Equities

21 May 2012 | 36 pages

British American Tobacco PLC (BATS.L)

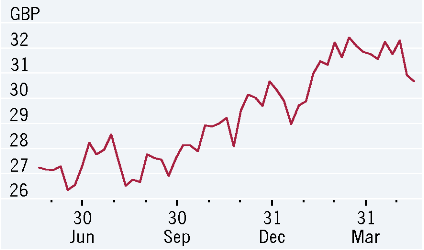
Smoking Prices in Emerging Markets

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

- **Upgrade to Buy because of emerging market pricing and mix** — We're upgrading BAT because we believe the outlook for its pricing and mix in its Top 5 emerging markets looks stronger than ever, and we think the market hasn't factored this in yet.
- **Accelerated profit growth this year** – This note goes into a lot of detail on pricing and tax in BAT's most important EMs, but the conclusion is that this year we're expecting especially good EBIT from the key EMs, with large price hikes in Brazil and Russia (together 20% of profit), while in South Africa and Malaysia (together 10%) pricing has been better than last year, albeit still in the low single digits. India (4%) remains strong.
- **And mix benefits into the future** – Brazil and Russia are scheduled to increase minimum price points rapidly until 2015, and we think this will accelerate the positive mix in both countries, helping profit for both BAT and its main competitors there.
- **We have lifted our organic EBIT forecasts by about 2 points** – However this is offset by the recent strength of sterling, so our EPS forecasts are barely changed.
- **Our long-term bearish view on DMs hasn't altered, but the strategists' bull case now seems even more compelling** – We haven't changed our view that in the long-term DM volumes are likely to worsen, and we continue to expect plain packaging. However we don't expect these to hit EPS in the next couple of years. Meanwhile, with the European crisis worsening, our strategists' arguments seem ever stronger. BAT has good defensive growth (9-10% on EPS), a self-help story (via pricing and cost savings), limited exposure to S Europe (8% of profit), attractive dividends (4.3% after CDS costs), and makes the strategists' "World Champion" list. What's not to like?
- **P/E multiple is above average, but we expect it to stay there** — BAT now trades at 13.2x next year's EPS. Our new price target (3400p) assumes this will rise slightly to about 13.5x, as we think the market will continue to value its self-help story.

Buy	**1**
from Neutral	
Price (18 May 12)	£30.11
Target price	£34.00
from £33.30	
Expected share price return	12.9%
Expected dividend yield	4.5%
Expected total return	**17.4%**
Market Cap	£58,975M
	US$93,158M

Price Performance
(RIC: BATS.L, BB: BATS LN)



British American Tobacco PLC (GBP)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (£M)	14,883.0	15,399.0	15,672.8	16,332.5	17,117.6
Profit Before Tax (£M)	5,126.0	5,718.0	6,021.9	6,467.2	6,969.5
Diluted EPS (p)	175.8	194.6	208.8	228.4	250.6
Diluted EPS (Old) (p)	175.8	194.6	208.3	228.2	249.8
PE (x)	17.1	15.5	14.4	13.2	12.0
EV/EBITDA (x)	11.3	10.1	9.5	8.9	8.3
DPS (p)	114.2	126.5	135.7	148.5	162.9
Net Div Yield (%)	3.8	4.2	4.5	4.9	5.4

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

BATS.L: Fiscal year end 31-Dec — Price: £30.11; TP: £34.00; Market Cap: £58,975m; Recomm: Buy

Profit & Loss (£m)	2010	2011	2012E	2013E	2014E
Sales revenue	14,883	15,399	15,673	16,332	17,118
Cost of sales	-6,518	-6,504	-6,503	-6,688	-6,903
Gross profit	8,365	8,895	9,170	9,645	10,215
Gross Margin (%)	56.2	57.8	58.5	59.1	59.7
EBITDA	**5,881**	**6,336**	**6,363**	**6,755**	**7,227**
EBITDA Margin (%)	39.5	41.1	40.6	41.4	42.2
Depreciation	-469	-394	-414	-423	-432
Amortisation	-428	-423	-155	-159	-165
EBIT	**4,984**	**5,519**	**5,794**	**6,173**	**6,631**
EBIT Margin (%)	33.5	35.8	37.0	37.8	38.7
Net interest	-480	-460	-477	-464	-456
Associates	550	670	705	758	795
Non-op/Except	-666	-798	-100	-100	-100
Pre-tax profit	**4,388**	**4,931**	**5,922**	**6,367**	**6,869**
Tax	-1,248	-1,556	-1,628	-1,750	-1,894
Extraord./Min.Int./Pref.div.	-261	-280	-306	-333	-363
Reported net profit	**2,879**	**3,095**	**3,988**	**4,284**	**4,612**
Net Margin (%)	19.3	20.1	25.4	26.2	26.9
Core NPAT	3,505	3,857	4,068	4,364	4,692

Per share data	2010	2011	2012E	2013E	2014E
Reported EPS (p)	144.4	156.1	204.7	224.2	246.3
Core EPS (p)	175.8	194.6	208.8	228.4	250.6
DPS (p)	114.2	126.5	135.7	148.5	162.9
CFPS (p)	225.1	233.9	276.4	297.6	321.9
FCFPS (p)	198.8	205.3	246.5	266.1	288.8
BVPS (p)	464.9	418.4	361.6	301.9	226.9
Wtd avg ord shares (m)	1,983	1,970	1,936	1,899	1,861
Wtd avg diluted shares (m)	1,994	1,982	1,948	1,911	1,873

Growth rates	2010	2011	2012E	2013E	2014E
Sales revenue (%)	4.8	3.5	1.8	4.2	4.8
EBIT (%)	11.7	10.7	5.0	6.5	7.4
Core NPAT (%)	15.1	10.1	5.5	7.3	7.5
Core EPS (%)	14.9	10.7	7.3	9.4	9.7

Balance Sheet (£m)	2010	2011	2012E	2013E	2014E
Cash & cash equiv.	2,329	2,194	2,194	2,194	2,194
Accounts receivables	2,409	2,423	2,405	2,387	2,369
Inventory	3,608	3,498	3,472	3,446	3,420
Net fixed & other tangibles	3,389	3,352	4,341	3,394	3,580
Goodwill & intangibles	12,458	11,992	11,896	11,796	11,694
Financial & other assets	3,256	3,317	3,317	3,317	3,317
Total assets	**27,449**	**26,776**	**27,624**	**26,534**	**26,574**
Accounts payable	808	808	3,196	3,172	3,148
Short-term debt	1,254	1,612	1,612	1,612	1,612
Long-term debt	8,916	8,510	8,159	7,927	7,851
Provisions & other liab	6,923	7,372	7,372	7,721	9,288
Total liabilities	**17,901**	**18,302**	**20,339**	**20,432**	**21,900**
Shareholders' equity	9,206	8,167	6,917	5,667	4,167
Minority interests	342	307	368	435	507
Total equity	**9,548**	**8,474**	**7,285**	**6,102**	**4,674**
Net debt	**7,841**	**7,928**	**7,578**	**7,345**	**7,269**
Net debt to equity (%)	82.1	93.6	104.0	120.4	155.5

Valuation ratios	2010	2011	2012E	2013E	2014E
PE (x)	17.1	15.5	14.4	13.2	12.0
PB (x)	6.5	7.2	8.3	10.0	13.3
EV/EBITDA (x)	11.3	10.1	9.5	8.9	8.3
FCF yield (%)	6.6	6.8	8.2	8.8	9.6
Dividend yield (%)	3.8	4.2	4.5	4.9	5.4
Payout ratio (%)	65	65	65	65	65
ROE (%)	34.2	35.6	52.9	68.1	93.8

Cashflow (£m)	2010	2011	2012E	2013E	2014E
EBITDA	5,881	6,336	6,363	6,755	7,227
Working capital	107	144	20	20	20
Other	-1,500	-1,844	-997	-1,089	-1,220
Operating cashflow	**4,488**	**4,636**	**5,386**	**5,686**	**6,027**
Capex	-523	-566	-583	-600	-618
Net acq/disposals	0	0	0	0	0
Other	-77	-404	0	0	0
Investing cashflow	**-600**	**-970**	**-583**	**-600**	**-618**
Dividends paid	-2,327	-2,633	-2,925	-3,140	-3,377
Financing cashflow	**-2,818**	**-3,857**	**-4,652**	**-4,854**	**-5,333**
Net change in cash	**1,001**	**-87**	**351**	**232**	**76**
Free cashflow to s/holders	**3,965**	**4,070**	**4,803**	**5,086**	**5,409**

Sales by Region (£ m)	2010	2011	2012E	2013E	2014E
Asia-Pacific	3,759	4,251	4,476	4,816	5,081
Americas	3,498	3,558	3,541	3,534	3,685
West Europe	3,695	3,600	3,522	3,544	3,590
EEMEA	3,931	3,990	4,133	4,438	4,761
Sales - total segments	14,883	15,399	15,673	16,332	17,118

Adj EBIT by Region (£ m)	2010	2011	2012E	2013E	2014E
Asia-Pacific	1,332	1,539	1,610	1,759	1,879
Americas	1,382	1,441	1,461	1,476	1,559
West Europe	1,103	1,228	1,248	1,286	1,335
EEMEA	1,167	1,311	1,475	1,651	1,858
EBIT - total segments	4,984	5,519	5,794	6,173	6,631

Organic EBIT Growth (%)	2010	2011	2012E	2013E	2014E
Asia-Pacific	2.4	11.1	5.1	10.3	6.7
Americas	5.5	4.5	8.4	3.7	5.6
West Europe	10.3	9.8	8.2	4.3	3.5
EEMEA	na	16.7	17.6	13.5	12.5
Total EBIT	6.4	10.3	9.6	8.2	7.3

For further data queries on Citi's full coverage universe please contact CIRA Data Services Europe at CIRADataServicesEMEA@citi.com or +44-207-986-4050
For definitions of the items in this table, please click here.

