

# British American Tobacco

Consumer Staples

**Hold**

## Company Update Report

Combustible volume decline and lower than expected NGP growth lowers our forecasts and cuts our target price.

### Analyst recommendation

Table 1: Analyst recommendation

Counter	Share price	Intrinsic value	Difference
British American Tobacco	£33.19	£32.73	1.4% downside

2 June 2025

### Executive summary

1. Declines in cigarette volumes do not seem to be mitigating, while the illicit vapour market continues to be worse than expected. However, the modern oral category is stronger than expected which partially offsets the other two issues.
2. Key points in the investment thesis are:
  - a. Management states that illicit vapour in the US account for 70% of sales and possibly 80%. The FDA is moving too slowly at the frustration of management. Aim for 50% smoke-free products by 2035.
  - b. US cigarette sales surprised on the downside with volumes down in the high single digits in the past 18 months. This was against the expectation of 3-5%. Going forward it is expected at low single digits. Vapour revenue was down 5% against an expectation of low teen positive growth.
  - c. £900 million in share buybacks expected in FY25. This was before another 2.5% sale of the stake in ITC which will raise an additional £200 million in buybacks taking the total to £1.1 billion for FY25.
  - d. NGPs still growing strongly and have turned to a profit. 46% modern oral growth for FY24 doesn't seem to be slowing as Velo continues to take market share and NielsenIQ data shows a 4-week year-on-year volume growth of 249.7% on 22 March 2025. This should surprise on the upside in 1H2025.
  - e. Company sitting on a dividend yield of 7.5% and forward PE of 9.5, 60% lower than Philip Morris.
3. We have an intrinsic value of £32.73 per share (down from £34.08 previously) and we maintain a Hold recommend.
  - a. Conservative revenue growth estimate of 2% for 2025-2026 after experiencing negative growth in 2024. EBIT margins remain strong at 46% and we forecast a 2026 EBITDA of £12.6 billion (down from £13.4 billion previously).
  - b. Assumption of no growth in the cigarette business with company falling short of its 2025 NGP target of £5 billion. Surprises on the upside could come from the modern oral segment (as discussed above) and a "less bad" outcome from cigarette volume declines.
  - c. Share price has run hard in the last year (up 38% on a price return basis). This has resulted in the share price reaching our intrinsic value and we changed our recommendation from a buy to a hold in February.



4. What would make us change our minds?
  - a. Modern oral segment revenue numbers reflecting the NielsenIQ data and competing with Philip Morris's Zyn offering.
  - b. Lower than expected decline in US cigarette volumes.

**Table 2: Qualitative summary**

Factor review	Rating	Description
<b>Valuation</b>		
Growth		Cigarette growth expected to be relatively flat with price increases offsetting volume declines whilst high growth in NGP business, however it is still a small part of revenue. Revenue is expected to be flat in 2025 and then low single digits growth in 2026.
Valuation		Value the company on a EV/EBITDA valuation with a 1.4% downside.
Dividend yield		Dividend yield of 7.5%
Issuance		Management has been buying back shares in with £700 million bought back in FY24 and £1.1 billion expected in FY25,
Catalyst		<ul style="list-style-type: none"> <li>Continued market share appreciation in Next Generation Products and FDA regulation on illicit vapes.</li> <li>Share buybacks.</li> <li>Slower than expected decline in the cigarette business.</li> </ul>
<b>Quality</b>		
Quality of earnings		Consistent, reliable and industry leading margins. Very few adjustments and non-IFRS reporting.
Moat		High brand power and loyalty in the cigarette business with competitive pricing power, however the threat of new market entrants in the NGP category could pose future threats to market share appreciation.
Management and governance		Long tenured management team with inside ownership of 12.5%.
Balance sheet		Neutral balance sheet with higher than usual debt levels, however management is focused on reducing this debt which is due to their acquisition of Reynolds American in 2017. Targeted Net Debt/EBITDA of sub-2.5x and it is currently 2.44x. Balance sheet is much stronger than five years ago and no longer an issue.
<b>Macro and quantitative sensitivities</b>		
Risks	<b>Upside risk</b> <ul style="list-style-type: none"> <li>Continued market share growth in Next Generation Products in the USA.</li> <li>NGP to start contributing meaningfully to profits</li> </ul>	
	<b>Downside risk:</b> <ul style="list-style-type: none"> <li>Higher than expected decline in the cigarette business.</li> <li>Litigation issues and "once-off" charges. This has happened twice in the last 18 months (write down of Reynolds American business and Canadian lawsuit settlement). Whilst these are not forecastable, they have had material impacts on the share price.</li> </ul>	



Regulation		Highly regulated industry. The tobacco industry faces an issue whereby the legitimate players are over regulated whilst the illicit market isn't regulated enough. Management is frustrated with the lack of action from the FDA.
ESG		Neutral rating on FactSet with a core 52/100. The tobacco industry faces headwinds on an ESG basis; however Next Generation Products is bringing it more in line.
Momentum price		Price momentum is positive, share price is above the 50 day and the 200-day moving average.
Momentum earnings		Neutral earnings momentum. In the last three months the earnings have been flat for the next financial year.
Piotroski Score		Piotroski score of seven out of nine.

Source: PSG Wealth

## Most recent results

On 13 February 2025, British American Tobacco released full year results for FY24.

1. Total revenue declined 6.4% to £25.9 billion, due to regulatory issues in Bangladesh and Australia as well as larger than expected decline in cigarette volumes in the US. DEPS was up 2% to 2400.24p/share.
2. Combustibles revenue was flat with price increases of 5.3% offsetting volume declines of 5.2%.
3. Profit from operations came in £2.7 billion impacted by a once off £6.2 billion charge related to provisioning for the settlement in Canada.
4. NGPs increased by £251 million and now have a contribution margin of 7.1%.
5. Adjusted net debt/EBITDA now sits at 2.44x, below the target of 2.54x.
6. A mixed bag of category performance with vapour disappointing at -5%, but Modern Oral growing at 46%, ahead of expectations.
7. Guidance remained unchanged at 1% revenue growth and share buybacks continue. Management guided for £700 million in FY24 (now completed) and a further £900 million in FY25. (Subsequently a further £200 million in share buybacks has been announced taking the total to £1.1 billion).

## Trading Update

On 3 June 2025 the company released a short trading update.

