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British American Tobacco

Consumer

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Moving to a smokeless world

British American Tobacco's (BAT's) strategy is to become a predominantly smokeless business, generating more than 50% of revenue (FY24: 17.5%) from smokeless products by FY35. The industry backdrop is favourable, with higher revenue growth expected as consumers move to new reduced-risk products. Having transformed its capabilities through scientific research, customer engagement and product innovation, management believes focused investment should enable BAT to continue capturing the enhanced growth opportunity with better returns. BAT is confident of higher profit growth in FY25 before hitting its full stride of 4–6% pa sustainable growth from FY26, comparable to BAT's growth rates before FY22.

Towards higher growth and strong cash generation

BAT's financial performance was below historical norms in FY23 and FY24, mainly due to weakness in the US. FY24 is seen as a transition year, following the implementation of commercial changes in the US and enhanced innovation in new categories, which drove a relative improvement in growth in H224. Management guides to gradual improvement in organic constant currency growth for profit from operations from 1.4% in FY24 to 1.5–2.5% (ex Canada) in FY25 before delivering 4–6% pa from FY26, above revenue growth of 3–5%. Medium-term positive drivers for BAT's revenue are: (1) improving US financial performance; (2) momentum/innovation in new categories; and (3) continued strong performance in the Americas and Europe. Over the medium term, revenue growth should be complemented by further cost efficiencies (c £2bn in FY26–30 vs £1.2bn in FY23–25) and greater profit contribution from new categories as they scale, driving greater profit growth. Key headwinds are from the US: macroeconomic pressures on consumers and limited enforcement actions to tackle the large illicit vapour market. Changes in regulations and duties in Australia and Bangladesh will dampen profit growth by 2pp in FY25. BAT expects operating cash conversion will remain at 90%+, a target it has regularly exceeded at 100% in the last five years, generating over £50bn free cash flow through 2030. This will fund a growing dividend (in sterling), debt reduction, further share buybacks (FY24: £700m, FY25: £900m) and potential bolt-on M&A.

Attractive dividend yield versus global peers

BAT offers an attractive prospective dividend yield versus the average for its global peers of 5.4%. The prospective FY25e P/E multiple of 8.4x compares favourably to the average for its global peers of 13.0x, but reflects lower projected growth in EPS for BAT of c 2% and 6% in FY24 and FY25 versus c 9% and c 8% for the peers. An improvement in BAT's growth would be helpful for its valuation on a relative basis.

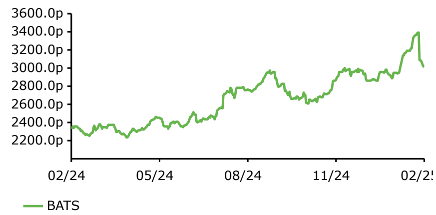
Consensus estimates

Year end	Revenue (£m)	EBIT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
12/23	27,283.0	12,465.0	375.60	235.52	8.2	7.6
12/24	25,867.0	11,890.0	362.52	240.24	8.5	7.8
12/25e	26,477.0	11,925.8	369.49	246.08	8.4	8.0
12/26e	27,134.0	12,288.7	391.51	254.75	7.9	8.2

Source: BAT, LSEG Data & Analytics. Note: Consensus unlikely to reflect estimate changes following FY24 results. EBIT adjusted profit from operations.

Price	**3,095.00p**
Market cap	**£68,273m**

Share price performance



Share details

Code	BATS
Listing	LSE
Shares in issue	2,205.9m
Net cash/(debt) at 31 December 2024	£(31,253.0)m

Business description

British American Tobacco manufactures and sells nicotine globally. These include cigarettes and reduced-risk products such as vapes, heated products and oral products.

Bull points

- BAT estimates the global nicotine market will grow at a CAGR of 4.6% from 2024–35 versus 3.8% from 2017–23, including double-digit growth from new categories in addition to 0-2% growth from combustibles (volume declines, pricing positive).
- Only 10% of the world's one billion smokers currently use new smokeless products.
- High cash conversion enables progressive dividend (FY24 was 26th consecutive year of dividend growth in sterling), further share buybacks, debt reduction and potential bolt-on M&A.

Bear points

- Potential financial losses from product liability and regulatory changes.
- Considerable divergence between countries on how to regulate new categories, including the banning of products despite reduced health risks.
- Competition from illegal products and illicit trade as external parties seek to avoid excise duty or take advantage of lack of regulation.

Analysts

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British American Tobacco is a research client of Edison Investment Research Limited

The author of this report holds shares in British American Tobacco and, as such, has a financial interest in the subject of this analysis.

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