

## British American Tobacco

## FY23 results: Next-generation products turn to profits, balance sheet improved.

Reiterate Rating: BUY | PO: 2,900 GBp | Price: 2,319 GBp

## FY24 guidance in line. Profitable NGPs. ITC stake.

BAT reported FY23 sales of £27,283m (-1.1% vs cons), and adj. EBIT of £12,465m (-1.1% vs cons.). FY24 guidance of LSD org. growth, LSD adjusted operating profit growth implies minor EPS estimate downgrades, but in our view investors should focus on: (1) NGP profitability (vs breakeven previously) with growth ahead; and (2) Better net debt/EBITDA leverage than expected (2.6x vs 2.7x). We lower our FY24/25/26E EPS estimates by -0.4/-1.3/-1.2%. We continue to expect strong growth in ex-US NGPs, now driving profitability, and US sales to improve in 2H24. Reiterate Buy. PO GBp2,900/\$37/ZAR700 (was ZAR690) derived from adjusted present value methodology.

## FY24 guidance: Low-single-digit growth 2H24 weighted

BAT sees FY24 organic growth of LSD (cons: +1.0%) and LSD adj. operating profit growth (cons: +1.0%). As commercial actions continue in the US, we expect 1H24E adj. operating profit to fall below 1H23, but expect to see the US commercial actions to drive improvement in 2H24E. Management does not expect any improvement in the illicit vape market to drive its guidance in FY24E.

## Unexpected NGP profitability to continue growing

Previously, BAT announced the NGP portfolio would be breakeven in FY23. The group in fact posted £398m adj. operating profit for the portfolio. This sets a base for profitability that should improve further in FY24 and beyond. Vapour gross margins are reaching 60%, while Modern Oral is ahead of combustibles. Innovations in Heated Products (glo Hyper Air, veo (tobacco-free)) will continue their geographic roll-outs through the year, supporting growth and market share gains, in our view.

## Better leverage than expected. ITC stake: When, not if.

The group's leverage was better than consensus expectations (2.6x vs 2.7x), closing in on its mid-2-3x range target. Ongoing dividend growth (2.0%) should further reassure investors, while the group's high FCF generation should continue to enable deleveraging. Management's position on the ITC stake is becoming clearer: Once the regulatory/bureaucratic barriers are passed, it should start reducing its stake. This would further support the likelihood of a share buyback program, in our view.

Estimates (Dec) (GBp)	2022A	2023A	2024E	2025E	2026E
EPS (Adjusted Diluted)	371	376	380	410	442
EPS Change (YoY)	12.9%	1.1%	1.2%	7.8%	7.8%
Dividend / Share	231	236	239	266	287
Valuation (Dec)					
P/E	6.24x	6.17x	6.10x	5.66x	5.25x
Dividend Yield	9.96%	10.2%	10.3%	11.5%	12.4%
EV / EBITDA*	6.43x	6.93x	6.50x	6.23x	5.97x
Free Cash Flow Yield*	15.7%	16.2%	16.1%	17.0%	18.3%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 6.

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**Refer to important disclosures on page 7 to 10. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.**

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08 February 2024

## Equity

## Key Changes

(GBp)	Previous	Current
2024E EPS	381.53	379.90
2025E EPS	415.35	409.65
2026E EPS	447.57	441.72
2024E EBITDA (£m)	13,480.0	13,288.1
2025E EBITDA (£m)	14,077.5	13,854.7
2026E EBITDA (£m)	14,700.6	14,468.6
2024E DPS	247.99	239.34

Joffrey Bellicha Meller &gt;&gt;

Research Analyst

MLI (UK)

+44 20 7995 7497

joffrey.bellichameller@bofa.com

Antoine Prevot &gt;&gt;

Research Analyst

MLI (UK)

antoine.prevot@bofa.com

## Stock Data

Price (Ord, Ord, ADR)	2,319 GBp / 557.41 ZAR / 29.41 USD
Price Objective	2,900 GBp / 700.00 ZAR / 37.00 USD
Date Established	11-Jan-2024 / 7-Feb-2024 / 11-Jan-2024
Investment Opinion	A-1-7 / B-1-7 / B-1-7
52-Week Range	2,233 GBp-3,242 GBp
Market Val / Shares Out (mn)	51,863 GBP / 2,236.4
Average Daily Value (mn)	63.56 USD
BofA Ticker / Exchange	BTAFF / LSE
BofA Ticker / Exchange	XTALF / JNB
BofA Ticker / Exchange	BTI / NYS
Bloomberg / Reuters	BATS LN / BATS.L
ROE (2024E)	16.0%
Free Float	99.9%
ESGMeter <sup>TM</sup>	High

**ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company.** For full details, refer to "[BofA ESGMeter Methodology](#)".