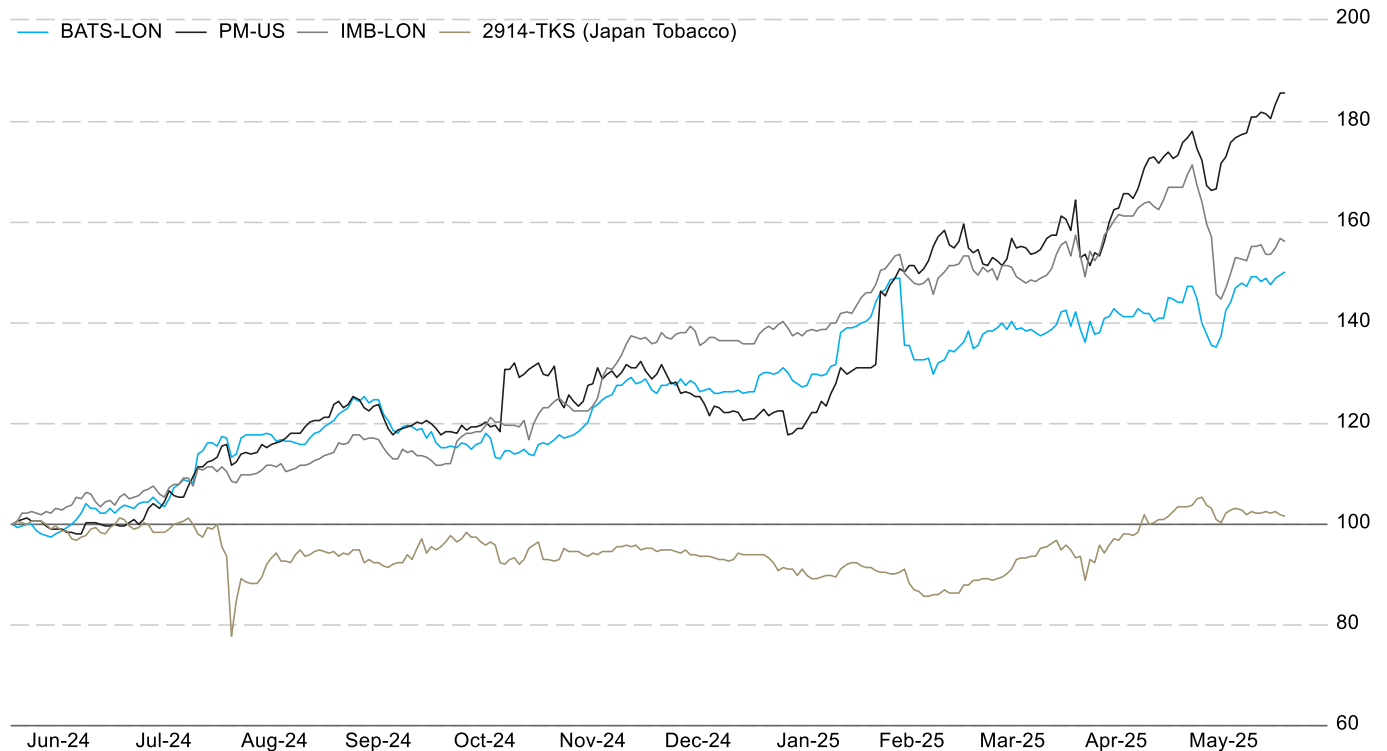
1. Revenue guidance raised to 1-2% from the previous 1%.
2. Global tobacco volume expected to be down 2%.
3. Strong global growth from Velo, the modern oral segment, and fastest growing segment.
4. Impact of Bangladesh and Australian excise duties and regulatory hurdles to play out through 2025.
5. Reaffirmed mid-term guidance of 3-5% revenue growth in 2026.



## Past 12 months performance

Over the past 12 months, tobacco stocks have been on a strong run, except for Japan Tobacco. On a total return basis BATS is up 48% in the last year whilst Philip Morris is up 85% and Imperial Brands is up 56%. These stocks are high dividend payers with BATS yielding 7% whilst Philip Morris yields 3%, above the market average. After a strong performance from the tech sector in 2024 and a volatile 2025 the defensive nature of these stocks has exceeded expectations.

**Graph 1: Total Return relative performance**



Source: Factset

**Table 3: Total Return performance**

Total Return	YTD	1M	3M	6M	1Y	2Y	3Y	5Y	10Y
British American Tobacco p.l.c.	18.9%	4.3%	10.3%	18.2%	47.8%	49.1%	14.6%	38.2%	51.5%
MSCi World Index	3.2%	4.3%	1.8%	0.7%	12.8%	38.8%	47.9%	94.8%	176.7%
Out / (Underperformance)	15.6%	0.0%	8.5%	17.5%	35.1%	10.2%	-33.3%	-56.5%	-125.2%

Source: FactSet

2 June 2025

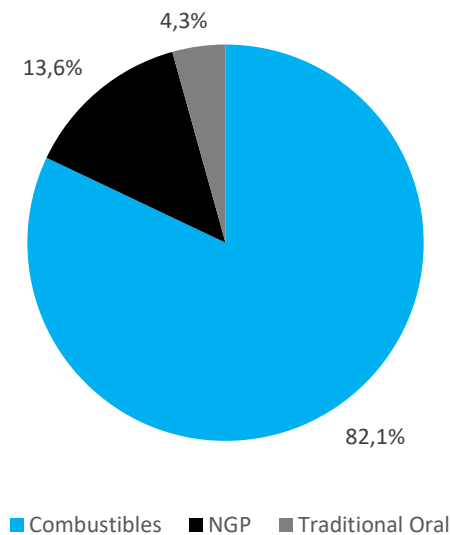


## Overview

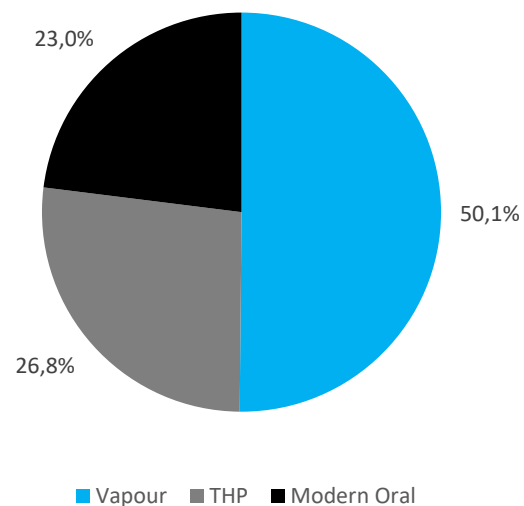
The company consists of three operating segments namely:

