



# British American Tobacco (BTI)

Updated June 20<sup>th</sup>, 2023 by Jonathan Weber

## Key Metrics

|                             |      |  |       |                                  |          |
|-----------------------------|------|--|-------|----------------------------------|----------|
| <b>Current Price:</b>       | \$33 | <b>5 Year CAGR Estimate:</b>               | 12.2% | <b>Market Cap:</b>               | \$74B    |
| <b>Fair Value Price:</b>    | \$38 | <b>5 Year Growth Estimate:</b>             | 3.0%  | <b>Ex-Dividend Date:</b>         | 06/29/23 |
| <b>% Fair Value:</b>        | 86%  | <b>5 Year Valuation Multiple Estimate:</b> | 3.0%  | <b>Dividend Payment Date:</b>    | 08/15/23 |
| <b>Dividend Yield:</b>      | 8.1% | <b>5 Year Price Target</b>                 | \$44  | <b>Years Of Dividend Growth:</b> | 0        |
| <b>Dividend Risk Score:</b> | C    | <b>Retirement Suitability Score:</b>       | A     | <b>Rating:</b>                   | Buy      |

## Overview & Current Events

British American Tobacco is one of the world's largest tobacco companies. British American Tobacco owns many tobacco brands, including *Kool*, *Benson & Hedges*, *Dunhill*, *Kent*, and *Lucky Strike*. The company also acquired the remaining 48% stake in Reynolds American Tobacco that it did not already own in July of 2017. Although the company is incorporated in the United Kingdom and headquartered in London, American investors can purchase its stock through American Depositary Receipts that trade on the New York Stock Exchange under the ticker BTI. Despite being headquartered in the United Kingdom, British American Tobacco triggers no dividend withholding tax for United States investors. All numbers in this report are in US\$ unless noted otherwise.

British American Tobacco announced its first-half pre-close trading update, its Q1 earnings report equivalent, on June 6. The company does not announce exact numbers in its pre-close trading updates, but comments on the overall performance of the business. Year-to-date, British American Tobacco has gained some volume share in the combustible market, primarily due to increased marketing efforts in the United States. British American Tobacco reports that its non-combustible segment is performing well, adding close to 1 million new customers during the first quarter, and gaining market share. According to management, British American Tobacco is on track to hit its 5 billion Pound sales target for the non-combustible segment in 2025, with profitability being expected before that.

British American Tobacco guides for revenue growth of 3% to 5% in organic terms during the current year, which would be attractive. Earnings-per-share are expected at around \$4.25, which would be down versus the previous fiscal year. Currency rate headwinds play a role here. The dividend remains well-covered.

## Growth on a Per-Share Basis

| Year                      | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   | 2023          | 2028          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$3.65 | \$3.71 | \$3.18 | \$3.08 | \$3.96 | \$3.89 | \$4.38 | \$4.58 | \$4.45 | \$4.49 | <b>\$4.25</b> | <b>\$4.93</b> |
| <b>DPS</b>                | \$2.11 | \$2.35 | \$2.42 | \$2.28 | \$2.84 | \$2.66 | \$2.71 | \$2.74 | \$2.94 | \$2.81 | <b>\$2.68</b> | <b>\$3.03</b> |
| <b>Shares<sup>1</sup></b> | 1900   | 1860   | 1860   | 1860   | 2290   | 2290   | 2290   | 2300   | 2300   | 2270   | <b>2270</b>   | <b>2200</b>   |

British American Tobacco's earnings-per-share grew by ~90% between 2009 and 2020, which equates to an annual earnings-per-share growth rate of ~6%. The company's growth has been uneven, though, as there were several years where British American Tobacco's profits declined. The company reports its results in Pound Sterling, whereas the results in the above table are in USD. Depending on the exchange rate between these two currencies, growth rates in USD can differ from British American Tobacco's reported growth rates. In 2018, for example, results in Pound Sterling were up, whereas results in USD declined. Currency rate changes also impact dividend payments.

Cost savings following the integration of Reynolds American will be a driver for British American Tobacco's earnings in the future. Other factors include ongoing organic growth due to rising cigarette prices and the rise of vaping products, and declining interest expenses as long as British American Tobacco is able to lower its debt load due to ongoing debt pay downs. Interest rates at all-time lows, especially in Europe, should help drive further interest savings. We see a low-single-digit earnings-per-share growth rate in the future, although management has a more positive growth goal.