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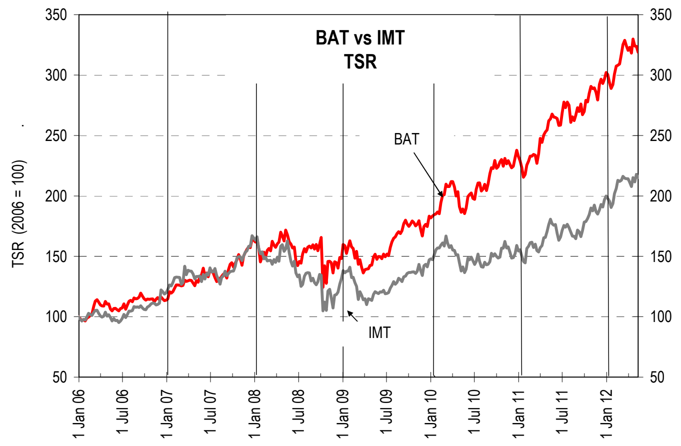
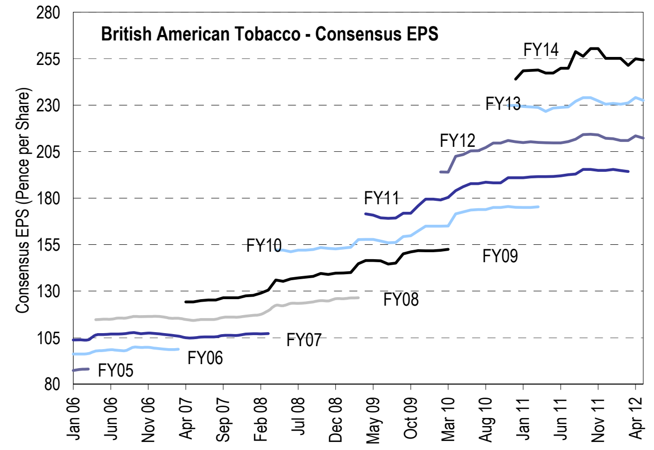
Key Charts

Figure 1. British American Tobacco vs. IMT, 2006 to Present (GBP)



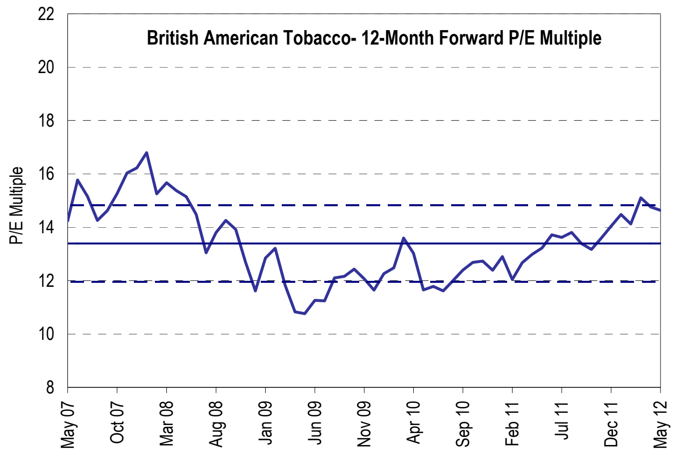
Source: Datastream and CIRA

Figure 2. British American Tobacco – Consensus EPS



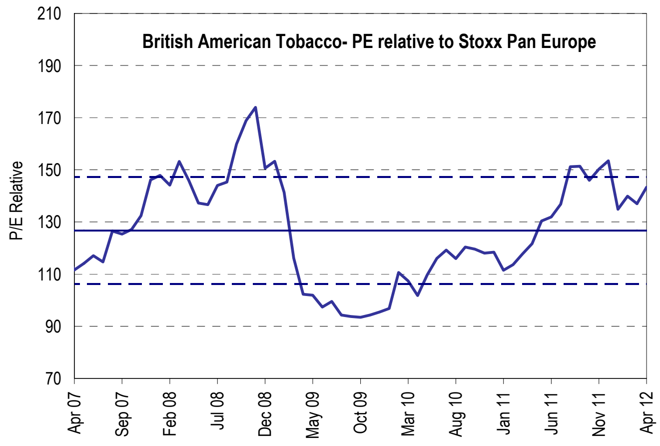
Source: Datastream and CIRA

Figure 3. British American Tobacco – 12 Month Forward P/E Multiple



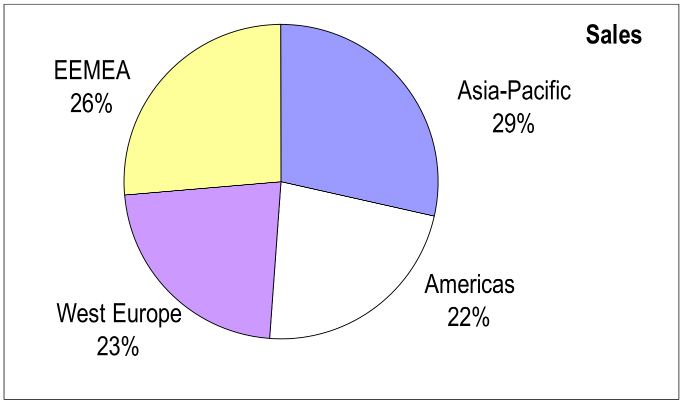
Source: Datastream and CIRA

Figure 4. British American Tobacco – P/E Relative to Stoxx Pan Europe



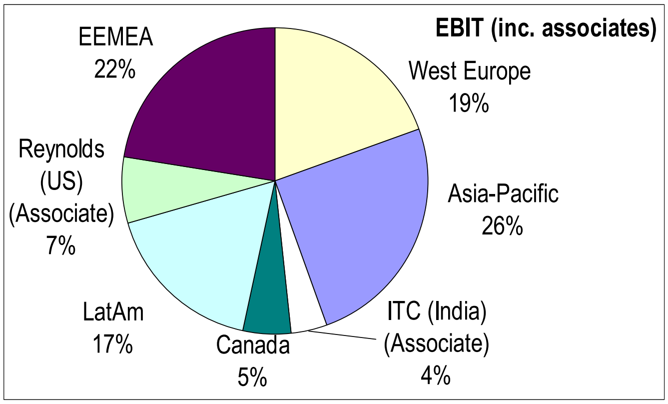
Source: Datastream and CIRA

Figure 5. British American Tobacco – Split of Sales, FY12E



Source: Datastream and CIRA

Figure 6. British American Tobacco – Split of EBIT, FY12E



Source: Datastream and CIRA

Upgrade to Buy

We are raising BAT to a Buy from a Hold, with our price target moving up to 3400p from 3330p.

At a time when the economic outlook looks fragile particularly in Western Europe, we are more convinced than ever that the outlook for BAT's pricing and mix is strong in its main emerging markets, both this year and into the future.

- **EBIT growth should be especially good in BAT's top 5 emerging markets this year** with large price hikes in Brazil and Russia. In South Africa and Malaysia pricing has been better than last year, albeit still in the low single digits.
- **We expect improving mix in Brazil and Russia over a number of years** because tax/ minimum price policies are likely to result in rapid price rises for the cheaper brands in those markets.

We believe these points have been almost completely overlooked by the market, and they show that in Ems at least, BAT's pricing power is, if anything, getting stronger. Given the stock market's decline, we're not surprised that BAT is now in negative territory YTD, but it seems to us that the current price is probably a good time to enter.

Changes to Estimates

We are leaving our estimates broadly unchanged. Our increased confidence about the main Ems, which collectively contribute about 30% of profit, results in an upgrade to our organic EBIT estimates by about 2%, but unfortunately this has been offset by cuts for F/X, particularly the weak Brazilian real.

F/X is an important driver for BAT's EPS, but we believe BAT would have more ability than many global companies to protect itself if EM currencies were to fall further as it can, if necessary, increase prices in local terms to protect its sterling earnings, cash flow and dividends.

Valuation/ Price target

On our numbers BAT is trading on 13.2x CY13 P/E which is fairly high relative to its history. We suspect this is because the market is valuing its ability to grow through self help (pricing, cost cutting, buybacks) more than ever before. We now think it will probably stay at this level because we expect its EM story to remain compelling and because we assume that in these uncertain times the market will continue to value self help.

Our new price target assumes that in 12 months' time, the multiple increases slightly to about 13.5x.

What about our long-term bear (and bull) arguments on BAT?

Existing bear points: We remain concerned for long term volumes and mix in DMs, but we don't expect this to hit EPS soon

For the very long term we remain quite bearish because we continue to think that:

1. Volumes will gradually worsen over time[1]; and
2. Plain packaging will be imposed in Australia and probably elsewhere[2].

However the important thing is that these two bear points are unlikely to make a noticeable difference to profit for several years.

Existing bull points: By contrast our strategists' bull case seems ever more urgent

On the bull side, the positive arguments that our strategists have been making for the need to own defensive growth stocks – in other words names like BAT – seem more compelling than ever because economic growth in Europe seems more elusive and quality government bonds are yielding less.

Figure 7. BAT vs CIRA Strategists' Themes

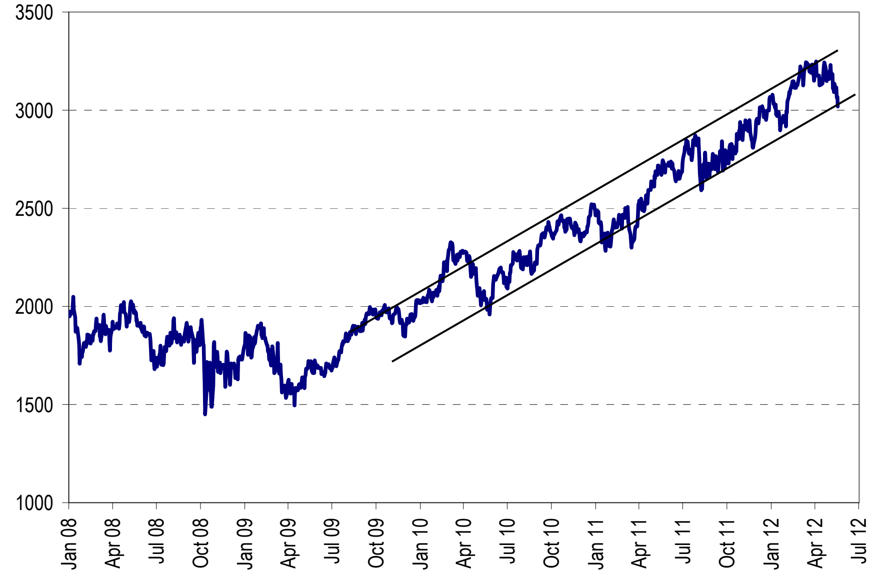
Theme	Insight	BAT
Growth	Any growth will stand out in likely future environment	■ 7-9% org EBIT growth
High EM/ Low Europe, esp S Europe	We forecast increasingly divergent economic growth	■ Ems: 54% ■ Southern EU[1]: 8% ■ Northern EU[2]: 11% ■ Other DMs: 27%
Self Help	Good in a world where economic environment is tough	■ Pricing ■ Cost Savings (3% of EBIT pa)
Quality	We back quality: growth & margins, B/S, cash generation, returns	■ World Champion (No2 place) ■ ND/EBITDA: 1.2 ■ Net Margins (subs): 37%
Risk Adjusted Yield	If growth is low, then yield is likely to contribute more to TSR, but have to take cost of CDS into account	■ 4.8% - 58bps = 4.3%
De-equitisation	Makes sense to buy equity when interest rates are so low vs cost of equity	■ Buybacks: 2% of mkt cap annually
Credit Crunch	Risks to Vendor and Supplier Financing	■ Not a problem
Survivors Party	Explosive returns can be made in beaten up companies as focus changes from disaster to cyclical upside. We focus on Big, Beta, Balance Sheet	■ Low beta: 0.65
Inflation	One way developed world may reduced debt is inflation.	■ Pricing power ■ Low capital intensity. High capital intensity companies suffer as capex exceeds depreciation

1: Italy, Spain, Greece, Portugal, Ireland. [2] Includes Switzerland and Central Europe, notably Poland, Hungary and Romania. Source: Citi Investment Research and Analysis

[1] We continue to believe the long-term arguments we made in our note "What if the last smoker quits in 2050?" (7 Jan 2011) hold true. In summary this was that smoking rates in many developed markets are falling in a series of straight lines, and that therefore volumes declines will gradually worsen in percentage terms over time, even if there may be variations in any particular year.

