

British American Tobacco

Share buyback = Unlocking the value pack.

Reiterate Rating: BUY | PO: 3,000 GBp | Price: 2,341 GBp

Partial ITC stake disposal. Share buyback. Unlocking value.

BAT announced the disposal of 3.5% of its 29% ITC stake (now 25.5%), which generated c.£1.5bn in net proceeds. The group will return the net proceeds to shareholders through a share buyback program (of which £700m in 2024) ending in 2025. BAT also seized the opportunity to update their net debt/EBITDA leverage target to 2-2.5x, aligning with global tobacco peers. We therefore incorporate the £700m SBB in 2024, reduce our share buyback in 2025 from £1bn to £800m, leading to mild EPS (and DPS) increases in FY24/25/26E. We reiterate our Buy rating, and increase PO to GBp3,000/ZAR730/\$39 (was GBp2,900/ZAR700/\$37) based on adjusted present value.

Improving shareholder returns and lower leverage target

With the disposal of 3.5% of its 29% (now 25.5%) ITC stake, BAT unlocked £1.5bn that it will return to shareholders until 2025-end, through a share-buyback program. We expect the group to now have an ongoing SBB program as part of its capital allocation framework. In our view, this first disposal of ITC shares is a proof point of the liquidity of this stake (currently representing 24% of BAT's market cap). Furthermore, the company changed its Net debt/EBITDA target from 2-3x to 2-2.5x, indicating 2.5x is now a ceiling for the management team (BofA FY24E: 2.3x). This enables the group to be more aligned with global peers' targets.

Cheap with US market share close to trough

We reiterate our Buy rating on BAT, as: 1) We see the group's commercial actions in the US leading to market share stabilization near-term, 2) BAT's next-generation products portfolio is now breakeven, and should further contribute to earnings increase, 3) The group's high free cash flow conversion will continue to support elevated shareholder returns. Additionally, the US states are taking the matter of illicit vapes in their own hands (still 50-60% of US vape market), as Louisiana implemented a bill in late 2023, which we expect to be soon followed by the state of Virginia. Unlocking the US vape market would benefit BAT's leading Vuse brand, and further support the profitability trajectory of its NGP portfolio. BAT shares currently trade on 6.2x 2024 PE, a 37% discount to global tobacco peers (historically 14%), offering a particularly attractive opportunity, and dividend yield (10.1%).

Estimates (Dec) (GBp)	2022A	2023A	2024E	2025E	2026E
EPS (Adjusted Diluted)	371	375	382	411	442
EPS Change (YoY)	12.9%	0.9%	1.9%	7.5%	7.6%
Dividend / Share	231	236	241	267	287
Valuation (Dec)					
P/E	6.30x	6.24x	6.13x	5.70x	5.30x
Dividend Yield	9.87%	10.1%	10.3%	11.4%	12.3%
EV / EBITDA*	6.41x	6.57x	6.48x	6.21x	5.95x
Free Cash Flow Yield*	15.6%	16.0%	15.8%	16.8%	18.0%

* For full definitions of *IQmethod™* measures, see page 5.

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Timestamp: 18 March 2024 01:30AM EDT

18 March 2024

Equity

Key Changes

(GBp)	Previous	Current
Price Obj.	2,900.00	3,000.00
2024E EPS	379.90	382.10
2025E EPS	409.65	410.85
2026E EPS	441.72	441.94
2024E DPS	239.34	240.72

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Stock Data

Price (Ord, Ord, ADR)	2,341 GBp / 563.97 ZAR / 30.30 USD
Price Objective	3,000 GBp / 730.00 ZAR / 39.00 USD
Date Established	18-Mar-2024 / 18-Mar-2024 / 18-Mar-2024
Investment Opinion	A-1-7 / B-1-7 / B-1-7
52-Week Range	2,233 GBp-3,022 GBp
Market Val / Shares Out (mn)	52,343 GBp / 2,236.4
Average Daily Value (mn)	127.86 USD
BofA Ticker / Exchange	BTAFF / LSE
BofA Ticker / Exchange	XTALF / JNB
BofA Ticker / Exchange	BTI / NYS
Bloomberg / Reuters	BATS LN / BATS.L
ROE (2024E)	16.1%
Free Float	99.7%
ESGMeter™	NA