## Glossary

NGP = Next-generation products

LSD = Low single digit

# iQprofile<sup>SM</sup> British American Tobacco

## Key Income Statement Data (Dec)

### (£ Millions)

	2022A	2023A	2024E	2025E	2026E
Sales	27,655	27,283	27,334	28,530	29,740
EBITDA Adjusted	13,428	12,465	13,288	13,855	14,469
Depreciation & Amortization	(1,305)	(1,323)	(2,478)	(2,512)	(2,547)
EBIT Adjusted	12,123	11,142	10,810	11,342	11,921
Net Interest & Other Income	(1,199)	(1,310)	(1,371)	(1,159)	(1,028)
Tax Expense / Benefit	(2,478)	2,872	(2,649)	(2,806)	(2,969)
Net Income (Adjusted)	8,420	8,379	8,476	9,063	9,609
Average Fully Diluted Shares Outstanding	2,267	2,231	2,231	2,212	2,175

## Key Cash Flow Statement Data

Net Income (Reported)	6,617	(14,011)	6,976	7,576	8,134
Depreciation & Amortization	1,305	1,323	2,478	2,512	2,547
Change in Working Capital	(285)	426	(293)	(309)	(325)
Deferred Taxation Charge	0	0	0	0	0
Other CFO	2,757	23,325	1,615	1,444	1,361
<b>Cash Flow from Operations</b>	<b>10,394</b>	<b>11,063</b>	<b>10,776</b>	<b>11,224</b>	<b>11,718</b>
Capital Expenditure	(625)	(547)	(550)	(719)	(749)
(Acquisition) / Disposal of Investments	(102)	(87.0)	(87.5)	(91.3)	(95.2)
Other CFI	187	195	87.5	91.3	95.2
<b>Cash Flow from Investing</b>	<b>(540)</b>	<b>(439)</b>	<b>(550)</b>	<b>(719)</b>	<b>(749)</b>
Share Issue / (Repurchase)	(2,012)	0	0	(1,000)	(1,200)
Cost of Dividends Paid	(5,073)	(5,160)	(5,363)	(5,405)	(5,913)
Increase (decrease) debt	3,481	(3,409)	(2,963)	(2,296)	(2,124)
Other CFF	(9,229)	1,111	1,063	491	393
<b>Cash Flow from Financing</b>	<b>(12,833)</b>	<b>(7,458)</b>	<b>(7,263)</b>	<b>(8,210)</b>	<b>(8,844)</b>
<b>Total Cash Flow (CFO + CFI + CFF)</b>	<b>(2,979)</b>	<b>3,166</b>	<b>2,963</b>	<b>2,296</b>	<b>2,124</b>
FX and other changes to cash	3,616	(1,953)	(2,963)	(2,296)	(2,124)
Change in Cash	637	1,213	0	0	0
Change in Net Debt	2,844	(4,622)	(2,963)	(2,296)	(2,124)
Net Debt (Reported)	39,693	35,071	32,108	29,813	27,689
Net Debt (Adjusted)	39,281	34,640	31,677	29,382	27,258

## Key Balance Sheet Data

Property, Plant & Equipment	4,867	4,583	4,199	3,942	3,675
Goodwill	0	0	0	0	0
Other Intangibles	129,075	95,562	94,019	92,482	90,951
Other Non-Current Assets	4,195	4,385	4,385	4,385	4,385
Trade Receivables	4,367	3,621	3,643	3,802	3,963
Cash & Equivalents	3,446	4,659	4,659	4,659	4,659
Other Current Assets	7,596	5,906	5,937	6,161	6,389
Total Assets	153,546	118,716	116,841	115,432	114,023
Long-Term Debt	38,726	35,406	32,443	30,148	28,024
Other Non-Current Liabilities	21,257	14,703	14,781	15,357	15,939
Short-Term Debt	4,413	4,324	4,324	4,324	4,324
Other Current Liabilities	13,440	11,349	11,413	11,884	12,360
Total Liabilities	77,836	65,782	62,961	61,712	60,646
Total Equity	75,710	52,934	53,879	53,720	53,377
Total Equity & Liabilities	153,546	118,716	116,841	115,432	114,023