[2] We believe that plain packaging will be introduced in Australia, and that it will spread, with the UK government likely to say around the end of the year that it wants to implement plain packaging. Ultimately we think plain packaging will hit mix, not volume, but this won't be apparent for a number of years. We think there is a more than 50% chance that the industry loses its case in Australia because of the way the constitution is phrased. However elsewhere we think the probabilities are more even.

Figure 8. BAT Share Price – January 08 to Present



Source: DataStream

Pricing in Emerging Markets

The trigger for this upgrade is our analysis of pricing in BAT's main emerging markets, which we think has been ignored by the market. Starting on page 11 we go into a lot of detail about what's happening in its key EMs and Figure 9 summarises the situation in each market, but the two critical conclusions are that:

1. **Pricing should drive particularly good EBIT growth in BAT's top 5 emerging markets this year** because:

   – In Brazil and Russia we expect especially large tax increases and correspondingly big price rises, so we expect mid- to high-teens EBIT growth

   – In South Africa and Malaysia, pricing is much more modest but it is better than last year

   – India remains very strong and we expect the high teens growth there will continue. ITC, which is BAT's associate in India, is our top pick among the Indian consumer universe.

2. **We expect further improvements in mix over the medium term** because the changes to the tax regimes in Brazil and Russia ought to bear down on low end and illicit brands. We expect this will boost premium brands, which are much more profitable, because (1) the price gaps will narrow, and (2) premium cigarettes are still reasonably cheap in these markets. In Brazil there is now a minimum price for the first time and in Russia the minimum tax is rapidly increasing. In both markets there are schedules for quite rapid increases in the minimum price/tax until 2015, so we expect the positive mix effect to continue for several years.

Figure 9. BAT's Top Five Emerging Markets

	Est % of Group Profit	What's happening	Likely impact in next 12 months	Long-Term impact
Brazil	13%	Rapid price hikes as taxes being raised and simplified. Minimum price being introduced.	Profits may grow 15-20%, thanks to pricing	Illicit likely to be contained, uptrading encouraged
Russia	7%	Large tax increases at bottom end in July but especially Jan 2013 likely to result in corresponding big tax increases	Sharp price rises, probably teens EBIT growth	Exposure to premium will be even more important; low end vols likely to fall fast
S Africa	7%	Smaller tax hike this year	BAT's net price increase with Budget was 2.3% this year, which is low but better than last year	Govt clearly listening on illicit
India / ITC	4%	Govt recently reversed proposal to introduce ad valorem tax	We expect high teens net profit growth will continue	We expect premium cigarettes to continue growing
Malaysia	3%	No tax hike this year; 1Q results were strong	We're projecting 5% EBIT growth this year vs low to mid single digit declines in recent years	About 35% of mkt is illicit; if this can be reduced there would be upside

Source: Citi Investment Research and Analysis

We're not trying to argue that the large tax rises in Brazil and Russian are positives in themselves; rather we like that (once again) they are being used as an excuse to increase net prices, and also that they will increase the prices on the cheaper brands by the greatest percentage.

Implications for JT and Philip Morris

In this note we've focused on the markets that are most important for BAT, but there is nothing in it which is negative for the other tobacco companies, and both JT and Philip Morris should benefit from the same trends. (Imperial Tobacco has little exposure to these markets.)

Other bull arguments

This note focuses on pricing in BAT's main EMs

As we've said this note focuses only on the pricing story in BAT's main emerging markets. However there are plenty of other bull points on the stock, for example:

- Increased margin in the EU, driven by a new phase of cost cutting that started in 2H11
- Higher market share in Japan
- The opportunity to grow profits in frontier markets like sub-Saharan Africa, Pakistan/Bangladesh/Sri Lanka and the CIS outside Russia.

In addition, it is worth remembering that EPS growth in last the down-turn was extremely solid, either with or without F/X being taken into account, as it was for all tobacco companies.

Figure 10. BAT, Imperial Tobacco & Philip Morris — Adjusted EPS Growth

	BAT		PMI		IMT	
	Incl F/X	Excl F/X	Incl F/X	Excl F/X	Incl F/X	Excl F/X
FY07	11%	15%	na	na	12%	10%
FY08	19%	9%	19%	13%	15%	8%
FY09	19%	9%	-1%	15%	18%	2%
FY10	15%	10%	18%	14%	11%	9%
FY11	11%	11%	26%	21%	5%	5%

Source: Company Reports and CIRA Estimates

What about F/X?

Like many large UK listed companies, BAT is suffering from the recent strength of the pound against the euro and some emerging market currencies (for example the Brazilian real and the Indian rupee). Altogether this has taken about 5% off our estimates relative to the start of the year.

However we believe that if currencies weaken further, the company is likely to increase prices in some markets to offset the weakness and protect sterling earnings because

1. Management is aware that its shareholders expect earnings, cash and dividends in pounds sterling, and

2. The EPS targets on which management are incentivised are set in sterling[3].

In the past management has said that if F/X gets so bad that EPS actually falls, it would raise its dividend payout ratio to ensure that its dividends are, at the worst, stable in sterling terms.

Changes to estimates

Our increased confidence about EM price and mix means we have lifted our estimate of BAT's organic EBIT growth rates for the next few years, and increased our (organic) estimate of EBIT for 2013 by about 2%. In simple terms this is an 8-9% increase in our organic EBIT forecast for next year in 20% of the business (Brazil + Russia), plus a 3% increase in 10% (S Africa and Malaysia).

Unfortunately, the increases have more or less closely been offset by worsening F/X rates, so the overall changes, which are shown in Figure 28 on page 24, are small.

Valuation

Our valuation assumes that the current forward multiple (about 13.2x P/E) will slightly increase in the next 12 months to about 13.5x, but in a year's time this will be applied to FY14E EPS, not FY13E. Given our estimate for 2014 EPS we set a price target of £34.

In the past we argued that BAT's multiple was more likely to fall than increase, driven down by worries about falling volumes and plain packaging. However we now think this is unlikely in the next 12 months because we are confident that pricing will remain strong, particularly in EMs, and because there are so many worse problems in other sectors[4].

[3] Senior management get the full payout from the EPS portion of their incentives if EPS (in sterling) grows over the three year incentive period at 8% more than inflation. Inflation is running at about 3.6%, so their current target is about 11.5% EPS growth a year.

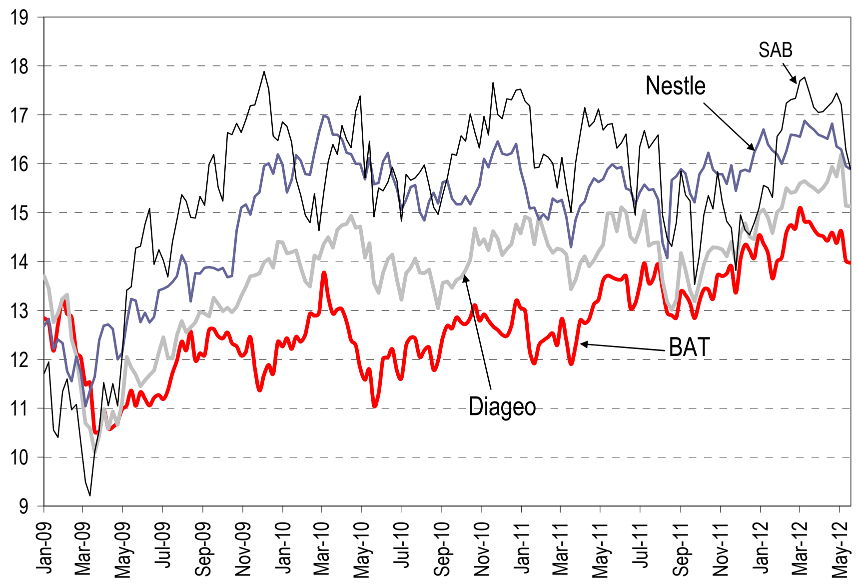
[4] Our recommendations are set on a 12 month view, and are based on absolute TSR including dividends. Bearing in mind that BAT grows its EPS about 10% each year and has a roughly 4-5% dividend yield the only reason for an investor to worry that it will not generate a decent absolute return is if he or she believes either the EPS will stop growing roughly in line with its historic rate or that the multiple will fall. If an investor believes the multiple will remain constant and the EPS will continue to grow about 10%, that would result in a roughly 10% return, with the dividend yield on top.

Bear case on valuation is that the multiple is too high

Bears will argue that although BAT (and the other tobacco companies) are no longer trading at all time highs, they have roughly doubled since their lows in early 2009. Figure 3 and Figure 11 show that BAT's P/E is high relative to history.

Our strategists argue that given the economic slowdown, investors will want increasingly to pay up for defensive growth, and this has already driven the P/E up, and may well drive it up higher, so the high absolute P/E is nothing to worry about, in our view. However BAT's P/E has increased not only in absolute terms, but since mid 2010 also relative to names like Diageo, SAB and Nestlé, that can also be described as quality defensive growth names. (Figure 11)

Figure 11. BAT vs DGE, SAB and Nestlé – 12 Month Forward P/Es vs Consensus



Source: DataStream and CIRA

But we are not convinced that BAT has to return to its previous multiples

This note is not an in-depth investigation of BAT's valuation, still less one on the comparative merits of BAT, Nestlé, SAB and Diageo. However, we can briefly say that we see no compelling reason why BAT has to derate within the next 12 months to where it used to trade, either on an absolute basis or relative:

- Arguments about historic valuation assume that the relative valuations were "correct" in the past. It is perfectly possible to believe that even relatively recently the market didn't fully appreciate just how robust BAT's financial performance would remain, or its commitment to returning capital to shareholders.

- Tobacco probably has more ability to drive earnings through self-help than other sectors and it may well be that the market is valuing this more than it did before. If this is correct, we can't see a reason why the market might reverse its view on the importance of self-help.