<sup>1</sup> In Millions

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## Valuation Analysis

| Year      | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Now  | 2028 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 14.7 | 14.6 | 15.3 | 17.6 | 19.2 | 16.4 | 8.5  | 9.6  | 8.1  | 8.9  | 7.8  | 9.0  |
| Avg. Yld. | 4.2% | 4.4% | 4.3% | 4.1% | 3.7% | 4.1% | 8.1% | 6.5% | 7.4% | 7.0% | 8.1% | 6.8% |

British American Tobacco's shares have declined slightly since our last update. Its valuation remains low on an absolute basis but is higher than it was over the last two years. British American Tobacco trades for a little less than 8 times this year's expected net earnings, which is below our fair value estimate. Due to uncertainties for the industry, such as increasing menthol regulation in the US, we believe that the valuation will not expand to the double digits. Investors get an attractive dividend yield at current prices.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year   | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  | 2023  | 2028  |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Payout | 57.8% | 63.3% | 76.1% | 74.0% | 55.1% | 68.4% | 61.9% | 59.8% | 66.1% | 62.6% | 63.1% | 61.5% |

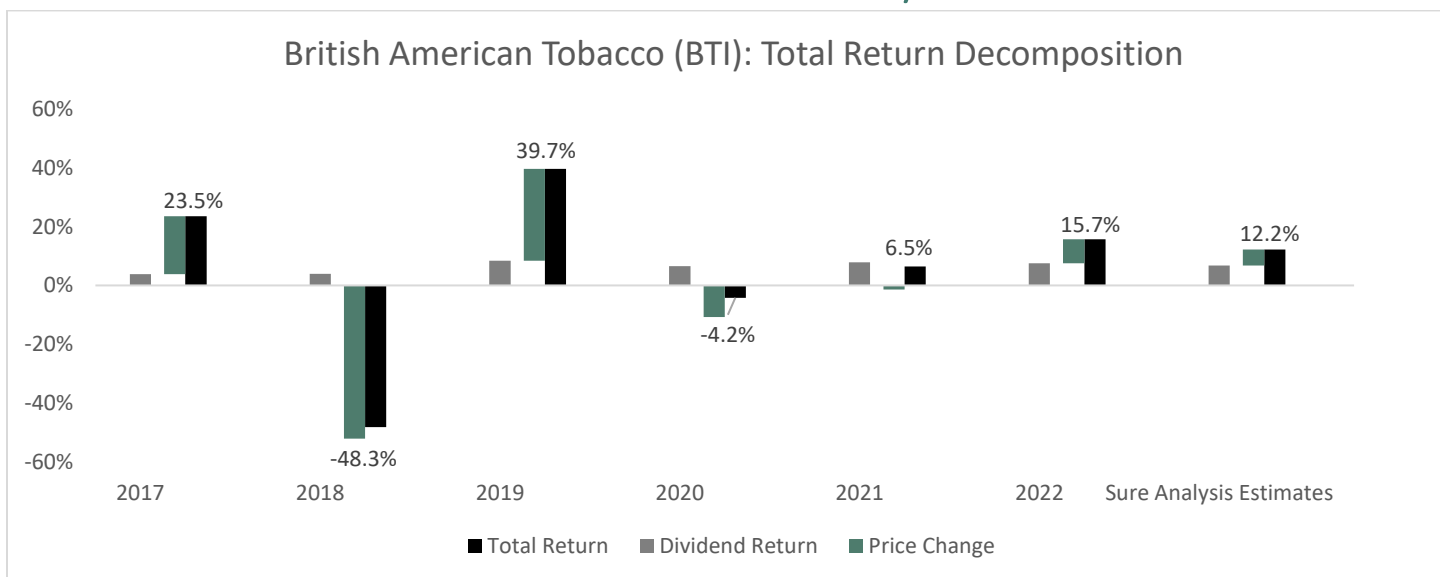
British American Tobacco has kept its dividend payout ratio in a range of 55%-75% throughout the last decade. Compared to other tobacco stocks, this is not a high payout ratio. Some competitors, such as Altria, pay out ~80% of their profits in the form of dividends. We believe that the dividend is safe for the foreseeable future.

British American Tobacco operates in an oligopoly that does not have a tendency to engage in price wars. The players in this industry have always focused on profits over market share gains, which is why the industry is not overly competitive, and why profits have been rising for all players. Demand for cigarettes is not cyclical, which is why British American Tobacco performed well during the last financial crisis, when profits continued to rise between 2008 and 2010.