## Business Performance\*

Return On Capital Employed	6.68%	7.49%	7.31%	7.86%	8.45%
Return On Equity	11.8%	13.1%	16.0%	17.0%	18.1%
Operating Margin	38.1%	-57.7%	39.5%	39.8%	40.1%
Free Cash Flow (MM)	8,276	8,360	8,326	8,701	9,237

## Quality of Earnings\*

Cash Realization Ratio	1.23x	1.32x	1.27x	1.24x	1.22x
Asset Replacement Ratio	0.61x	NA	0.69x	0.87x	0.87x
Tax Rate	26.6%	16.8%	28.1%	27.6%	27.3%
Net Debt/Equity	52.4%	66.3%	59.6%	55.5%	51.9%
Interest Cover	7.39x	5.88x	5.69x	6.29x	6.89x

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 6.

## Company Sector

Tobacco

## Company Description

London based British American Tobacco is the largest European tobacco company with operations in most major markets across the globe. The company's biggest market is the US, where it generates around 55% of EBIT. BAT's main brands are Kent, Dunhill, Lucky Strike, Pall Mall, Rothmans, Newport, Camel and Natural American Spirit. The company also plays in the Heated Tobacco category with its brand glo, in vaping where its main brand is Vuse and in Modern Oral with Velo.

## Investment Rationale

Our Buy rating on BAT is based on three key points: 1) The next-generation product portfolio now represents c.13% of revenues and is breaking even, offsetting in our view the negative regulatory risks in US menthol cigarettes, 2) US market shares are stabilizing and volume declines should normalize, 3) The group's high FCF generation offers ample room to deleverage and then restart a share buyback program.

## Stock Data

Price to Book Value

1.0x

## BofA Old vs New estimates

### Exhibit 1: BofA Old vs New estimates

BofAe EPS FY24/25/26 decline by -0.4/-1.3/-1.2% respectively

€ mn	2024E			2025E			2026E		
	New	Old	% change	New	Old	% change	New	Old	% change
<b>Revenue</b>	<b>27,334</b>	<b>27,839</b>	<b>-1.8%</b>	<b>28,530</b>	<b>29,106</b>	<b>-2.0%</b>	<b>29,740</b>	<b>30,335</b>	<b>-2.0%</b>
<b>EBITDA</b>	<b>13,288</b>	<b>13,473</b>	<b>-1.4%</b>	<b>13,855</b>	<b>14,069</b>	<b>-1.5%</b>	<b>14,469</b>	<b>14,691</b>	<b>-1.5%</b>
US	6,632	6,719	-1.3%	6,813	6,903	-1.3%	7,039	7,130	-1.3%
AME	9,974	9,557	4.4%	10,600	10,210	3.8%	11,263	10,855	3.8%
APMEA	5,725	6,258	-8.5%	5,999	6,566	-8.6%	6,193	6,789	-8.8%
EBITDA margin (%)	48.6%	48.4%		48.6%	48.3%		48.7%	48.4%	
<b>EBIT</b>	<b>12,495</b>	<b>12,666</b>	<b>-1.3%</b>	<b>13,027</b>	<b>13,225</b>	<b>-1.5%</b>	<b>13,606</b>	<b>13,811</b>	<b>-1.5%</b>
EBIT margin (%)	45.7%	45.5%		45.7%	45.4%		45.8%	45.5%	
<b>EPS</b>	<b>379.90</b>	<b>381.33</b>	<b>-0.4%</b>	<b>409.65</b>	<b>415.11</b>	<b>-1.3%</b>	<b>441.72</b>	<b>447.29</b>	<b>-1.2%</b>
DPS	239.34	247.87	-3.4%	266.27	269.82	-1.3%	287.12	290.74	-1.2%
FCF	8,326	8,554	-2.7%	8,701	9,025	-3.6%	9,237	9,582	-3.6%
Net Debt (cash)	31,677	33,503	-5.5%	29,382	31,076	-5.5%	27,258	28,691	-5.0%
EV/EBITDA	5.3x	5.5x	-4.7%	5.0x	5.3x	-4.6%	4.8x	5.1x	-4.6%
PE	6.2x	6.2x	0.4%	5.7x	5.7x	1.3%	5.3x	5.2x	1.3%
FCF yield (%)	15.9%	16.4%		16.6%	17.3%		17.6%	18.4%	
ND/EBITDA	2.3x	2.4x	-4.2%	2.1x	2.2x	-4.1%	1.8x	1.9x	-3.6%

Source: BofA Global Research estimates

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## Valuation: Reiterate Buy

We reiterate our Buy rating and mildly adjust our South African PO from ZAR690 to ZAR700 driven by FX. Our other POs remain unchanged (GBp2,900/USD37). Our valuation is based on an adjusted present valuation model, detailed below, with unchanged drivers.