Brazil – Minimum price and price rises should accelerate EBIT growth

Brazil is important not only because it is BAT's biggest profit generator but also because one of the biggest changes to the tax system anywhere in the world this year is occurring there. Taxes are going up quite sharply, but the positive points are (1) the introduction of a minimum price, which is scheduled to rise over time, and (2) there have been significant price rises.

This year we expect that Brazilian cigarette profits could easily grow 15-20%, with volumes down 5-8%, but with price mix of 12% and excellent margin growth.

In the long-term we think the increasing minimum price will benefit BAT because it should prevent further growth of the illicit market, which is currently about 20% of consumption, and possibly even reduce it. We're not sure if it will tend to help legitimate low end brands (like Derby) most, or whether the people who used to smoke illicit cigarettes will jump to mid- or premium- brands, but either way, Souza Cruz is likely to be the main beneficiary.

Background on Brazil

BAT is exposed to Brazil via its 75% stake in Souza Cruz[5], the dominant Brazilian tobacco company. Souza Cruz's profits are principally made from cigarettes but it also produces leaf and historically has distributed other products, for example phone cards, although this has largely stopped. Figure 12 summarises its operating performance.

Figure 12. Souza Cruz Operating Performance, 2008-2011, BRL and GBP in Millions

	BRL				GBP			
	2008	2009	2010	2011	2008	2009	2010	2011
Cigarettes								
Volume	78.6	72.8	71.9	70.9	78.6	72.8	71.9	70.9
Net Sales		3,420	3,796	4,212		1,099	1,396	1,570
Operating profit			1,678	1,994			617	743
Leaf								
Net Sales			1,039	1,058			382	394
Operating profit			116	122			43	45
Other								
Net Sales			684	281			252	105
Operating profit			147	71			54	26
Total Souza Cruz								
Net Sales	5,300	5,793	5,519	5,550	1,578	1,862	2,030	2,069
Operating profit	1,604	1,890	1,941	2,186	477	607	714	815

Source: Company Reports

This note considers only its cigarette business, which generated operating profit of BRL2.0 bln, or £743m, last year. Souza Cruz has five main brand families, outlined in Figure 13. The discount brand Derby accounts for slightly over 40% of volumes, Free and Hollywood are mid priced brands, each accounting for about 16% of Souza Cruz's volumes, and Dunhill is its main premium brand. Souza Cruz already has high margins, but it has successfully driven positive mix, and we expect this to accelerate with the introduction of the minimum price.

[5] (CRUZ3.SA; R$27.28; Not Rated)

According to Souza Cruz, about 20% of the market is either illicit or what Souza Cruz calls “unfair competition”, which is from brands that look legitimate but that are sold at prices that imply they have not paid taxes in full. Both the illicit and the “unfair” brands are sold through regular retailers, unlike the trade in Europe or Canada, which is why the government hopes the imposition of the minimum price will reduce this trade.

The other important point is that the government has a strong anti-tobacco programme, with taxes that are higher than in surrounding markets. The government is planning on increasing the amount of each pack devoted to health warnings, and is proposing a ban on all flavourings in tobacco, except sugar[6] from September 2014.

Figure 13. Souza Cruz – Brand Portfolio (Volumes in Blns)

	Current Retail Price[1] (R$ for 20)	% of 2011 volume	Volume (blns) 2009	2010	2011
Dunhill	6.00	13%	8.3	8.6	9.4
Free	5.00/5.50	17%	11	11.5	11.8
Lucky Strike	5.25	1%	0.5	0.7	1
Hollywood	4.60	16%	12.2	11.3	11.6
Derby	4.25	42%	33.3	32.5	29.5
Others		11%	7.5	7.3	7.6
Total Volumes		**100%**	**72.8**	**71.9**	**70.9**

[1]Outside São Paolo. Source: Company Reports

What’s changing?

Brazil has a complicated tax system, but it is being simplified and increased, with the first step of this multi-year programme being implemented on May 1 this year. The new minimum price is R$3.00 per pack, whereas the non-tax paid brands retail at prices as low as R$1.00/pack and Derby, Souza Cruz’s main discount brand, was at R$3.40, and is now moving to R$4.25.

Importantly, Souza Cruz has used the opportunity to increase its own prices significantly, with a weighted average price increase of 16% in most of Brazil. It is true that Philip Morris has not moved the price of Marlboro up as much as Dunhill, so in the state of São Paolo, Souza Cruz has lowered some prices, which means the net increase is only 7% in that state (which accounts for about 22% of the population.). However we expect this situation will sort itself out relatively soon, because in tobacco price wars rarely last long.

Figure 14 summarises the new price points. Investors interested in the precise details of the tax changes should contact the authors.

[6] This ban will make it hard (or impossible) to make traditional American Blend cigarettes, which use burley and traditionally require certain flavourings beyond sugar. (Sugar is lost in the curing of burley tobacco).

Figure 14. Souza Cruz – Main Cigarette Prices Before and After Tax Rise

	Price in Feb 2012			New Price Outside São Paolo			São Paolo		
	Retail	Net[1]	Manufacturer[2]	Retail	Net[1]	Manufacturer[2]	Retail	Net[1]	Manufacturer[2]
Dunhill	4.75	1.61	1.18	6.00	2.24	1.70	5.50	1.95	1.46
Free (soft packs)	4.00	1.63	1.27	5.00	1.97	1.52	4.40	1.62	1.23
Hollywood	3.75	1.47	1.14	4.60	1.74	1.32	4.30	1.57	1.18
Derby	3.40	1.39	1.08	4.25	1.54	1.15	4.25	1.54	1.15
Increase									
Dunhill				26%	39%	**44%**	16%	21%	**23%**
Free (soft packs)				25%	20%	**19%**	10%	-1%	**-4%**
Hollywood				23%	18%	**16%**	15%	6%	**4%**
Derby				25%	11%	**7%**	25%	11%	**7%**
Weighted average				25%	18%	**16%**	19%	10%	**7%**

[1]Retail price less all taxes (includes retailers' margin). [2]Citi estimate of net price for Souza Cruz (= Retail price less all taxes and less Citi's estimate for retailer margins)

Source: Company Reports and CIRA Estimates

The government has laid out tax plans up until 2015, and we regard these as quite beneficial, because the plan requires price rises of only about 8% each year to pass them on which is close to inflation in Brazil. More importantly, the minimum tax is scheduled to increase by R$0.50 each year (≈15%), which we regard as a positive because we think it will encourage uptrading away from the illicit market.

Figure 15. Minimum Retail Price (BRL for 20)

	Minimum price
2012 (from May)	3.00
2013	3.50
2014	4.00
2015	4.50

Source: Company Reports

Likely impact on volumes

It is impossible to be certain of the impact on volumes, but we believe Souza Cruz's volumes are likely to fall by no more than 7% this year, considering:

- In 2009, when retail prices increased by 20-27% but no minimum price was introduced, the decline in Souza Cruz's volumes was about 7%
- In 2012, a minimum price has been implemented that should reduce, or at the least, limit the amount of ultra-cheap product being consumed
- In 2012 there has been an increase in the minimum wage by 9% in real terms, which is slightly greater than the corresponding figure for 2009.

Figure 16. Brazilian Cigarette Market – Legal vs Illegal (Blns of Sticks)

	2008	2009	2010	2011	Proportion
Consumption	126.6	117.3	115.4	116.2	100%
BAT/ Souza Cruz	78.6	72.8	71.9	70.9	61.0%
Other Fully Taxed Companies	27.4	22.8	20.8	21.8	18.8%
Illicit & Unfair Competition	20.6	21.7	22.7	23.5	20.2%
Growth					
Consumption		-7%	-2%	1%	
BAT/ Souza Cruz		-7%	-1%	-1%	
Other		-17%	-9%	5%	
Illicit & Unfair		5%	5%	4%	

Source: Company Reports

Mix

We suspect this change will also accelerate the positive mix that Souza Cruz is achieving. In 2011, mix added +4% to sales (on top of pricing of +8%), and we think it will be at least this good in 2012.

Conclusion on Brazil

Brazil is BAT's No1 profit generator and taxes are scheduled to increase over a number of years. We don't regard this as a positive in itself, but what is helpful is that (1) Souza Cruz has lifted its own net prices by between 7% and 44%, with a weighted average increase of about 16% (outside Sao Paolo) and 7% within Sao Paolo; and (2) the introduction of the minimum price.

Judging by what happened in 2009, when there was a similar price rise, we can expect volumes to fall by no more than 7%, and we also expect mix to improve by at least 4%.

The combination of such large volume declines and price increases should result in strong margin expansion, maybe of as much as 200bps, which is why we expect high teens EBIT growth.

The introduction of the minimum price, and its acceleration over time, should encourage smokers to trade away from the illicit sector, which should help Souza Cruz even if it hurts overall consumption in Brazil.

Russia – Increasing minimum tax and price rises

After Brazil, Russia is BAT's next most important market, about equal with South Africa and, like Brazil, we think that the big increases in excise tax will play into BAT's hands particularly in 2H12. This is because we expect:

- Large price rises this year, particularly on discount brands in Russia
- Significant uptrading

We think it is reasonable to suppose that in 2H12 Russia produces high teens growth in operating profit. This wouldn't be an exceptional figure for Russia, but it would support our view that BAT's outlook this year is for good organic growth, particularly from its most important EMs. To put it in context:

- In 2H11, BAT's organic operating profit in EEMEA[7] was +13%, although this was held back by S Africa (which is about as big as Russia for BAT) and Turkey
- In 1Q12, PM's organic operating profit in EEMEA was +18%. For PM's region, Africa is much less important than it is for BAT's.
- Figure 18 shows the retail value of the cigarette market grew consistently in the teens during the economic crisis, and currently real incomes are growing well in Russia

Long-term, the rapid rise in the specific and minimum taxes should force sharp price rises on the bottom end brands (maybe as much as 60% for a couple of years). We expect this will both reduce low-end volumes and boost mid- and premium-priced brands because of the reduced price gaps. We think this will be helpful because in Russia the low price volumes contribute very little profit because their price is so low whereas premium brands contribute more than their equivalents in many emerging markets, as Figure 17 shows.

BAT stands to gain because of its strength in premium. Its main brand, Kent, has just over 5% share, and BAT says its share of the total premium segment is 38%. PM is also strong in premium, thanks to Parliament and Marlboro (together about 5.2% share). JT's Winston brand is pre-eminent in mid-price[8].