SBB = Share buyback

NGP = Next-generation products

BAT= British American Tobacco

iQprofileSM 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	13,108	13,288	13,855	14,469
Depreciation & Amortization	(1,305)	(1,323)	(2,478)	(2,512)	(2,547)
EBIT Adjusted	12,123	11,785	10,810	11,342	11,921
Net Interest & Other Income	(1,199)	(1,310)	(1,366)	(1,220)	(1,087)
Tax Expense / Benefit	(2,478)	2,872	(2,649)	(2,806)	(2,969)
Net Income (Adjusted)	8,420	8,365	8,480	9,002	9,550
Average Fully Diluted Shares Outstanding	2,267	2,231	2,219	2,191	2,161

Key Cash Flow Statement Data

Net Income (Reported)	6,617	(14,011)	6,981	7,514	8,074
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	1,513	1,402	1,306
Cash Flow from Operations	10,394	11,063	10,679	11,120	11,603
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
Cash Flow from Investing	(540)	(439)	(550)	(719)	(749)
Share Issue / (Repurchase)	(2,012)	0	(700)	(800)	(1,000)
Cost of Dividends Paid	(5,073)	(5,160)	(5,335)	(5,384)	(5,891)
Increase (decrease) debt	3,481	(3,409)	(3,694)	(2,412)	(2,231)
Other CFF	(9,229)	1,111	3,294	608	500
Cash Flow from Financing	(12,833)	(7,458)	(6,435)	(7,988)	(8,622)
Total Cash Flow (CFO + CFI + CFF)	(2,979)	3,166	3,694	2,412	2,231
FX and other changes to cash	3,616	(1,953)	(3,694)	(2,412)	(2,231)
Change in Cash	637	1,213	0	0	0
Change in Net Debt	2,844	(4,622)	(3,694)	(2,412)	(2,231)
Net Debt (Reported)	39,693	35,071	31,377	28,965	26,734
Net Debt (Adjusted)	39,281	34,640	30,946	28,534	26,303

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	92,519	90,982	89,451
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	115,341	113,932	112,523
Long-Term Debt	38,726	35,406	31,712	29,300	27,069
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	62,231	60,864	59,691
Total Equity	75,710	52,934	53,110	53,068	52,832
Total Equity & Liabilities	153,546	118,716	115,341	113,932	112,523

Business Performance*

Return On Capital Employed	6.68%	7.92%	7.36%	7.96%	8.56%
Return On Equity	11.8%	13.1%	16.1%	17.1%	18.2%
Operating Margin	38.1%	-57.7%	39.5%	39.8%	40.1%
Free Cash Flow (MM)	8,276	8,360	8,229	8,596	9,122

Quality of Earnings*

Cash Realization Ratio	1.23x	1.32x	1.26x	1.24x	1.21x
Asset Replacement Ratio	0.61x	0.85x	0.69x	0.87x	0.87x
Tax Rate	26.6%	16.8%	28.0%	27.7%	27.4%
Net Debt/Equity	52.4%	66.3%	59.1%	54.6%	50.6%
Interest Cover	7.39x	6.22x	5.69x	6.29x	6.89x

* For full definitions of iQmethodSM measures, see page 5.

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 continue its share buyback program.

Stock Data

Price to Book Value

1.0x

Valuation

Exhibit 1: Discounted cash flow table

12.8% cost of equity, 4.5% cost of debt, and -1% terminal growth rate

	FY24	FY25	FY26	FY27	FY28	FY29	FY30	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	
Operating Cash Flow	12,885	13,436	14,033	14,653	14,151	14,345	14,302	
Net CapEx	-550	-719	-749	-781	-800	-820	-837	
Tax	-2,649	-2,806	-2,969	-2,969	-3,370	-3,485	-3,541	
Free Cash Flow	9,686	9,911	10,315	10,904	9,981	10,040	9,924	
Discount factor	0.97	0.86	0.76	0.67	0.59	0.53	0.47	
Discounted Free Cash Flow	9,349	8,475	7,813	7,316	5,931	5,285	4,628	33,326
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%	
Tax Shield								
Cost of Debt (pre tax)	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	
Net Debt	30,946	28,534	26,303	24,068	17,534	17,778	17,735	
Interest	-1,748	-1,612	-1,486	-1,360	-991	-1,004	-1,002	
Tax shield	416	384	354	324	242	250	255	
Discount factor	0.99	0.95	0.91	0.87	0.84	0.80	0.77	
Discounted Tax Shield	411	363	321	282	202	201	196	3,645

Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Exhibit 2: PO derivation table

Reduced share count in 2024 year-end leads to PO increase to Gbp3,000

PO derivation table	£m
Free Cash Flow NPV	82,123
Net Debt	-34,640
Non-controlling interest	1,424
Associates	12,583
Equity Value	61,491
Tax shield	6,035
Implied share price	67,525
Price Objective (12 months)	30

Source: BofA Global Research estimates

BofA GLOBAL RESEARCH

Price objective basis & risk

British American Tobacco (BTAF / BTI)

Our PO of £30/ZAR730/\$39 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.