### Exhibit 2: Free cash flow net present value derivation table

Drivers unchanged: Beta 1.0, risk free rate 3.5%, equity risk premium 6.0%, regulatory risk premium 3.0%, terminal growth -1.0%

	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	TV
Net Revenue	27,334	28,530	29,740	30,977	31,751	32,545	33,196	
EBITA (after restructuring)	12,495	13,027	13,606	14,207	13,812	13,994	13,942	
Other charges/income	-110	-110	-110	-110	-110	-110	-110	
Depreciation	793	827	862	898	800	820	837	
Decrease/(Increase) in working capital	-293	-309	-325	-343	-351	-360	-367	
<b>Operating Cash Flow</b>	<b>12,885</b>	<b>13,436</b>	<b>14,033</b>	<b>14,653</b>	<b>14,151</b>	<b>14,345</b>	<b>14,302</b>	
Net CapEx	-550	-719	-749	-781	-800	-820	-837	
Tax	-2,649	-2,806	-2,969	-2,969	-3,370	-3,485	-3,541	
<b>Free Cash Flow</b>	<b>9,686</b>	<b>9,911</b>	<b>10,315</b>	<b>10,904</b>	<b>9,981</b>	<b>10,040</b>	<b>9,924</b>	
Discount factor	0.95	0.85	0.75	0.66	0.59	0.52	0.46	
<b>Discounted Free Cash Flow</b>	<b>9,232</b>	<b>8,377</b>	<b>7,730</b>	<b>7,245</b>	<b>5,878</b>	<b>5,243</b>	<b>4,595</b>	<b>33,339</b>
Revenue Growth	0.6%	4.4%	4.2%	4.2%	2.5%	2.5%	2.0%	
EBITA margin	45.7%	45.7%	45.8%	45.9%	43.5%	43.0%	42.0%	
CapEx/Depreciation	69%	87%	87%	87%	100%	100%	100%	
Depreciation/Sales	2.9%	2.9%	2.9%	2.9%	2.5%	2.5%	2.5%	
Net Capex/Sales	2.0%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	
Underlying Tax Rate	23.8%	23.8%	23.8%	23.8%	24.4%	24.9%	25.4%	
<b>Tax Shield</b>								
Cost of Debt (pre tax)	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	
Net Debt	31,677	29,382	27,258	24,926	17,534	17,778	17,735	
Interest	-1,790	-1,660	-1,540	-1,408	-991	-1,004	-1,002	
Tax shield	426	395	367	335	242	250	255	
Discount factor	0.98	0.94	0.90	0.87	0.83	0.80	0.77	
<b>Discounted Tax Shield</b>	<b>419</b>	<b>373</b>	<b>331</b>	<b>291</b>	<b>201</b>	<b>200</b>	<b>195</b>	<b>3,617</b>

Source: BofA Global Research estimates



Exhibit 2: Free cash flow net present value derivation table

Drivers unchanged: Beta 1.0, risk free rate 3.5%, equity risk premium 6.0%, regulatory risk premium 3.0%, terminal growth -1.0%

	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	TV
								BofA GLOBAL RESEARCH

Exhibit 3: PO derivation table

Derivation table implies £29 PO, or £65.6bn market cap

PO derivation table	£m
Free Cash Flow NPV	81,639
Net Debt	-34,640
Non-controlling interest	1,424
Associates	15,758
Equity Value	59,539
Tax shield	6,037
Implied share price	65,576
Price Objective (12 months)	29

Source: BofA Global Research estimates

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## Price objective basis & risk

### British American Tobacco (BTAFF)

Our PO of £29/ZAR700/\$37 is based on the Adjusted Present Value methodology (a variation of the DCF) whereby we discount the business' operating cash flows at the cost of equity (for BAT we use 12.8%, inclusive of 3.0% regulatory/litigation risk premium) and the tax shield at the cost of debt (4.5%). We assume a terminal growth rate of -1%.

