about it, and I was surprised we haven't got the question previously, what's different? I think when you think about it, I'd really differentiate it in three buckets. One is certainty, so this is an authorized product versus a pending product. There are no litigation challenges. The usage is at minimal and so that brings a level of certainty. I would say the other

is about control. This is about 100% ownership versus a minority investment. I think when you think about that and you think about certainty and control, that brings us significant level of clarity and that clarity is really related to what we can do to bring value enhancements immediately to the table. That clarity is around our sales force and the relationships they've built over decades that NJOY would take decades to build, we can bring that strength to the table, our responsible approach to the marketplace and continuing what we've seen NJOY do in the marketplace as their responsible approach. I think that's how I would differentiate the two.

Jennifer Maloney:

Moving forward, you never want a minority stake in anything ever again?

Billy Gifford:

I had a wise person tell me never to say never, but certainly, having control and certainty is significant in being able to set the future.

Jennifer Maloney:

Thank you.

Billy Gifford:

Thank you.

Operator:

Thank you. Once again, if you have a question, please press star, one at this time. [Pause] It appears there are no further questions at this time. I would like to turn the call back over to Mac Livingston for any closing remarks.

Mac Livingston:

Thanks, everybody, for joining us this morning. Please contact the Investor Relations team if you have further questions. Thanks and have a great day.

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