1. Combustibles & Other
2. Next Generation Products
3. Traditional Oral

Graph 2: Revenue Split FY24



Graph 3: NGP Split FY24

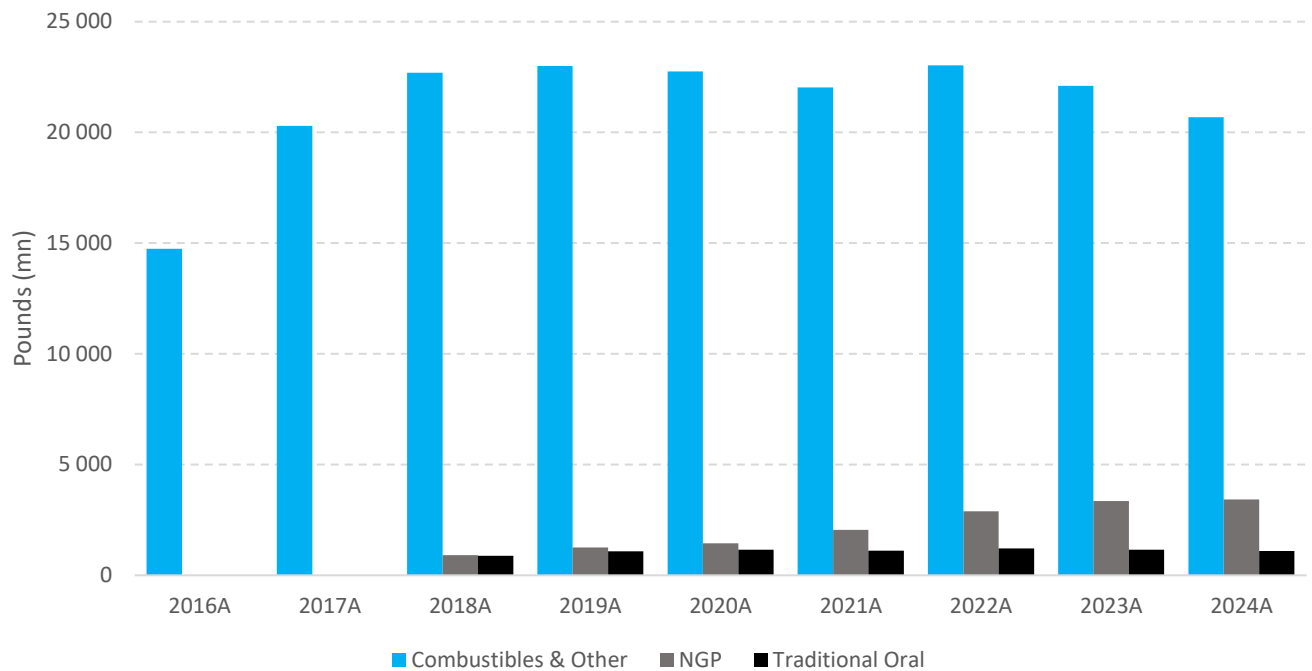


The company's strategy is set out clearly:

1. To continue transitioning away from cigarettes to NGPs – “Building a Smokeless World”:
  - a. The goal is to be 50% NGP by 2035.
  - b. Their US Vapour market share has grown from 15.5% in 2019 to 45.6% in 2023 but saw a small contraction in FY24.
  - c. Tobacco Heating Products market share has grown from 12.9% in 2019 to 18.2% in 2023, however, this segment seems to be stagnating and declined 7% in FY24.
  - d. Total NGPs have grown from £917 million in 2018 to £3.34 billion in 2023 and had a marginal increase in FY24 to £3.42 billion. We expected this to grow to £4.12 billion in FY25, short of the £5 billion initial target set out.



Graph 4: Revenue Analysis



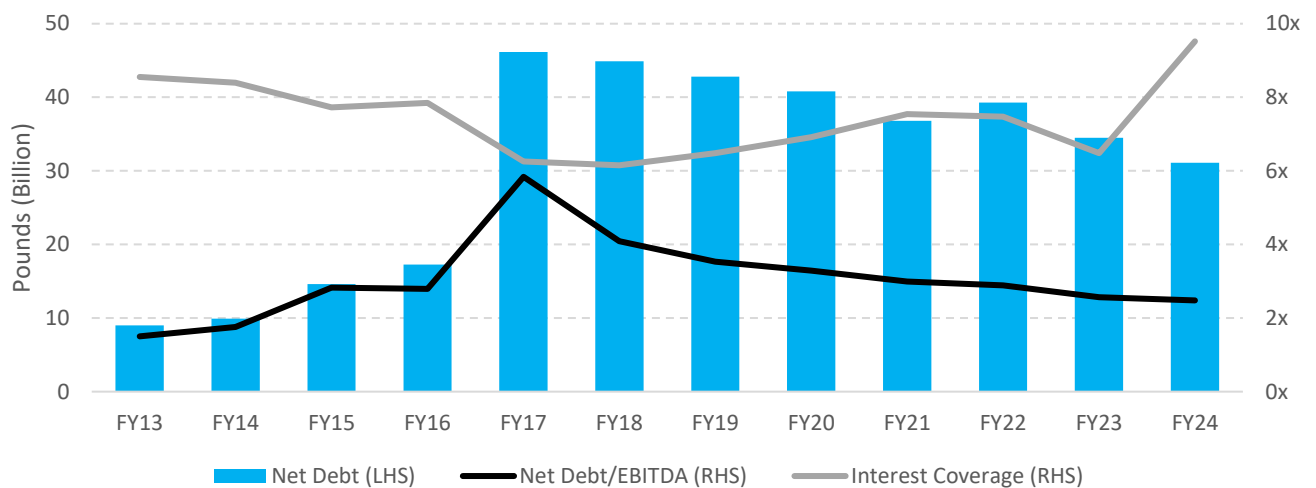
Source: Factset

2. Continue debt reduction.

- Reduce Net Debt/ EBITDA to 2.5x. This has now been achieved as of FY24 at 2.44x, however it was expected at FY23 and FY24 was expected at 2.2x-2.3x. This is slower progress than expected.
- Net Debt/EBITDA peaked at 5.2x in 2017 following the purchase of Reynolds American for \$49.4 billion. There was a slight miss on the target for FY23 and FY23, but the recent partial sale of the ITC stake will assist in bringing this closer to the 2.2x-2.3x mark.



Graph 5: Debt Profile



Source: Factset

3. Continue to protect margins.

- BATS has an industry leading EBIT margin of 46% at the end of FY24. Margins have shown consistent improvement since 2013; however, we do not anticipate greater than 46% going forward.
- Adjusted net margin sits at approximately 31%.
- NGPs are expected to contribute to margins in the future, however, they are currently undergoing extensive investment in products and marketing. This segment has just turned profitable and now margin expansion should continue to occur over the next five years.

4. Continue to offset cigarette volume decline with price increases.

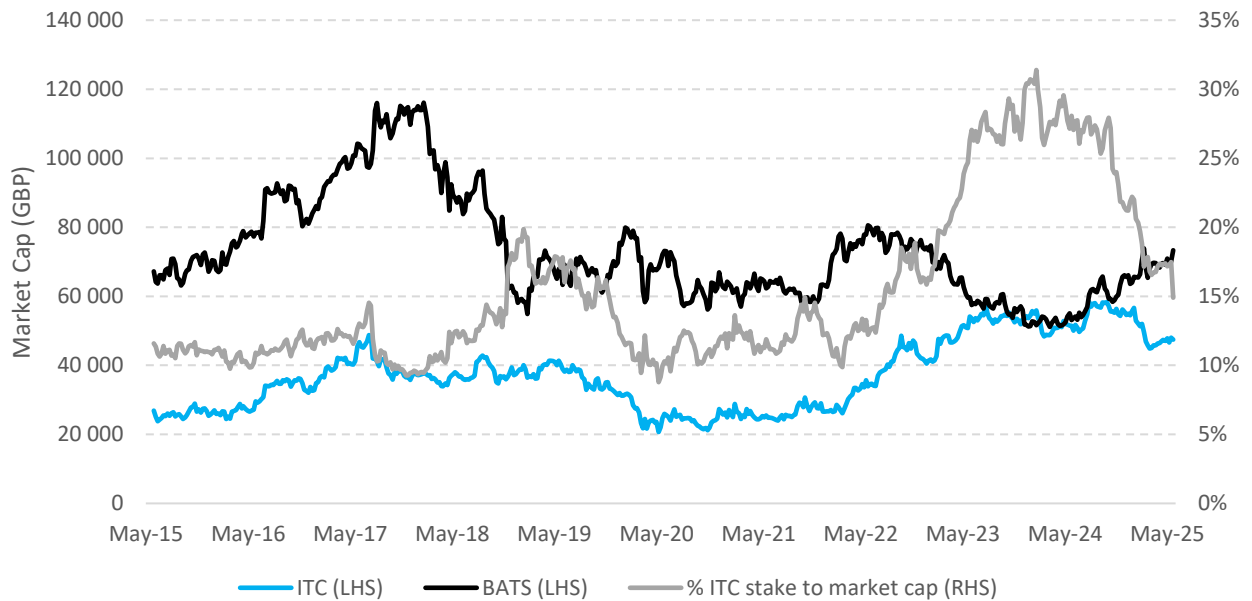
- The business currently has a global market share of 22%, excluding China. However, global cigarette volumes have been declining between 3% and 5% for the last decade, however, they saw a “high single-digit decline” in the US in 2024 which is concerning. The global trend of declining cigarette sales is expected to continue. Vapour sales will take some of this market share, however the illicit market sales need to be addressed by authorities.
- The company’s discount cigarette brands trade at a price discount of approximately 40% to Marlboro. Whether a switch from Marlboro to cheaper alternatives will occur in future remains to be seen. However, Marlboro smokers appear to be loyal to their product as market share has not declined.