Upside risks to our PO are a relaxation of the regulatory risk faced by the sector, a better than expected sales performance of Next Generation Products (both on sales and margins) and reversal of market share losses in the US .

Downside risks to our PO are an intensification of the regulatory risk (especially in the US), lower-than-expected sales performance in vaping and THP, market share losses, weaker than expected US combustibles market.

## Analyst Certification

I, Joffrey Bellicha Meller, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### EMEA - HPC, Food & Tobacco Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Beiersdorf	BDRFF	BEI GY	Victoria Petrova
	Beiersdorf	BDRFY	BDRFY US	Victoria Petrova
	British American Tobacco	BTAFF	BATS LN	Joffrey Bellicha Meller
	British American Tobacco	BTI	BTI US	Joffrey Bellicha Meller
	British American Tobacco	XTALF	BTI SJ	Joffrey Bellicha Meller
	Haleon	HLNCF	HLN LN	Victoria Petrova
	Haleon	HLN	HLN US	Victoria Petrova
	Henkel	HENOF	HENOF US	Victoria Petrova
	Henkel	HENOF	HEN3 GY	Victoria Petrova
	Nestle	NSRGF	NESN SW	Victoria Petrova
	Nestle	NSRGY	NSRGY US	Victoria Petrova
<b>NEUTRAL</b>				
	Imperial Brands	IMBBF	IMB LN	Joffrey Bellicha Meller
	Imperial Brands	IMBBY	IMBBY US	Joffrey Bellicha Meller
	Reckitt Benckiser	RBGPF	RKT LN	Victoria Petrova
	Reckitt Benckiser	RBGLY	RBGLY US	Victoria Petrova
<b>UNDERPERFORM</b>				
	Danone	DANOY	DANOY US	Victoria Petrova
	Danone	GPDNF	BN FP	Victoria Petrova
	Unilever	UL	UL US	Victoria Petrova
	Unilever	UNLYF	ULVR LN	Victoria Petrova
	Unilever	UNLVF	UNA NA	Victoria Petrova
<b>RSTR</b>				
	Essity	ETTYF	ESSITYB SS	Othmane Bricha
<b>RVW</b>				
	BIC	BICEF	BB FP	Othmane Bricha
	Ontex	ONXXF	ONTEX BB	Othmane Bricha



## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

iQmethod<sup>SM</sup> is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

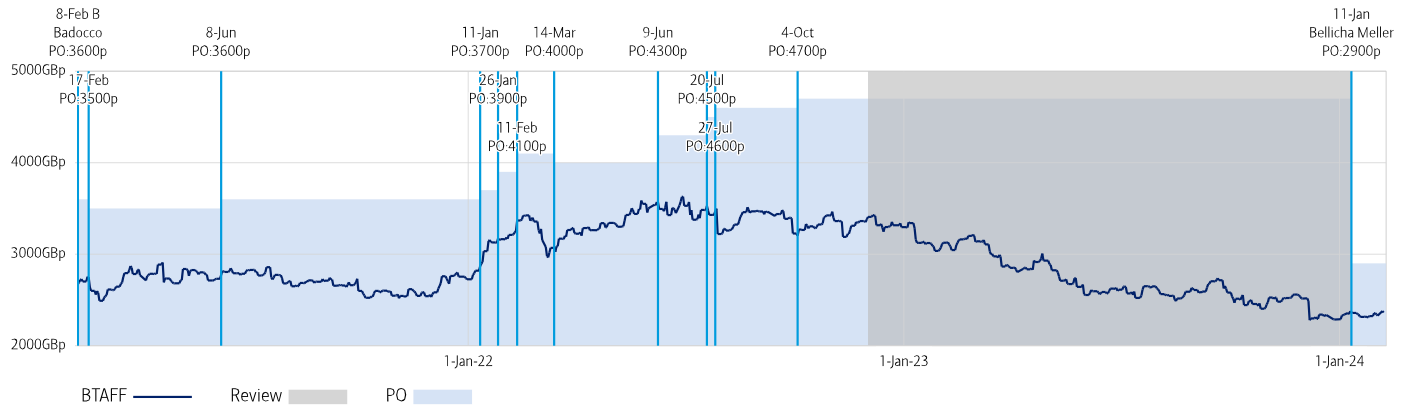
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# Disclosures