British American Tobacco (XTALF)

Our PO of £30/ZAR730/\$39 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.

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, accelerated negative brand mix from NGPs, market share losses, lower-than-expected cost efficiencies/synergies and acceleration in the rise of interest rates.

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
BUY				
	Beiersdorf	BDRFF	BEI GY	Victoria Petrova
	Beiersdorf	BDRFY	BDRFY US	Victoria Petrova
	British American Tobacco	BTAF	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

EMEA - HPC, Food & Tobacco Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Nestle	NSRGY	NSRGY US	Victoria Petrova
NEUTRAL				
	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
UNDERPERFORM				
	Danone	DANOY	DANOY US	Victoria Petrova
	Danone	GPDF	BN FP	Victoria Petrova
	Unilever	UL	UL US	Victoria Petrova
	Unilever	UNLYF	ULVR LN	Victoria Petrova
	Unilever	UNLVF	UNA NA	Victoria Petrova
RSTR				
	Essity	ETTYF	ESSITYB SS	Othmane Bricha
RVW				
	BIC	BICEF	BB FP	Othmane Bricha
	Ontex	ONXXF	ONTEX BB	Othmane Bricha

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

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

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

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

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Amortization
Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

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

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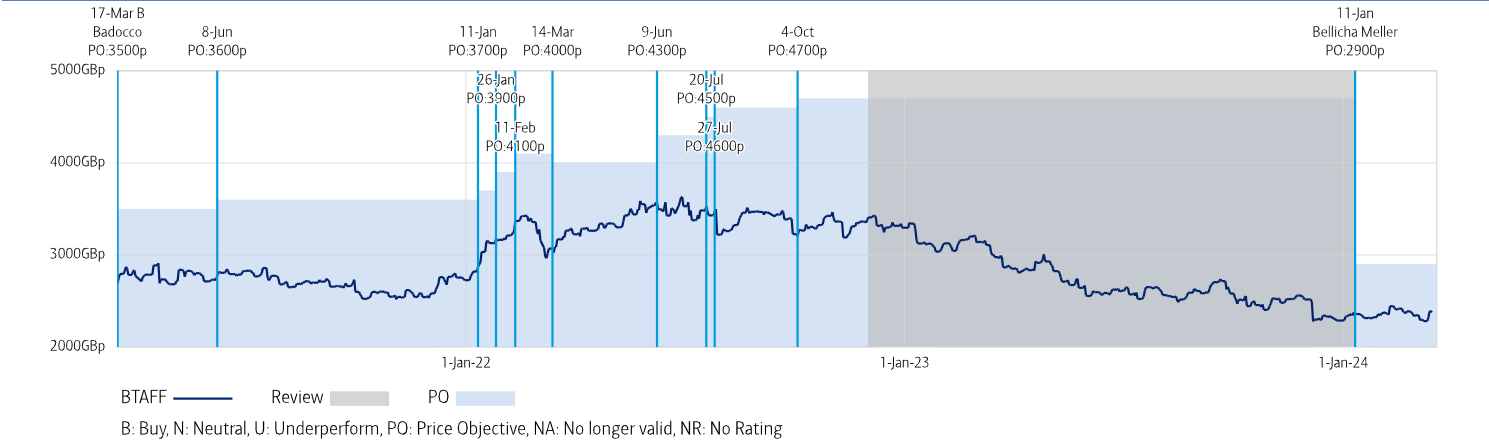
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Disclosures