5. BATS has been a long-term shareholding in ITC (previously Indian Tobacco Company).

- BATs held a 29% stake in ITC and since ITC has moved away from tobacco and become a conglomerate of various companies.
- Indian regulation does not allow for foreign investment in tobacco companies. BATS legacy shareholding allowed them to keep their stake but makes any future sale difficult due to the restrictions.
- BATS has no intention of a full sale of their stake, however, in March 2024 of last year they reduced the stake to 25.5% which generated about £2.5 billion and allowed the company to retain voting control.
- They have just (27 May 2025) completed a further 2.5% sale generating £1 billion of which £200 million will be for further share buybacks in FY25. It seems as if BATS management is no longer concerned about voting control in ITC.



Graph 6: ITC Stake



Source: PSG Wealth

## Valuation

We value BATS shares using a EV/EBITDA valuation. The current two year forward EV/EBITDA is 8.2x, in slightly above its five-year average post the 2017 acquisition of Reynolds American. We assign a probability of 10%, 60% and 30% for the bear, base and bull case respectively. We do not believe that the company will trade closer to the 10x multiple (the 1- year average) as cigarette volumes have declined faster than expected and the issues surrounding the illicit vapes will cause headwinds. A 7x multiple (bear case) is a conservative estimate and the current 8x multiple is fair. As they reduce debt and buyback shares it could trade closer to 9x EV/EBITDA and possibly get closer to the 10x ten-year average, although we believe that the industry has changed enough that this is unlikely.





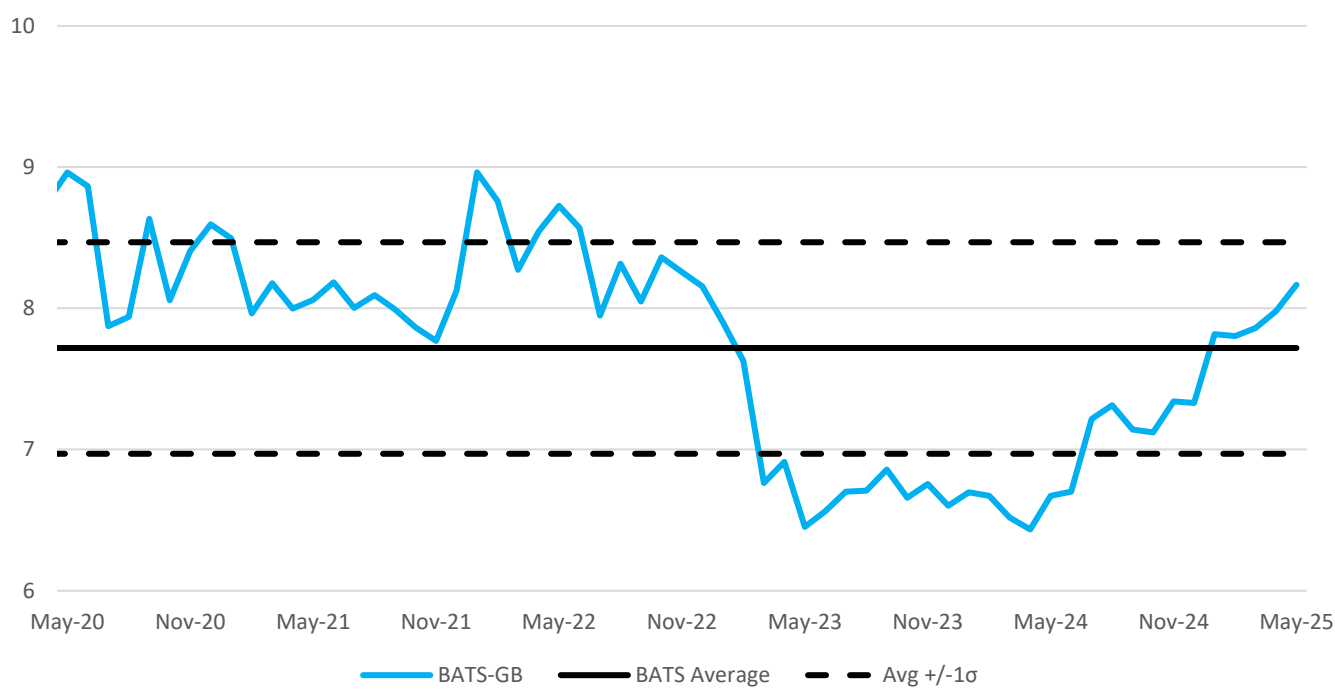
Table 4: Valuation

	Bear	Base	Bull
2026 EBITDA (£)	12,604	12,604	12,604
Consensus EBITDA (£)	12,801	12,801	12,801
EV/EBITDA Multiple assumptions (x)	7	8	9
Enterprise Value (£)	88,228	100,832	113,436
Net Debt/(Cash) (£)	31,140	31,140	31,140
Equity Value (£)	57,088	69,692	82,296
Shares in Issue	2206	2206	2206
Intrinsic Value per case (£)	25.88	31.59	37.31
Upside/downside per case	-22.0%	-4.8%	12.4%
Case Weight	10%	60%	30%
<b>Intrinsic Value (£)</b>		£ 32.73	
<b>Current share price</b>		£ 33.19	
<b>Upside/(downside)</b>		-1.4%	