Background on Russia

Russia is an important market for Japan Tobacco and Philip Morris as well as for BAT. JT is the price leader, thanks to its two leading brands, Winston, the No1 brand, and LD, the No2. Historically taxes have been low, which means there is a very large market for low priced (and low margin) cigarettes, like BAT's Alliance and PM's Optima; by contrast premium cigarettes (like Kent, Dunhill and Parliament) generate very attractive margins. Figure 17 shows that even after several years of tax increases, the cheap cigarettes in Russia like Alliance retail for about 1/3 of the price of the roughly equivalent brand in Brazil (Derby), but Dunhill in Russia generates 40% more net revenue per pack than Dunhill in Brazil[9]. The difference in revenue per pack within each market shows that mix is very important in all three markets shown in Figure 17, but it is particularly important in Russia.

[7] Eastern Europe Middle East and Africa.

[8] All three companies, BAT, JT and PM, have brand offerings in the premium, mid and the discount sectors.

[9] Figure 17 also shows just how expensive cigarettes are in Britain. The premium cigarettes are certainly very profitable.

Figure 17. Cigarette Prices in Russia, Brazil and UK, May 2011

	Russia				Brazil				UK	
	Dunhill	Kent	Winston	Alliance	Dunhill	Free	Hollywood	Derby	Marlboro	JPS Silver
Local Currency for 20	RUB				BRL				GBP	
Retail Price	72	60	41	24	6.00	5.0	4.60	4.25	7.50	6.10
Net Price[1]	48.4	39.15	24.5	11.14	2.24	1.97	1.74	1.54	1.66	0.73
US Dollars for 20	USD				USD				USD	
Retail Price	2.33	1.94	1.33	0.78	3.00	2.49	2.30	2.13	11.93	9.70
Net Price[1]	1.57	1.27	0.79	0.36	1.12	0.98	0.87	0.77	2.64	1.16

[1] After all taxes. Source: Company Reports and CIRA Estimates

The government is increasing taxes on tobacco fast, as well as imposing tougher anti-smoking regulations. However despite this, volumes have held out reasonably well and value has increased in the teens right through the economic crisis.

Figure 18. Russia Cigarette Market – Change in Volume and Retail Value

	Volume	Retail Value
2006	3%	19%
2007	-2%	11%
2008	6%	14%
2009	-2%	13%
2010	-2%	15%
2011E	-2%	n/a

Source: Euromonitor and CIRA Estimates

Russian Taxes

Russia has a mixed tax system, similar to that used in the various EU markets, with combination of three taxes on cigarettes:

1. An ad valorem tax (which is a percentage of the final retail price)
2. A specific tax (which is levied per stick); and
3. A minimum tax, which kicks in if the first two taxes don’t reach the minimum

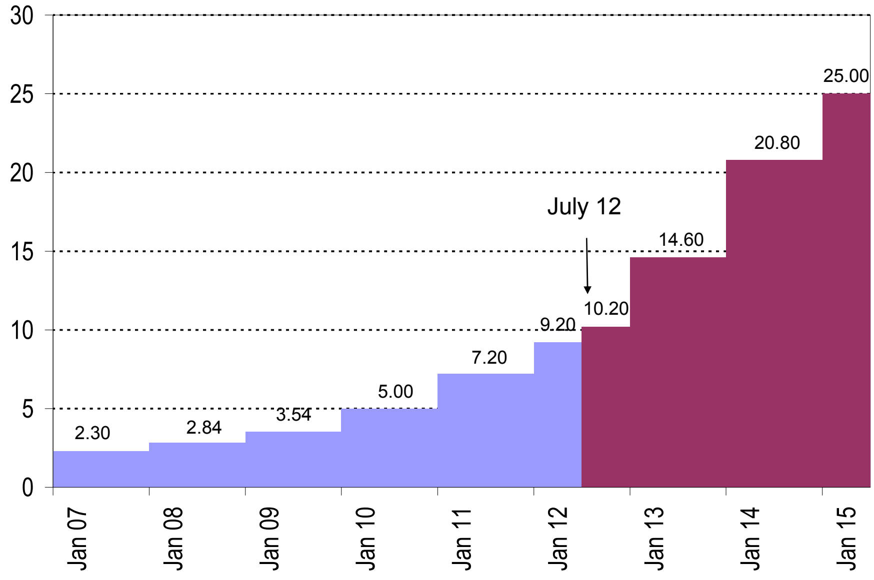
All these taxes are going up, as can be seen in Figure 19, but there have been accelerating increases on the specific and minimum taxes, with particularly large jumps in January 2013 and January 2014, and an unusual step increase in July 2012 as well. (Best seen in Figure 20.)

Figure 19. Russia – Cigarette Excise Tax Regime

	Ad valorem	Specific tax (RUB/20)	Minimum tax (RUB/20)
January 07	5.0%	2.00	2.30
January 08	5.5%	2.40	2.84
January 09	6.0%	3.00	3.54
January 10	6.5%	4.10	5.00
January 11	7.0%	5.60	7.20
January 12	7.5%	7.20	9.20
July 12	7.5%	7.80	10.20
January 13	8.0%	11.00	14.60
January 14	8.5%	16.00	20.80
January 15	9.0%	19.20	25.00

Source: Company Reports

Figure 20. Russia – Minimum Excise Tax on 20 Cigarettes (Rubles), Historic and Proposed



Source: Company Reports

We think the change in tax structure will help BAT (and the other tobacco companies)

We believe the end result will be increased profits for all the main tobacco companies there, even if volumes fall quite significantly at the low end, because we think they will trigger both price rises and uptrading.

Japan Tobacco has the greatest exposure, so we expect it to be the main beneficiary, but we also expect the changes to help BAT and PM.

Historically Japan Tobacco, has always increased the prices on LD, the cheaper of its two benchmark brands, so that its price triggers an excise tax that is just above the minimum tax, and this can be seen in Figure 21. Assuming that it continues to do so, and we're quite confident that it will, the scheduled tax rates imply that it will take meaty price rises in July 2012 and 2013.

Figure 21 not only shows the track record in LD's prices from 2009 to Jan 2012, but it also shows two plausible price points for July 2012 and January 2013, based on the assumption that the retail price will continue to be moved to a point which triggers a figure that is at or just above the minimum tax. However this assumption implies the retail price increases about 30% in July and about 60% in January, with similarly large increases in the net price. There has to be more uncertainty about the January price rise because it needs to be so large to keep up with the tax rise, but we think the companies will want (if anything) to accelerate the price rise in July to ease consumers into the January prices.

Figure 21. LD Prices in Russia – Relative to Excise Tax

	Jan-09	Jul-09	Jan-10	Jul-10	Jan-11	Jul-11	Jan-12	Jul-12E	Jan-13E
LD Retail Price	**15.00**	**17.00**	**18.0**	**20.0**	**23.0**	**25.0**	**28.0**	**33.0E**	**45.0E**
Increase on yr earlier			*20%*	*18%*	*28%*	*25%*	*22%*	*32%*	*61%*
Excise tax									
Ad Valorem	0.90	1.02	1.17	1.3	1.61	1.75	2.1	2.475	3.60
Specific	3.00	3.00	4.10	4.10	5.60	5.60	7.20	7.80	11.00
Combined	3.90	4.02	5.27	5.40	7.21	7.35	9.30	10.28	14.60
Minimum	3.54	3.54	5.00	5.00	7.20	7.20	9.20	10.20	14.60
Excess over minimum	0.36	0.48	0.27	0.40	0.01	0.15	0.10	0.08	0.00
VAT	2.29	2.59	2.75	3.05	3.51	3.81	4.27	5.03	6.86
Net price	**8.81**	**10.39**	**9.98**	**11.5**	**12.3**	**13.8**	**14.4**	**17.7**	**23.5**
Increase on yr earlier			*13%*	*11%*	*23%*	*20%*	*17%*	*28%*	*63%*

E Citi estimates. Source: Company Reports and CIRA Estimates

Figure 22. Cigarette Prices in Russia – Rubles per 20

	Jan 10	Jul 10	Jan 11	Jul 11	Jan 12	Jul 12E	Jan 13E
1. Retail Prices (RUB/20)							
LD (JT)	18.0	20.0	23.0	25.0	28.0	33	45
Winston (JT)	31	33	36	38	41	46	58
Alliance (BAT)	18	17	20	21	24	28	38
Yava Gold (BAT)	21	22	25	27	30	35	47
Kent (BAT)	50	53	56	58	60	65	77
2. Price Premium/ (Discount) to LD							
Alliance Relative to LD	0	(3)	(3)	(4)	(4)	(5)	(7)
Yava Gold Relative to LD	3	2	2	2	2	2	2
Winston Relative to LD	13	13	13	13	13	13	13
Kent Relative to LD	32	33	33	33	32	32	32
3. Net Prices							
LD	10.0	11.5	12.3	13.8	14.4	17.7	23.5
Winston	20.2	21.7	22.4	23.9	24.5	27.7	33.5
Alliance	10.0	9.2	9.7	10.6	11.1	13.5	17.6
Yava Gold	12.3	13.1	13.8	15.4	16.0	19.2	25.1
Kent	35.0	37.4	37.9	39.5	39.1	42.4	48.1
4. Increase in Prices							
4a. Retail							
LD			28%	25%	22%	32%	61%
Winston			16%	15%	14%	21%	41%
Alliance			11%	24%	**20%**	**33%**	58%
Yava Gold			19%	23%	**20%**	**30%**	57%
Kent			12%	9%	**7%**	**12%**	28%
4b. Net prices							
LD			23%	20%	17%	28%	63%
Winston			11%	10%	9%	16%	37%
Alliance			-2%	15%	**14%**	**28%**	58%
Yava Gold			12%	17%	**15%**	**25%**	57%
Kent			8%	6%	**3%**	**7%**	23%

Source: Company Reports and CIRA Estimates

Figure 22 explains why we expect such big increases in the retail and net prices for BAT's brands in Russia.

- **Section 1** shows the history and our forecasts for the retail price for LD, and shows the corresponding prices for Winston (the No1 brand in Russia) and three key BAT brands: Alliance, Yava Gold and Kent.
- **Section 2** shows the price points relative to LD. With the exception of Alliance, these have held relatively constant in the past, so we expect them to be in the future[10]. We expect Alliance and similar brands to be further depositioned.
- **Section 3** shows the net prices implied by the retail prices and the tax rates shown in Figure 19.
- **Section 4** shows the increase in retail and net prices.

Conclusions on Russia

The main conclusions of Figure 21 and Figure 22 are that:

- In 1H12, we have had price increases in the bottom end of about 20% at retail and 15% net, with more modest increases in premium cigarettes
- In 2H12, we are expecting about 30% retail price increases at the bottom end, and very roughly 7-12% increases at premium

At the bottom end we expect net prices also to increase, and this is likely to improve profitability even while volumes fall. In most markets a 30% increase in prices would result in about a 12% decline in volumes, but with a roughly 18% increase in sales.