## Final Thoughts & Recommendation

British American Tobacco's dividend yield remains at an attractive level. 2022 was a solid year for the company as it saw rapid growth in the New Categories space while continuing to deleverage. The operational outlook for 2023 is solid as well, and the company has increased its dividend by 6% in Pound Sterling, although the growth rate in USD was lower. We rate British American Tobacco a buy at current prices as the total return outlook is compelling.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year             | 2013   | 2014   | 2015   | 2016   | 2017    | 2018   | 2019   | 2020   | 2021   | 2022   |
|------------------|--------|--------|--------|--------|---------|--------|--------|--------|--------|--------|
| Revenue          | 23,875 | 23,029 | 20,026 | 19,145 | 25,260  | 32,678 | 33,041 | 33,082 | 35,335 | 34,246 |
| Gross Profit     | 18,802 | 18,035 | 15,391 | 14,087 | 18,762  | 26,608 | 27,376 | 27,771 | 29,306 | 28,607 |
| Gross Margin     | 78.7%  | 78.3%  | 76.9%  | 73.6%  | 74.3%   | 81.4%  | 82.9%  | 83.9%  | 82.9%  | 83.5%  |
| SG&A Exp.        | 23     | 25     | 19     | 15     | 39      | 34     | 32     |        |        | 1,472  |
| D&A Exp.         | 746    | 862    | 654    | 822    | 1,165   | 1,385  | 1,931  | 1,861  | 1,480  | 1,616  |
| Operating Profit | 8,716  | 7,670  | 6,979  | 6,745  | 8,697   | 12,592 | 11,785 | 12,790 | 14,083 | 18,921 |
| Op. Margin       | 36.5%  | 33.3%  | 34.9%  | 35.2%  | 34.4%   | 38.5%  | 35.7%  | 38.7%  | 39.9%  | 55.2%  |
| Net Profit       | 6,108  | 5,135  | 6,556  | 6,298  | 48,400  | 8,048  | 7,283  | 8,214  | 9,356  | 8,255  |
| Net Margin       | 25.6%  | 22.3%  | 32.7%  | 32.9%  | 191.6%  | 24.6%  | 22.0%  | 24.8%  | 26.5%  | 24.1%  |
| Free Cash Flow   | 5,812  | 4,985  | 6,295  | 5,333  | 5,641   | 12,478 | 10,446 | 11,591 | 12,343 | 12,059 |
| Income Tax       | 2,503  | 2,398  | 2,037  | 1,905  | -10,496 | 2,857  | 2,634  | 2,706  | 3,011  | 3,069  |

## Balance Sheet Metrics

| Year                | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   | 2021   | 2022   |
|---------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Total Assets (\$B)  | 44.33  | 40.73  | 46.69  | 48.86  | 190.62 | 185.69 | 184.88 | 187.65 | 185.39 | 185.8  |
| Cash & Equivalents  | 3,212  | 2,534  | 2,658  | 2,515  | 4,231  | 2,927  | 2,490  | 2,461  | 3,791  | 4,170  |
| Acc. Receivable     | 4,743  | 4,308  | 4,839  | 4,772  | 5,477  | 4,553  | 5,367  | 5,071  | 5,332  | 5,285  |
| Inventories         | 6,665  | 6,433  | 6,292  | 7,117  | 7,925  | 7,650  | 7,990  | 8,174  | 7,125  | 6,863  |
| Goodwill/Int. (\$B) | 18.48  | 16.82  | 15.46  | 14.89  | 159.17 | 157.36 | 155.75 | 157.19 | 156.05 | 156.2  |
| Total Liab. (\$B)   | 32.89  | 31.68  | 39.23  | 38.53  | 108.21 | 102.34 | 100.76 | 101.85 | 94.43  | 94.19  |
| Accounts Payable    | 9,467  | 8,598  | 8,796  | 9,011  | 12,038 | 13,490 | 12,754 | 13,210 | 12,926 | 12,645 |
| Long-Term Debt      | 19,287 | 19,079 | 25,187 | 23,950 | 66,827 | 60,284 | 59,483 | 59,921 | 53,524 | 51,581 |
| Total Equity        | 10,939 | 8,576  | 7,250  | 10,052 | 82,110 | 83,042 | 83,786 | 85,413 | 90,562 | 91,210 |
| LTD/E Ratio         | 1.76   | 2.22   | 3.47   | 2.38   | 0.81   | 0.73   | 0.71   | 0.70   | 0.59   | 0.57   |

## Profitability & Per Share Metrics

| Year             | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020  | 2021  | 2022  |
|------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Return on Assets | 13.8% | 12.1% | 15.0% | 13.2% | 40.4% | 4.3%  | 3.9%  | 4.4%  | 5.0%  | 4.4%  |
| Return on Equity | 53.1% | 52.6% | 82.8% | 72.8% | 105%  | 9.7%  | 8.7%  | 9.7%  | 10.6% | 9.1%  |
| ROIC             | 20.2% | 17.4% | 21.6% | 18.8% | 52.7% | 5.5%  | 5.1%  | 5.7%  | 6.4%  | 5.8%  |
| Shares Out.      | 1900  | 1860  | 1860  | 1860  | 2290  | 2290  | 2290  | 2300  | 2300  | 2270  |
| Revenue/Share    | 12.51 | 12.32 | 10.75 | 10.27 | 12.32 | 14.26 | 14.42 | 14.42 | 15.38 | 15.11 |
| FCF/Share        | 3.05  | 2.67  | 3.38  | 2.86  | 2.75  | 5.44  | 4.56  | 5.05  | 5.37  | 5.32  |

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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