2 June 2025



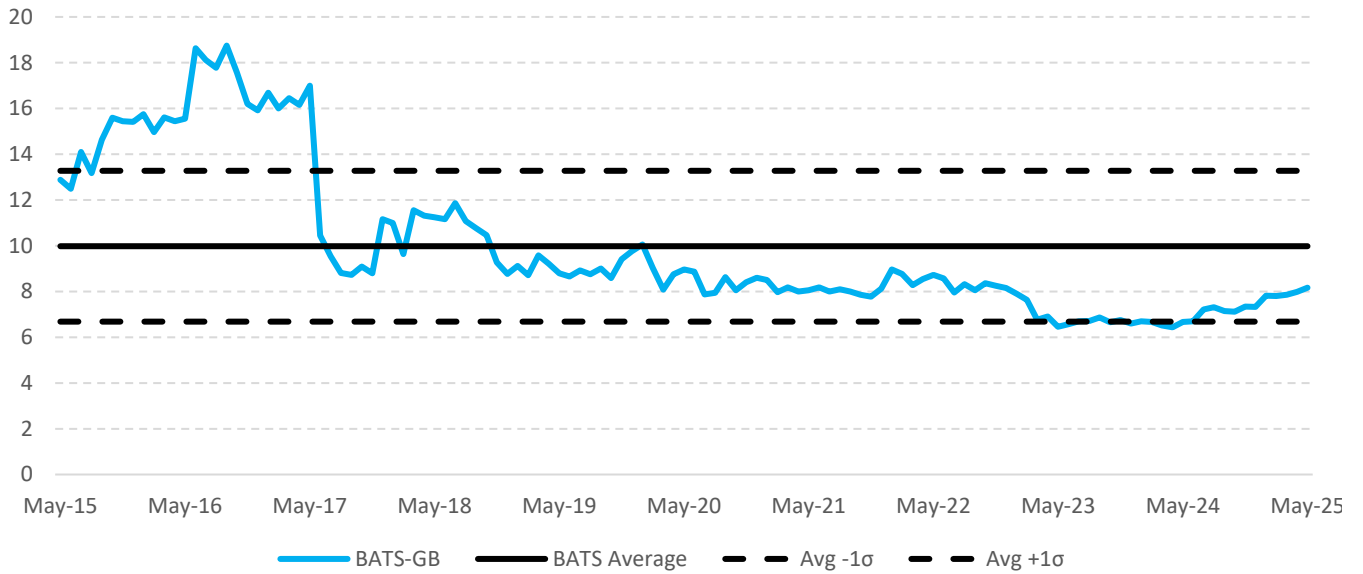
Graph7: EV/EBITDA five-year average



Source: FactSet

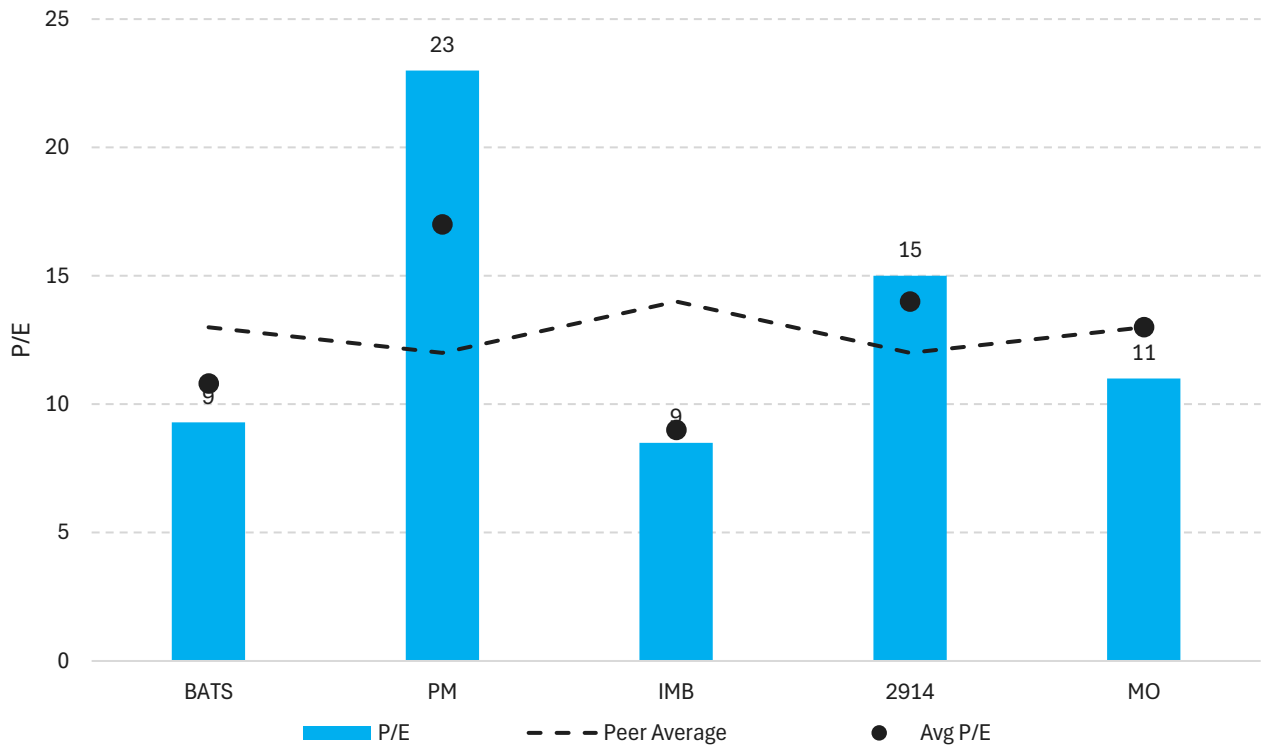


Graph 8: EV/EBITDA 10-year average



Source: FactSet

Graph 9: P:E peer comparison

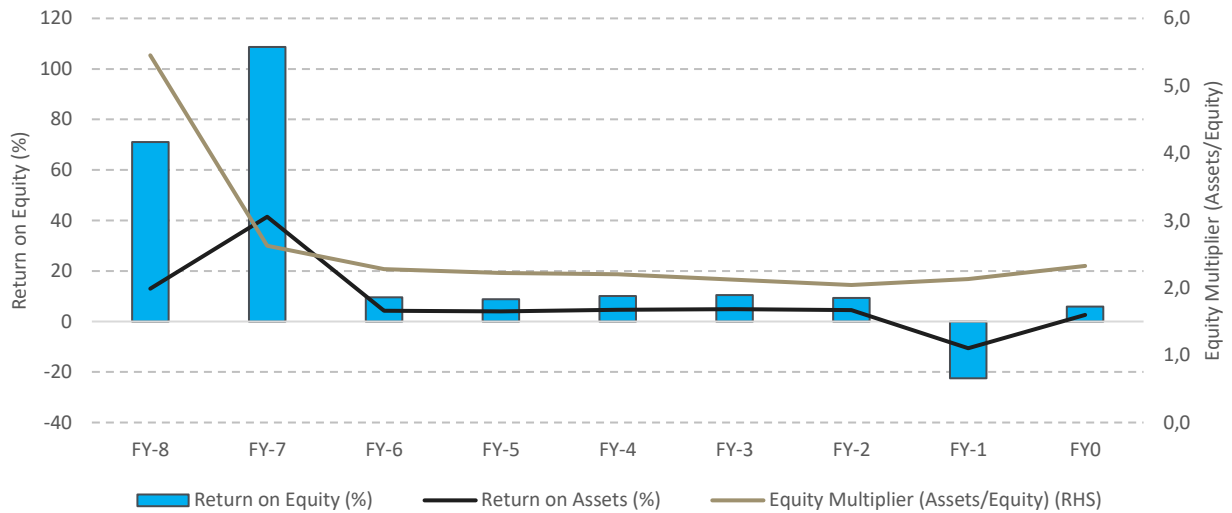


Source: Factset



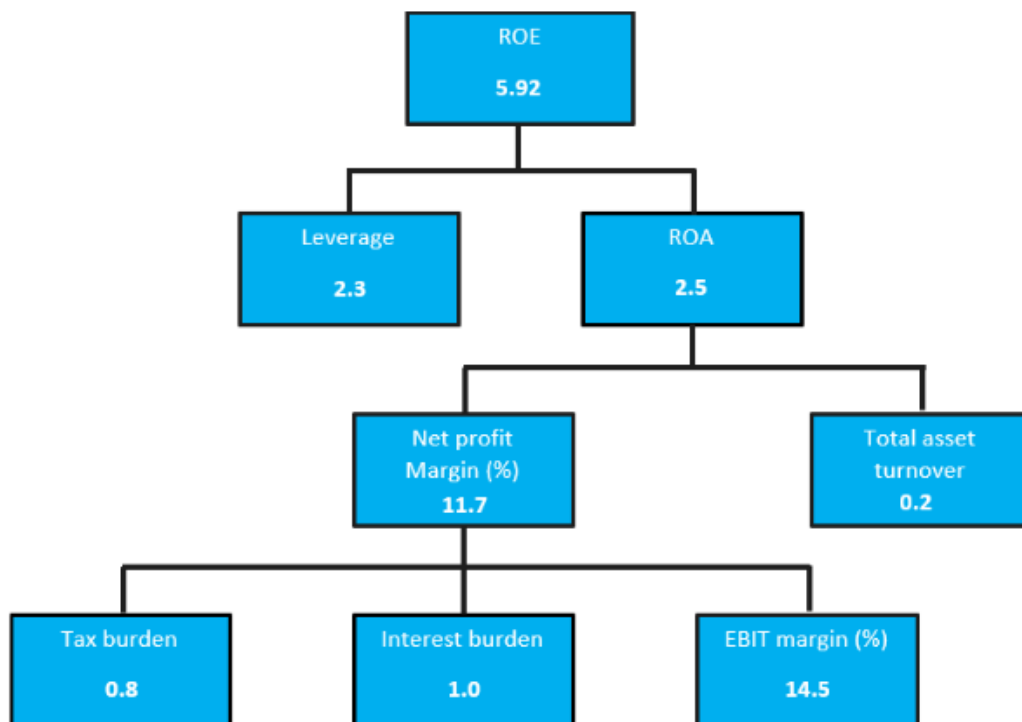
## DuPont

Graph 10: Return on equity



Source: FactSet

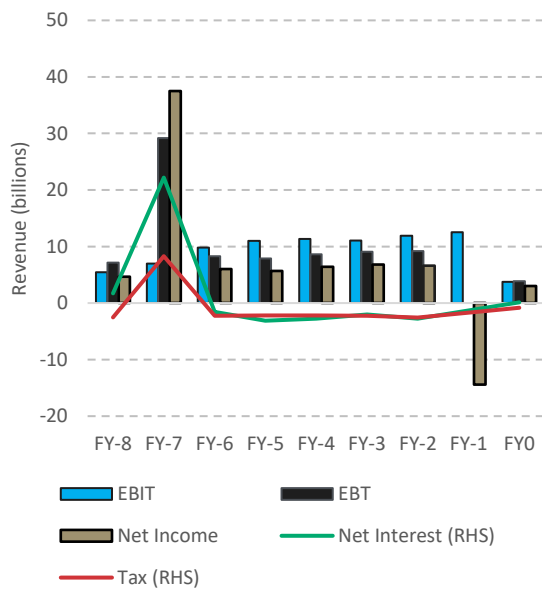
Graph 11: Dupont analysis summary