These changes are also likely to improve mix, which is critical in Russia, as the difference in margin between discount cigarettes and premium is probably greater there than anywhere else in the world. We expect a relatively benign outcome both because volumes and retail values have held up well in previous years, but also because real wages are increasingly sharply in Russia currently. Altogether we think it is likely that Russian produces high teens EBIT growth in 2H12.

In the longer term, we expect the rapid increase in the minimum tax both to reduce the volumes of deep discount brands and to encourage consumers to trade up, and we think this will be beneficial to all the companies exposed to the mid priced and premium sectors in Russia.

[10] We think Kent has moved to a RUB19 premium simply to stick at a round price point – RUB60. Alliance seems to have been depositioned

Other Emerging Markets

Figure 23. BAT – Estimated Profit Split by Market, Including Associates, 2011

	Country	Cumulative
Emerging Markets		
Brazil	13%	13%
Russia	7%	20%
S Africa	7%	27%
India/ ITC	4%	31%
Malaysia	3%	34%
Nigeria	2%	37%
Other EMs	17%	54%
Total EMs		54%
Developed Markets		
Australia/NZ	10%	10%
US/ Reynolds	7%	17%
Canada	5%	23%
Japan	5%	28%
Italy	5%	33%
Germany	4%	37%
France	2%	39%
Other DMs	6%	46%
Total DMs		46%
Total		100%

Source: Citi Investment Research and Analysis

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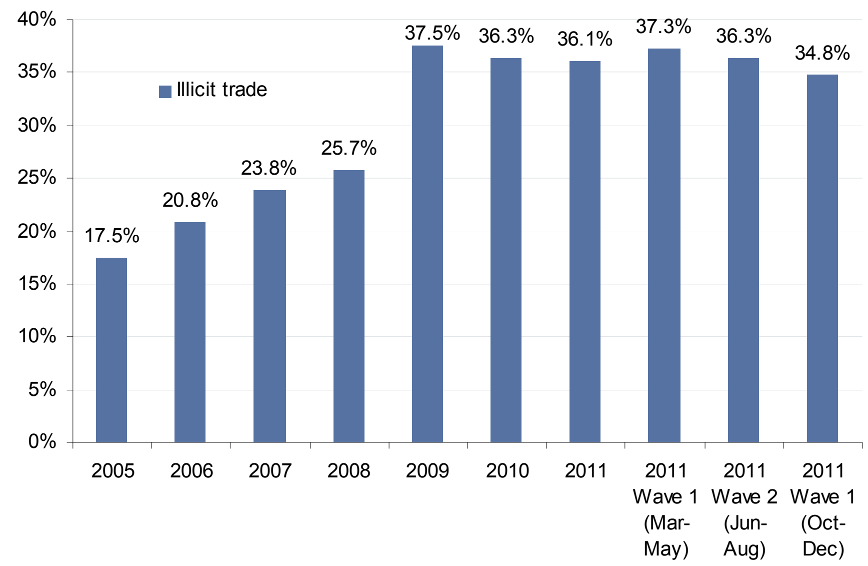
In the previous sections we argued that tax changes in Brazil and Russia would result in excellent profit grow for BAT in those markets, which together account for about 20% of group profit. Beyond this, there have been changes in two of BAT's other main emerging markets – South Africa and Malaysia – which means that we think both will produce better results in 2012 than last year. We believe that S Africa contributes about 7% of group profit and Malaysia about 3%, as shown in Figure 23.

- **In South Africa** the limitation on pricing and profit is the illicit trade, which accounts for about 20% of the market. In its February 2012 budget, the government increased taxes less than normal[11]. The result was that BAT took a net price rise of 2.3% on its main brand, Peter Stuyvesant, this year, which is a bit better than the 0.6% price rise in 2011[12].

- **In Malaysia** BAT's exposure comes from its 50% stake in BAT Malaysia (BATO.KL; RM52.00; 2). As with South Africa, the limitation on pricing and profit is illicit, which is around 35% of the market. However in the budget for 2012 (announced in October 2011) there was no tax increase and, partly as a result, pricing has improved. In the six months since the budget[13] BAT Malaysia's price mix was +2.5%, vs -2.6% in the year earlier period. BAT Malaysia's operating profit grew 5% for the six months, and for the full year we're also projecting 5% growth, which would be a distinct improvement on last three years (-7% in 2009, -5% in 2010, and -1% in 2011)

Figure 24. Illicit Trade in the Malaysian Tobacco Industry



Source: Company Reports and CIRA

[11] In 2010, excise taxes rose by 16%; in 2011 they rose by 9% but in the February 2012 budget they rose only 6%.

[12] There are at least two important differences between S Africa and Brazil, even though illicit is about 20% of both markets. First, cigarettes are more expensive in S Africa, with mainstream packs retailing at about US$3.20, whereas they retail at about US$2.30-2.50 in Brazil (and they were about $2 before April). Second, illicit cigarettes are typically sold through legal shops in Brazil, whereas they're not in S Africa. We think both points mean it is harder for the government to control the illicit market in S Africa, and we expect much less pricing for BAT there.

[13] 4Q11 and 1Q12

India/ ITC

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About 4% of BAT's profit comes from its 32% stake in ITC (ITC.BO; Rs239.20; 1), the dominant Indian tobacco company, and our top pick among the Indian consumer universe. As with the other EMs we have considered, the tax outlook in India seems quite favourable currently, and we are forecasting continued high teens profit growth, as Figure 25 shows. We had been worried that the Union government (ie the federal government) would introduce an ad valorem tax which would have probably hurt the premium sector, but it seems to have reverse this policy, which we believe is a clear positive. About 40% of ITC's profit comes from premium cigarettes, and these are growing at about twice the rate of the rest of the business.

Figure 25. ITC – Summary Income Statement (INR in Millions)

Year ended Mar 31	2007	2008	2009	2010	2011	2012E	2013E	2014E
Net Sales	123,693	139,475	153,881	181,532	211,676	251,727	282,086	324,249
% change YoY	*26.3%*	*12.8%*	*10.3%*	*18.0%*	*16.6%*	*18.9%*	*12.1%*	*14.9%*
EBITDA	39,638	44,113	48,818	60,740	71,534	86,554	102,217	118,735
% change YoY	*18.9%*	*11.3%*	*10.7%*	*24.4%*	*17.8%*	*21.0%*	*18.1%*	*16.2%*
EBIT	36,009	39,728	43,324	54,653	64,975	79,796	94,934	110,890
% change YoY	*20.0%*	*10.3%*	*9.1%*	*26.1%*	*18.9%*	*22.8%*	*19.0%*	*16.8%*
Net Profit	27,000	31,201	32,636	40,610	49,876	61,122	72,638	84,932
% change YoY	*18.4%*	*15.6%*	*4.6%*	*24.4%*	*22.8%*	*22.5%*	*18.8%*	*16.9%*

Source: Company Reports and CIRA Estimates

Changes to Estimates

Upgrades to organic growth rates for 2012 and beyond

Our increased confidence about EM price mix means we have lifted our estimate of the sustainable growth of EBIT that BAT can achieve, even as we've slightly lowered our volume growth assumptions. We're now expecting over 9½% organic EBIT growth for this year, and about 8% next year, before EBIT returns to about 7.3% growth in 2014 and beyond.

- For 2012 we have upgraded our forecasts for the organic EBIT growth by about 150bps, which in simple terms represents:
  - a 6½% upgrade for our estimates for 20% of the business (ie Brazil and Russia); plus
  - a 2% upgrade for 10% (ie S Africa and Malaysia).
- For 2013 we have increased our expected growth rate by about 50bps as we now assume better mix in Brazil and Russia, but no extra growth in the other markets.

Because we are expecting the 2012E base to be 1.5% higher than previously, this means our forecast for 2013 EBIT is actually 2% higher than before organically (=150bps + 50bps).

Figure 26. BAT — Changes to Estimates for F/X alone (Pounds in Millions)

	2012E			2013E			2014E		
	New	Old	Change	New	Old	Change	New	Old	Change
Volume by Region									
Asia-Pacific	-0.4%	-0.4%	+0.0%	+0.8%	+0.8%	+0.0%	+0.5%	+0.5%	+0.0%
Americas	-5.0%	-4.0%	-1.0%	-3.5%	-3.0%	-0.5%	-2.2%	-2.0%	-0.2%
West Europe	-1.0%	-1.0%	+0.0%	-2.0%	-2.0%	+0.0%	-2.2%	-2.2%	+0.0%
EEMEA	+1.2%	+1.5%	-0.3%	+0.0%	+1.0%	-1.0%	-0.5%	+1.0%	-1.5%
Total Volume	**-0.5%**	**-0.3%**	**-0.1%**	**-0.5%**	**-0.2%**	**-0.2%**	**-0.9%**	**-0.4%**	**-0.6%**
Sales by Region									
Asia-Pacific	+5.8%	+5.6%	+0.2%	+8.8%	+8.8%	+0.0%	+5.5%	+5.5%	+0.0%
Americas	+6.0%	+5.0%	+1.0%	+2.5%	+2.0%	+0.5%	+4.3%	+4.0%	+0.3%
West Europe	+4.5%	+4.5%	+0.0%	+2.0%	+2.0%	+0.0%	+1.3%	+1.3%	+0.0%
EEMEA	+8.7%	+8.0%	+0.7%	+8.9%	+7.5%	+1.4%	+7.3%	+7.5%	-0.2%
Total Sales	**+6.3%**	**+5.8%**	**+0.5%**	**+5.9%**	**+5.4%**	**+0.5%**	**+4.8%**	**+4.8%**	**+0.0%**
EBIT by Region									
Asia-Pacific	+5.1%	+4.7%	+0.3%	+10.3%	+10.3%	-0.0%	+6.7%	+6.7%	-0.0%
Americas	+8.4%	+6.3%	+2.1%	+3.7%	+3.0%	+0.7%	+5.6%	+5.3%	+0.4%
West Europe	+8.2%	+8.2%	+0.0%	+4.3%	+4.3%	-0.0%	+3.5%	+3.5%	-0.0%
EEMEA	+17.6%	+14.6%	+3.1%	+13.5%	+12.4%	+1.1%	+12.5%	+11.9%	+0.6%
Total EBIT	**+9.6%**	**+8.1%**	**+1.5%**	**+8.2%**	**+7.7%**	**+0.5%**	**+7.3%**	**+7.0%**	**+0.3%**

Source: Citi Investment Research and Analysis

F/X downgrades

We last updated our estimates on April 27 to reflect the last F/X rates, and at the time we had to downgrade numbers by about 3-4%, but even so the pound has risen again, particularly against the Brazilian real, and the Euro. Figure 27 shows that were it not for our organic upgrades we would be lowering our estimates by almost 2% again.