## Important Disclosures

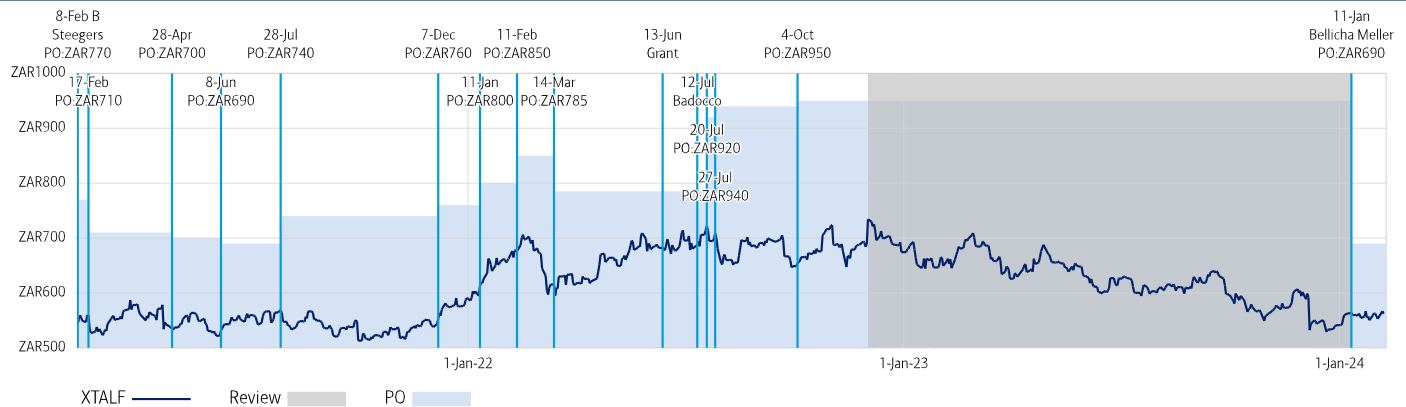
### BAT (BTAFF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

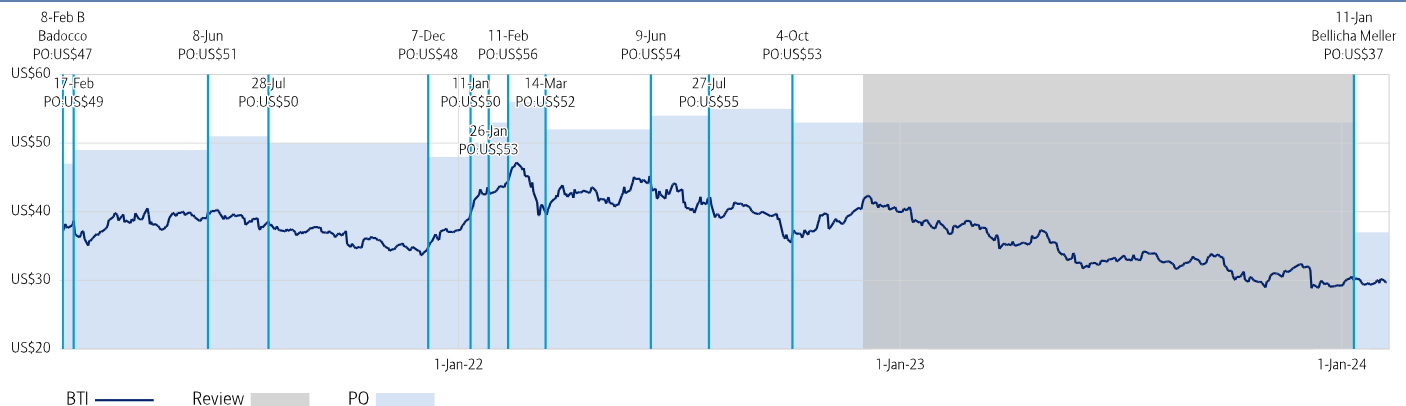
### BAT (XTALF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### BAT (BTI) Price Chart



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**Equity Investment Rating Distribution: Tobacco Group (as of 31 Dec 2023)**

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	3	60.00%	Buy	1	33.33%
Hold	1	20.00%	Hold	0	0.00%
Sell	1	20.00%	Sell	0	0.00%

**Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)**

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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