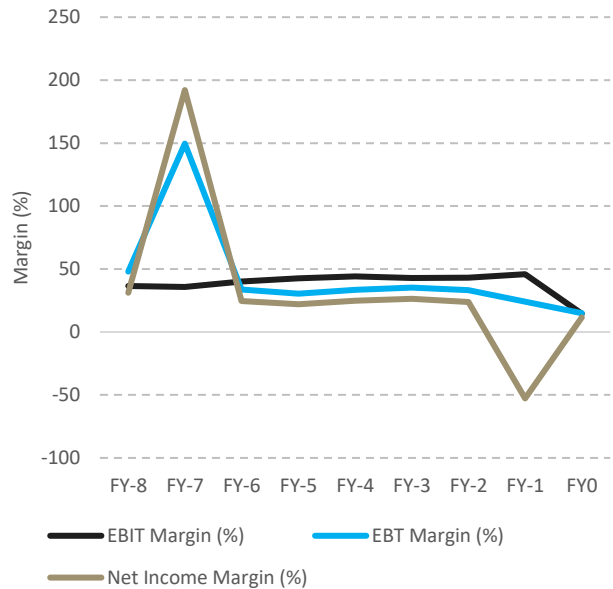
Source: FactSet



**Graph 12: EBIT, EBT and Net Income**



**Graph 13: Margins**



Source: FactSet

## Financial analysis

**Table 5: Share price summary**

52-week high	£34.16
52-week low	£23.68
Market value (bn)	£73.3
Price momentum	Positive
3m earnings revision	0.0%
Fiscal year end	2025/12/31
Beta (3Y, daily)	0.59

Source: FactSet



Graph 14: Price-to-earnings 5-year history

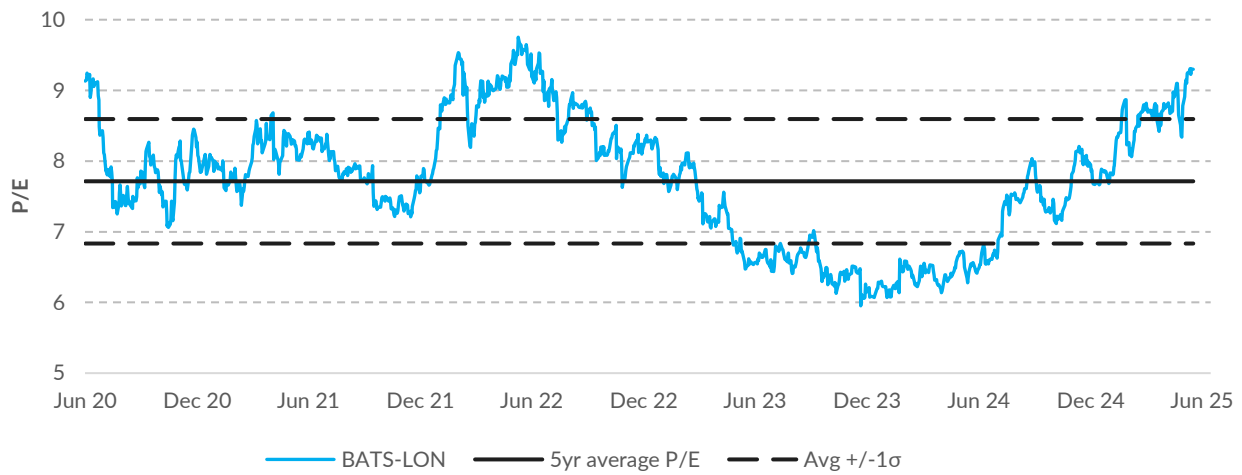
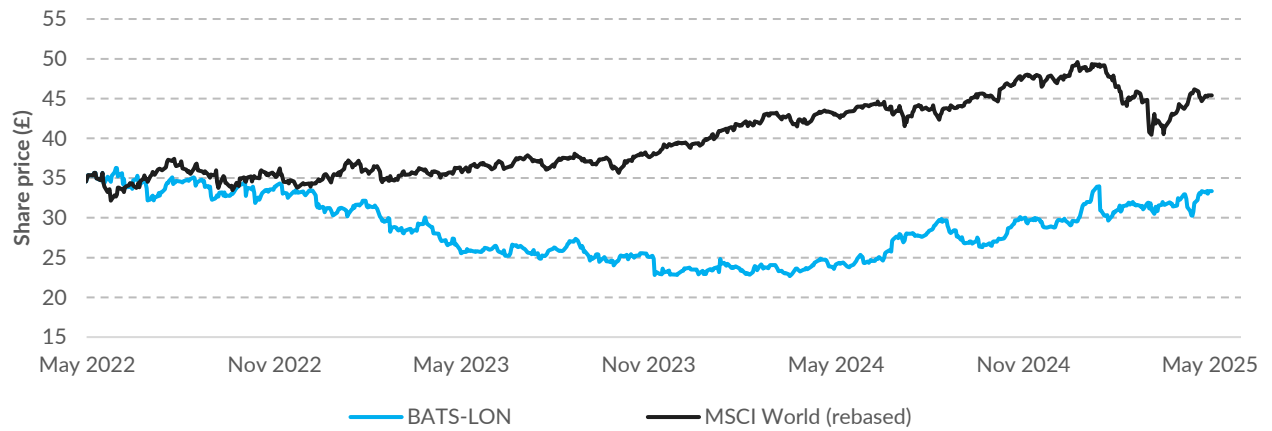