Figure 27. BAT — Changes to Estimates for F/X alone (Excludes Organic Estimates) (Pounds in Millions)

	2012E			2013E			2014E		
	New	Old	Change	New	Old	Change	New	Old	Change
Net sales									
Asia-Pacific	4,468	4,485	-0.4%	4,807	4,833	-0.5%	5,071	5,099	-0.5%
Americas	3,506	3,570	-1.8%	3,481	3,580	-2.7%	3,621	3,723	-2.7%
West Europe	3,522	3,569	-1.3%	3,544	3,619	-2.1%	3,590	3,666	-2.1%
EEMEA	4,105	4,178	-1.7%	4,350	4,469	-2.7%	4,676	4,804	-2.7%
Total Sales	**15,601**	**15,802**	**-1.3%**	**16,183**	**16,501**	**-1.9%**	**16,959**	**17,292**	**-1.9%**
EBIT									
Asia-Pacific	1,605	1,611	-0.4%	1,753	1,763	-0.5%	1,873	1,883	-0.5%
Americas	1,431	1,458	-1.8%	1,436	1,476	-2.7%	1,511	1,554	-2.7%
West Europe	1,248	1,264	-1.3%	1,286	1,312	-2.0%	1,335	1,362	-2.0%
EEMEA	1,435	1,459	-1.6%	1,591	1,632	-2.5%	1,781	1,827	-2.5%
Total EBIT, pre exceptionals (ex Associates)	**5,719**	**5,791**	**-1.2%**	**6,066**	**6,184**	**-1.9%**	**6,500**	**6,626**	**-1.9%**
Associates (exc exceptionals)	705	700	+0.7%	758	751	+1.0%	795	787	+1.0%
Exceptionals	-100	-100	+0.0%	-100	-100	+0.0%	-100	-100	+0.0%
Net finance costs	-477	-480	-0.6%	-464	-469	-1.0%	-456	-461	-1.0%
Pretax Profit	5,847	5,912	-1.1%	6,261	6,366	-1.6%	6,738	6,852	-1.7%
Adjusted Pretax Profit	**5,947**	**6,012**	**-1.1%**	**6,361**	**6,466**	**-1.6%**	**6,838**	**6,952**	**-1.6%**
Tax	-1,605	-1,627	-1.3%	-1,717	-1,752	-2.0%	-1,854	-1,891	-2.0%
~ Tax on ordinary activities	-1,625	-1,647	-1.3%	-1,737	-1,772	-2.0%	-1,874	-1,911	-2.0%
Tax rate on ordinary activities	*31.0%*	*31.0%*		*31.0%*	*31.0%*		*31.0%*	*31.0%*	
Minorities	-306	-306	+0.0%	-333	-333	+0.0%	-363	-363	+0.0%
Net Profit	3,936	3,979	-1.1%	4,211	4,281	-1.6%	4,522	4,598	-1.6%
Adjusted Net Profit	**4,016**	**4,059**	**-1.1%**	**4,291**	**4,361**	**-1.6%**	**4,602**	**4,678**	**-1.6%**
Per Share									
Adjusted Diluted EPS	**206.1**	**208.3**	**-1.1%**	**224.6**	**228.2**	**-1.6%**	**245.7**	**249.8**	**-1.6%**
DPS	134.0	135.4	-1.1%	146.0	148.3	-1.6%	159.7	162.4	-1.6%
Diluted Shares Outstanding	1,948	1,948	+0.0%	1,911	1,911	+0.0%	1,873	1,873	+0.0%

Source: Citi Investment Research and Analysis

Overall changes are minimal

In Figure 28 we show our overall changes to estimate, which (after more than 20 pages of detailed analysis) are effectively zero.

Figure 28. BAT – Overall Changes to Estimates (Pounds in Millions)

	2012E			2013E			2014E		
	New	Old	Change	New	Old	Change	New	Old	Change
Net sales									
Asia-Pacific	4,476	4,485	-0.2%	4,816	4,833	-0.4%	5,081	5,099	-0.4%
Americas	3,541	3,570	-0.8%	3,534	3,580	-1.3%	3,685	3,723	-1.0%
West Europe	3,522	3,569	-1.3%	3,544	3,619	-2.1%	3,590	3,666	-2.1%
EEMEA	4,133	4,178	-1.1%	4,438	4,469	-0.7%	4,761	4,804	-0.9%
Total Sales	**15,673**	**15,802**	**-0.8%**	**16,332**	**16,501**	**-1.0%**	**17,118**	**17,292**	**-1.0%**
EBIT									
Asia-Pacific	1,610	1,611	-0.1%	1,759	1,763	-0.2%	1,879	1,883	-0.2%
Americas	1,461	1,458	+0.2%	1,476	1,476	+0.0%	1,559	1,554	+0.4%
West Europe	1,248	1,264	-1.3%	1,286	1,312	-2.0%	1,335	1,362	-2.0%
EEMEA	1,475	1,459	+1.1%	1,651	1,632	+1.2%	1,858	1,827	+1.7%
Total EBIT, pre exceptionals (ex Associates)	**5,794**	**5,791**	**+0.0%**	**6,173**	**6,184**	**-0.2%**	**6,631**	**6,626**	**+0.1%**
Associates (exc exceptionals)	705	700	+0.7%	758	751	+1.0%	795	787	+1.0%
Exceptionals	-100	-100	+0.0%	-100	-100	+0.0%	-100	-100	+0.0%
Net finance costs	-477	-480	-0.6%	-464	-469	-1.0%	-456	-461	-1.0%
Pretax Profit	5,922	5,912	+0.2%	6,367	6,366	+0.0%	6,869	6,852	+0.3%
Adjusted Pretax Profit	**6,022**	**6,012**	**+0.2%**	**6,467**	**6,466**	**+0.0%**	**6,969**	**6,952**	**+0.3%**
Tax	-1,628	-1,627	+0.1%	-1,750	-1,752	-0.1%	-1,894	-1,891	+0.2%
~ Tax on ordinary activities	-1,648	-1,647	+0.1%	-1,770	-1,772	-0.1%	-1,914	-1,911	+0.2%
Tax rate on ordinary activities	*31.0%*	*31.0%*		*31.0%*	*31.0%*		*31.0%*	*31.0%*	
Minorities	-306	-306	+0.0%	-333	-333	+0.0%	-363	-363	+0.0%
Net Profit	3,988	3,979	+0.2%	4,284	4,281	+0.1%	4,612	4,598	+0.3%
Adjusted Net Profit	**4,068**	**4,059**	**+0.2%**	**4,364**	**4,361**	**+0.1%**	**4,692**	**4,678**	**+0.3%**
Per Share									
Adjusted Diluted EPS	**208.8**	**208.3**	**+0.2%**	**228.4**	**228.2**	**+0.1%**	**250.6**	**249.8**	**+0.3%**
DPS	135.7	135.4	+0.2%	148.5	148.3	+0.1%	162.9	162.4	+0.3%
Diluted Shares Outstanding	1,948	1,948	+0.0%	1,911	1,911	+0.0%	1,873	1,873	+0.0%

Source: Citi Investment Research and Analysis

Financial Summary

Figure 29. BAT – Financial Summary, 2007-2016E (Pounds in Millions)

Profit and Loss / Year to Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Net Sales	**10,018**	**12,122**	**14,208**	**14,883**	**15,399**	**15,673**	**16,332**	**17,118**	**17,961**	**18,831**	**4.1%**
EBITDA	**3,339**	**4,147**	**4,907**	**5,426**	**5,966**	**6,255**	**6,647**	**7,119**	**7,625**	**8,158**	**6.5%**
Margin	*33.3%*	*34.2%*	*34.5%*	*36.5%*	*38.7%*	*39.9%*	*40.7%*	*41.6%*	*42.5%*	*43.3%*	
Operating Profit (Adj EBIT)	**3,003**	**3,717**	**4,461**	**4,984**	**5,519**	**5,794**	**6,173**	**6,631**	**7,121**	**7,639**	**6.7%**
Margin	*30.0%*	*30.7%*	*31.4%*	*33.5%*	*35.8%*	*37.0%*	*37.8%*	*38.7%*	*39.6%*	*40.6%*	
Associates	533	477	541	622	659	705	758	795	846	898	6.4%
Trading Profit including Assoc	3,536	4,194	5,002	5,606	6,178	6,499	6,931	7,425	7,967	8,537	6.7%
Net Finance	(269)	(391)	(504)	(480)	(460)	(477)	(464)	(456)	(453)	(446)	
Adj Pretax Profit	**3,267**	**3,792**	**4,484**	**5,126**	**5,718**	**6,022**	**6,467**	**6,969**	**7,514**	**8,091**	**7.2%**
Exceptionals (Pretax)	(98)	(119)	(418)	(738)	(787)	(100)	(100)	(100)	(100)	(100)	
Tax	(791)	(1,025)	(1,124)	(1,248)	(1,556)	(1,628)	(1,750)	(1,894)	(2,047)	(2,210)	
Underlying Tax Rate	*29.6%*	*30.8%*	*30.3%*	*30.2%*	*31.2%*	*31.0%*	*31.0%*	*31.0%*	*31.0%*	*31.0%*	
Minorities	(157)	(202)	(243)	(261)	(280)	(306)	(333)	(363)	(396)	(431)	9.0%
Net Profit (Pre Amort/Ex)	**2,296**	**2,582**	**3,046**	**3,505**	**3,857**	**4,068**	**4,364**	**4,692**	**5,051**	**5,430**	**7.1%**

Per-Share Data	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
EPS (Adjusted)	**112.6**	**128.8**	**153.0**	**175.8**	**194.6**	**208.8**	**228.4**	**250.6**	**275.6**	**302.5**	**9.2%**
DPS	66.2	83.7	99.5	114.2	126.5	135.7	148.5	162.9	179.1	196.7	9.2%
Number of Dil. Shares Out	2,039	2,005	1,991	1,994	1,982	1,948	1,911	1,873	1,833	1,795	-2.0%
Buyback (% of Shares)	2.2%	1.1%	0.0%	0.0%	1.4%	2.0%	1.9%	2.1%	2.2%	2.0%	

Growth Rates (%)	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Sales	2.6%	21.0%	17.2%	4.8%	3.5%	1.8%	4.2%	4.8%	4.9%	4.8%	4.1%
EBITDA	4.4%	24.2%	18.3%	10.6%	10.0%	4.8%	6.3%	7.1%	7.1%	7.0%	6.5%
EBIT	7.4%	23.8%	20.0%	11.7%	10.7%	5.0%	6.5%	7.4%	7.4%	7.3%	6.7%
Profit before Tax	11.3%	16.1%	18.2%	14.3%	11.5%	5.3%	7.4%	7.8%	7.8%	7.7%	7.2%
Net Profit	12.7%	12.4%	18.0%	15.1%	10.1%	5.5%	7.3%	7.5%	7.7%	7.5%	7.1%
EPS	**14.8%**	**14.4%**	**18.8%**	**14.9%**	**10.7%**	**7.3%**	**9.4%**	**9.7%**	**10.0%**	**9.8%**	**9.2%**