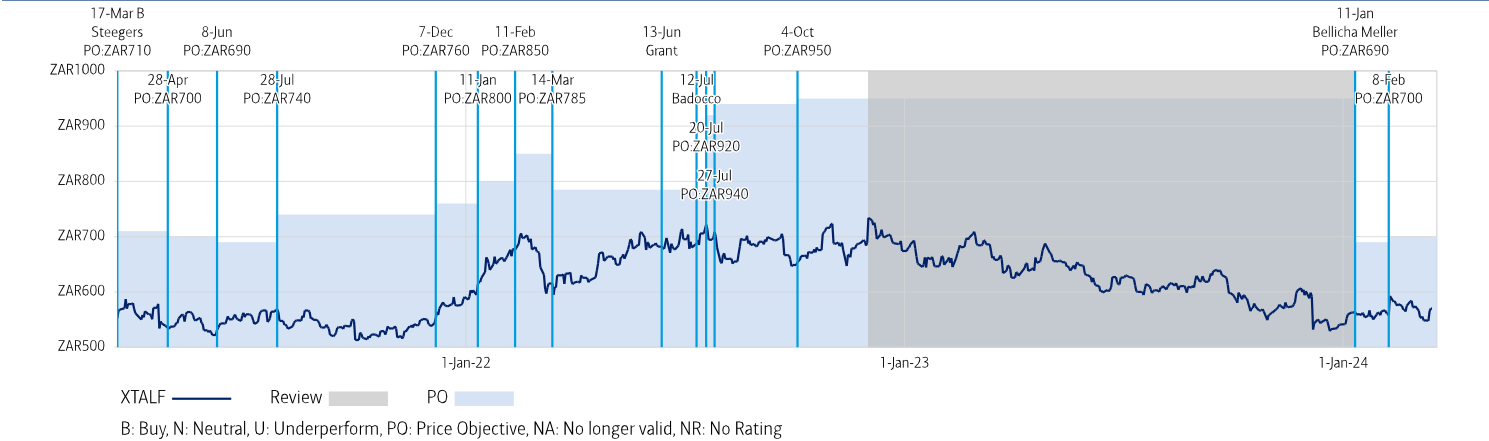
Important Disclosures

BAT (BTAFF) Price Chart



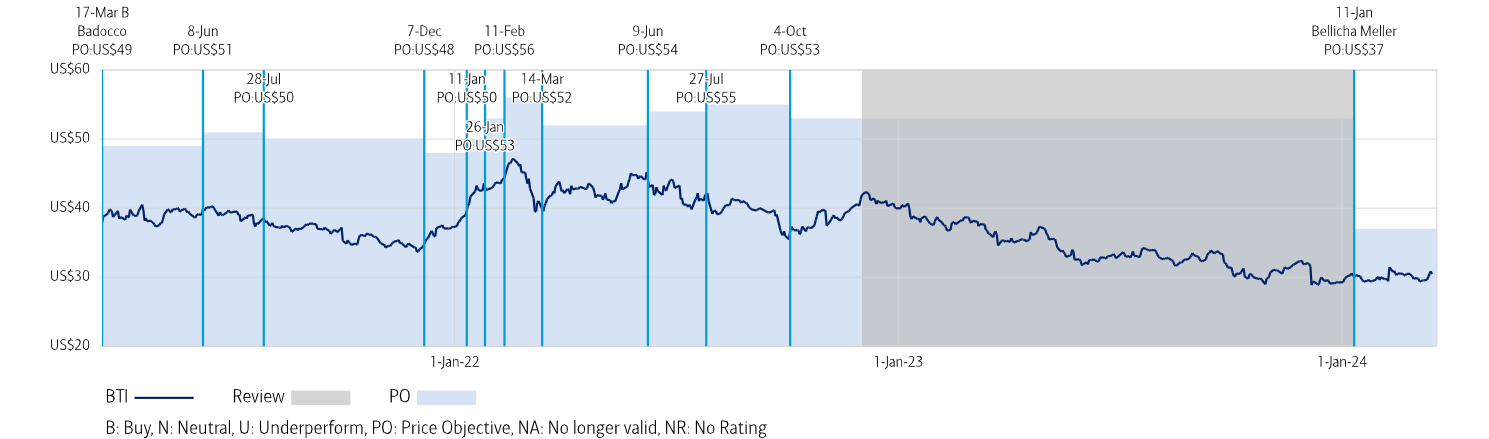
The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey 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



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



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.



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

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	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 ^{R1}	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%

^{R1} 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 ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} 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.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. *Coverage Cluster* is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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The issuer is or was, within the last 12 months, a non-securities business client of BofAS and/or one or more of its affiliates: BAT.

BofAS or an affiliate has received compensation for investment banking services from this issuer within the past 12 months: BAT.

BofAS or an affiliate expects to receive or intends to seek compensation for investment banking services from this issuer or an affiliate of the issuer within the next three months: BAT.

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Other Important Disclosures

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