Table 6: Valuation multiples

Multiple	Latest:	Last note:
	Jun-2025	Feb-2025
P:E	9.3x	8.5x
P/S	2.8x	2.6x
P/B	1.5x	1.3x
P/CF	9.7x	8.3x
EV/EBITDA	8.4x	8.0x
EV/EBIT	9.1x	8.7x
EV/SALES	4.0x	3.9x
Dividend yield	7.5%	8.0%
FCF yield	9.5%	9.0%



**Graph 15: Share price history vs benchmark**



Source: FactSet

**Table 7: Performance versus benchmark**

Period	YTD	MTD	3M	6M	1Y	2Y	3Y	5Y	10Y
British American Tobacco p.l.c.	16.0%	0.2%	8.3%	11.4%	38.4%	30.0%	-5.5%	4.4%	-4.7%
MSCI World	-3.3%	0.0%	-5.2%	-5.3%	5.8%	24.4%	27.7%	64.4%	146.2%

Source: FactSet

**Table 8: Key competitors**

Code	Price (local)	Market Cap (£bn)	Sales FY (£bn)	EBIT FY (£bn)	Net Income FY (£bn)	EV/EBIT	P:E	Price % (3mo)	Price % (1YR)
British American Tobacco	33.4	73	26	12	8	9.1x	9.3x	8.3%	38.4%
Philip Morris International	182.8	210	31	12	8	19.2x	23.4x	9.3%	69.3%
Imperial Brands PLC	28.5	23	8	4	3	8.7x	8.6x	1.9%	46.7%
Japan Tobacco Inc.	4411.0	46	16	4	2	11.5x	14.9x	15.4%	2.5%

Source: FactSet



## Factset Consensus

**Table 9: Financial statement summary**

Income statement (£bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Sales	25.9	25.8	25.7	27.7	27.3	25.9	0.0%	25.7	26.3
Y/Y growth (%)	-	-0.4	-0.2	7.6	-1.2	-5.2		-0.6	2.4
Gross income	17.6	18.1	17.8	19.4	19.1	16.4	-1.5%	18.0	18.4
Y/Y growth (%)	-	2.7	-1.6	8.9	-1.3	-14.5		10.0	2.6
EBITDA	12.0	12.2	12.0	13.0	13.4	6.0	-12.8%	12.1	12.5
Y/Y growth (%)	-	2.0	-1.5	8.0	3.4	-55.0		101.1	2.9
EBIT	11.0	11.4	11.1	11.9	12.5	3.8	-19.4%	11.3	11.6
Y/Y growth (%)	-	3.0	-2.6	7.7	5.4	-70.0		200.1	2.9
Net income	5.7	6.4	6.8	6.6	-14.4	3.0	-11.9%	7.6	7.9
Y/Y growth (%)	-	12.2	6.1	-2.5	-317.8	-121.0		152.4	3.8
EPS (£)	2.5	2.8	3.0	2.9	-6.5	1.4	-11.4%	3.5	3.7
Y/Y growth (%)	-	12.1	6.0	-1.2	-320.4	-121.1		155.3	5.4

Balance sheet and cash flow (£bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Capex	0.78	0.71	0.71	0.64	0.49	0.434	-11.1%	0.6	0.6
Cash from operations	7.6	10.2	8.3	9.0	10.8	8.6	2.5%	7.7	10.7
Free cash flow	6.6	7.5	7.5	8.2	8.5	8.5	5.2%	6.0	8.9
Y/Y growth (%)	-	13.4	-0.3	9.9	3.5	-0.1		-29.2	48.8
Cash and ST investments	2.5	3.4	2.8	3.4	4.7	5.6	17.3%	3.7	4.8
Total assets	141.0	137.7	137.4	153.5	118.7	118.2	-3.5%	115.4	114.8
ST debt	7.1	3.5	3.5	0.1	4.3	4.3	-9.5%	4.3	4.3
LT debt	37.8	39.9	35.7	38.7	35.4	32.6	-2.9%	31.9	31.4

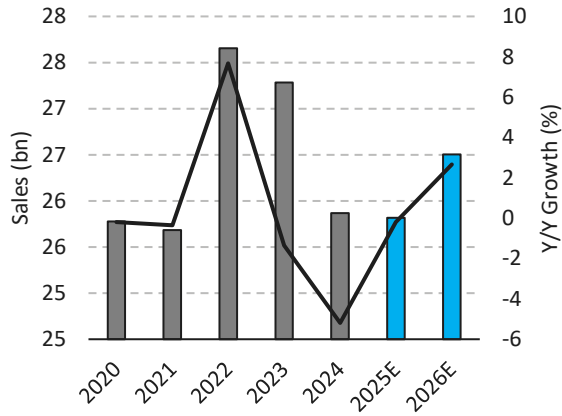
Ratios (£bn)	2019	2020	2021	2022	2023	2024	5Yr CAGR	2025E	2026E
Gross margin (%)	68.2	70.3	69.3	70.1	70.0	63.2	68.1	70.0	70.0
EBIT margin (%)	42.6	44.1	43.0	43.0	45.9	14.5	44.8	43.7	44.2
Net income margin (%)	22.1	24.8	26.4	23.9	-52.7	11.7	30.3	29.7	30.4
Current ratio	0.7	0.9	0.8	0.9	0.9	0.8	0.9	-	-
Total debt to equity	70.3	69.4	58.4	51.6	75.6	74.4	65.9	-	-
Total debt to assets	31.8	31.6	28.5	25.3	33.5	31.1	30.0	-	-
ROA (%)	4.0	4.6	4.9	4.5	-10.6	2.5	1.2	-	-
ROE (%)	8.8	10.1	10.5	9.3	-22.5	5.9	2.7	-	-

Source: FactSet



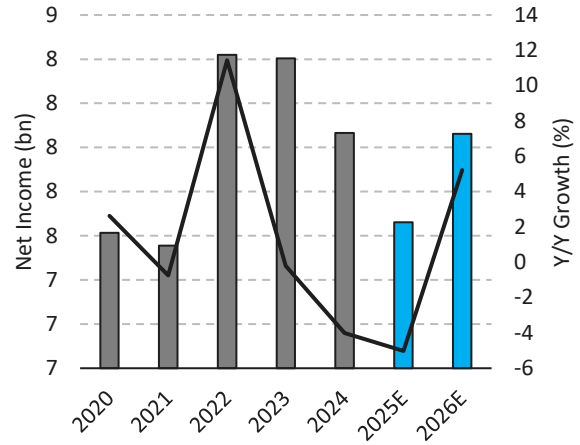


Graph 16: Annual sales

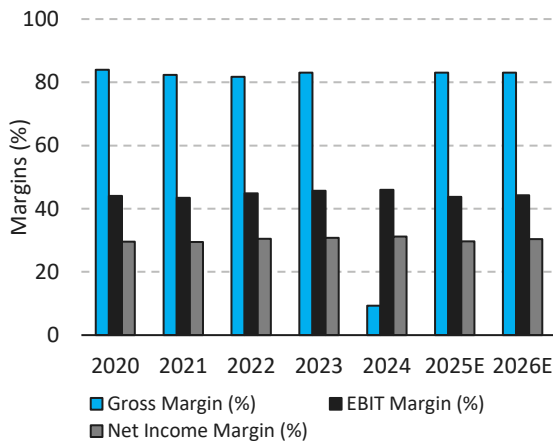


Source: FactSet

Graph 17: Annual net income

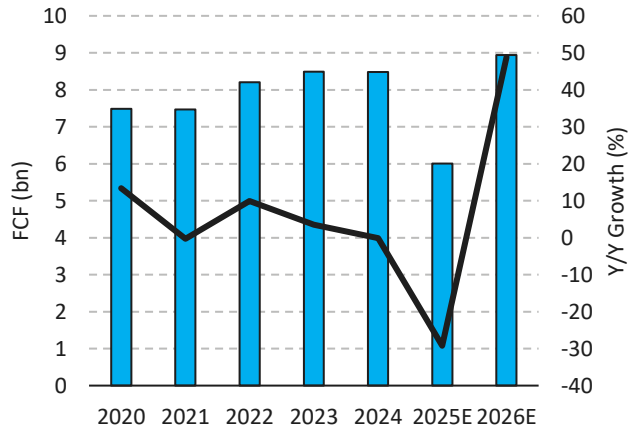


Graph 18: Gross, EBIT, Net Margins

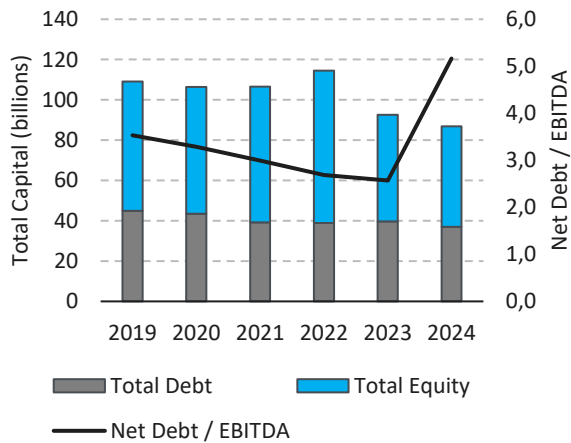


Source: FactSet

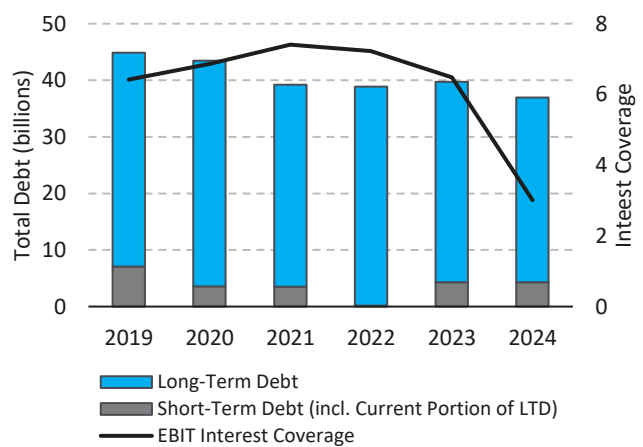
Graph 19: Free cash flow



Graph 20: Capital Structure and Net Debt/EBITDA



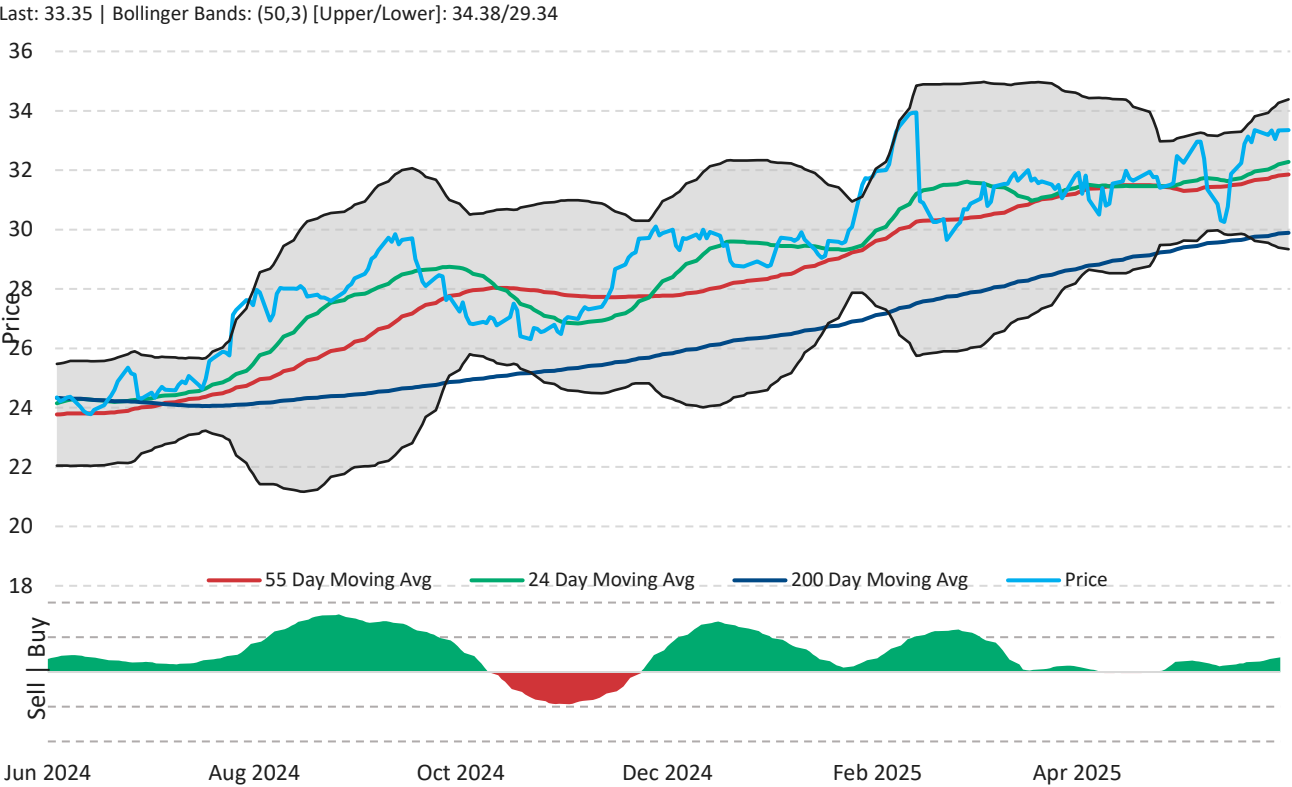
Graph 21: Total Debt & Interest Coverage



Source: FactSet



Graph 22: Price Momentum





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**House view guidance:** House view guidance is indicative only. Each client's circumstances are different, and it remains critical that indicative guidance is discussed with your portfolio manager or financial adviser.

**Date and share price:** The date the report was reviewed and approved by the portfolio committee is likely to precede the release date and price on the report.

\*Share price as at closing.

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