Cash Flow	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Operating Cash Flow	3,181	4,156	4,645	5,207	5,537	6,283	6,675	7,147	7,653	8,186	8.1%
Interest	(280)	(280)	(499)	(491)	(469)	(477)	(464)	(456)	(453)	(446)	
Tax	(866)	(943)	(1,095)	(1,178)	(1,447)	(1,628)	(1,750)	(1,894)	(2,047)	(2,210)	
Capex	(436)	(482)	(515)	(523)	(566)	(583)	(600)	(618)	(637)	(656)	3.0%
Other (Divs to/from minorities/associates)	112	153	94	225	271	434	440	428	428	427	
Free Cash Flow	**1,711**	**2,604**	**2,630**	**3,240**	**3,326**	**4,029**	**4,301**	**4,607**	**4,944**	**5,301**	**9.8%**
Margin	*17.1%*	*21.5%*	*18.5%*	*21.8%*	*21.6%*	*25.7%*	*26.3%*	*26.9%*	*27.5%*	*28.1%*	*5.4%*
M&A	152	(2,343)	(399)	(77)	(404)	0	0	0	0	0	
New Equity	(750)	(400)	0	0	(755)	(1,250)	(1,250)	(1,500)	(1,600)	(1,600)	
Change in Cash Items	(85)	(1,532)	433	1,070	(191)	151	232	76	82	195	
Non-Cash Items	(500)	(2,778)	616	(69)	104	200	0	0	0	0	
Change in Net Debt	(585)	(4,310)	1,049	1,001	(87)	351	232	76	82	195	
End of Year Net Cash/(Debt)	**(5,581)**	**(9,891)**	**(8,842)**	**(7,841)**	**(7,928)**	**(7,578)**	**(7,345)**	**(7,269)**	**(7,188)**	**(6,992)**	**-2.5%**

Ratios	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Interest Cover	11.2	9.5	8.9	10.4	12.0	12.1	13.3	14.5	15.7	17.1	
Cash Interest Cover	11.4	14.8	9.3	10.6	11.8	13.2	14.4	15.7	16.9	18.4	
Dividend Payout Ratio	59%	65%	65%	65%	65%	65%	65%	65%	65%	65%	
Net Debt/EBITDA	1.7	2.4	1.8	1.45	1.3	1.2	1.1	1.0	0.9	0.9	
ROIC	13.9%	13.7%	14.5%	16.7%	18.0%	19.4%	21.8%	23.3%	25.0%	26.7%	

Historical Multiples	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Historical Average Share Price	1,659	1,820	1,807	2,242	2,678	3,057	3,021	3,021	3,021	3,021	
P/E	14.7	14.1	11.8	12.8	13.8	14.6	13.2	12.1	11.0	10.0	
FCF Yield	5.1%	7.2%	7.3%	7.3%	6.3%	6.8%	7.5%	8.2%	9.0%	9.8%	
Historic EV	33,676	39,723	41,882	46,916	53,744	59,855	57,560	56,254	54,969	53,677	
EV/EBITDA	10.1	9.6	8.5	8.6	9.0	9.6	8.7	7.9	7.2	6.6	

Source: Company Reports and CIRA Estimates

Figure 30. BAT – Regional Summary, 2007-2016E (Pounds in Millions)

Net Sales / Year to Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Asia-Pacific		2,717	3,270	3,759	4,251	4,476	4,816	5,081	5,360	5,655	5.9%
Americas		2,863	3,156	3,498	3,558	3,541	3,534	3,685	3,832	3,985	2.3%
West Europe		3,218	3,884	3,695	3,600	3,522	3,544	3,590	3,626	3,663	0.3%
EEMEA				3,931	3,990	4,133	4,438	4,761	5,142	5,528	6.7%
TOTAL Sales	**10,018**	**12,122**	**14,208**	**14,883**	**15,399**	**15,673**	**16,332**	**17,118**	**17,961**	**18,831**	**4.1%**

Operating profit / Year to Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5-yr CAGR
Asia-Pacific		924	1,148	1,332	1,539	1,610	1,759	1,879	2,016	2,162	7.0%
Americas		1,052	1,186	1,382	1,441	1,461	1,476	1,559	1,641	1,727	3.7%
West Europe		760	994	1,103	1,228	1,248	1,286	1,335	1,381	1,428	3.1%
EEMEA				1,167	1,311	1,475	1,651	1,858	2,083	2,322	12.1%
TOTAL Operating Profit	**3,003**	**3,717**	**4,461**	**4,984**	**5,519**	**5,794**	**6,173**	**6,631**	**7,121**	**7,639**	**6.7%**

Operating Margins / Year to Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E	5 yr. chg
Asia-Pacific		34.0%	35.1%	35.4%	36.2%	36.0%	36.5%	37.0%	37.6%	38.2%	2.0%
Americas		36.7%	37.6%	39.5%	40.5%	41.3%	41.8%	42.3%	42.8%	43.3%	2.8%
West Europe		23.6%	25.6%	29.9%	34.1%	35.4%	36.3%	37.2%	38.1%	39.0%	4.9%
EEMEA				29.7%	32.9%	35.7%	37.2%	39.0%	40.5%	42.0%	9.2%
TOTAL Operating Margins	**30.0%**	**30.7%**	**31.4%**	**33.5%**	**35.8%**	**37.0%**	**37.8%**	**38.7%**	**39.6%**	**40.6%**	**4.7%**

Source: Company Reports and CIRA Estimates

Figure 31. BAT – Organic Growth Summary, 2007-2016E (Pounds in Millions)

Volume / Year to Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2015E	5-yr CAGR
Asia-Pacific					+2.0%	-0.4%	+0.8%	+0.5%	+0.5%	+0.5%	+0.4%
Americas					-5.0%	-5.0%	-3.5%	-2.2%	-2.0%	-2.0%	-2.9%
Western Europe					+0.0%	-1.0%	-2.0%	-2.2%	-2.5%	-2.5%	-2.0%
EEMEA					+1.0%	+1.2%	+0.0%	-0.5%	+1.0%	+1.0%	+0.5%
Total Volume	**-1.0%**	**+1.0%**	**-3.0%**	**-3.0%**	**-0.2%**	**-0.5%**	**-0.5%**	**-0.9%**	**-0.4%**	**-0.4%**	**-0.5%**

Net Sales / Year to Dec	2009	2010	2011	2012E	2013E	2014E	2015E	2015E	5-yr CAGR
Asia-Pacific		+2.0%	+10.4%	+5.8%	+8.8%	+5.5%	+5.5%	+5.5%	+6.2%
Americas		+3.3%	+6.0%	+6.0%	+2.5%	+4.3%	+4.0%	+4.0%	+4.1%
Western Europe		-0.7%	+3.5%	+4.5%	+2.0%	+1.3%	+1.0%	+1.0%	+2.0%
EEMEA			+7.5%	+8.7%	+8.9%	+7.3%	+8.0%	+7.5%	+8.1%
Total Sales	**+5%**	**+2.8%**	**+6.6%**	**+6.3%**	**+5.9%**	**+4.8%**	**+4.9%**	**+4.8%**	**+5.3%**

EBIT / Year to Dec	2009	2010	2011	2012E	2013E	2014E	2015E	2015E	5-yr CAGR
Asia-Pacific		+2.4%	+11.1%	+5.1%	+10.3%	+6.7%	+7.1%	+7.0%	+7.2%
Americas		+5.5%	+4.5%	+8.4%	+3.7%	+5.6%	+5.2%	+5.2%	+5.6%
Western Europe		+10.3%	+9.8%	+8.2%	+4.3%	+3.5%	+3.2%	+3.1%	+4.4%
EEMEA			+16.7%	+17.6%	+13.5%	+12.5%	+12.2%	+11.5%	+13.4%
Total EBIT	**+7%**	**+6.4%**	**+10.3%**	**+9.6%**	**+8.2%**	**+7.3%**	**+7.3%**	**+7.2%**	**+7.9%**

Source: Company Reports and CIRA Estimates

British American Tobacco PLC

Company description

BAT is a global tobacco company, with more than half its profit coming from emerging markets. Its most valuable assets are its 32% stake in ITC and its 42% stake in Reynolds American. In many markets (e.g. Canada, Brazil, South Africa, Australia) it is the dominant company. It owns many brands, with its top four accounting for one-fifth of volume. It is centralising management, marketing and production, thereby cutting costs.

Investment strategy

We have a Buy rating on BAT. We expect BAT will continue to post strong, predictable EPS growth, and an attractive dividend. The tax system is changing in two of its most important markets, Brazil and Russia, and we think this will accelerate the uptrading in those markets. In addition, it is continuing to drive costs lower, adding about 3 points to EBIT growth each year. In this economic environment we think investors will continue to value BAT's defensive growth, self help and emerging market exposure. BAT has a strong balance sheet and effectively it has an exclusive option to buy the 58% it doesn't already own of Reynolds.

Valuation

Our 12-month price target is 3400p. This represents our view of fair value, based on P/Es. Our fair value estimate assumes that in 12 months' time the shares will be trading at c.13.5x next year's EPS. However, in 12 months this will be based on calendar 2014E earnings, not 2013E earnings. Given our estimate for 2014 EPS, this implies fair value is 3380p, which we've rounded up to £34. Currently BAT is trading at a slightly lower forward P/E but we think this may rise as the market comes to appreciate the beneficial structural changes to the tax systems in Russia and Brazil. In the past five years, BAT has traded at an average of about 13.4x forward P/E based on the next 12 months consensus earnings.

Risks

Positive risks to our target price include the fact that tobacco is a fairly steady and predictable industry. Furthermore, BAT has by far the greatest geographical diversification of any tobacco company. We would highlight in particular the following negative risks that may affect the achievement of our target price:

BAT shares are likely to rise or fall, depending on sector rotation. If the market rotates away from defensives, tobacco will underperform.

Foreign-exchange risk is significant for BAT. If some of its emerging market currencies fall, it may be subject to a worse-than-expected transactional squeeze.

One or more of BAT's major markets could suffer from a **price war**, like the one we saw in Spain in 2011.

Of all the European tobacco companies, BAT has the biggest risk from **litigation**, via its exposure to Canada and Brazil as well as the US. Several Canadian provinces have passed legislation designed to help the provinces sue BAT for billions of dollars using reduced levels of proof.

BAT could suffer from **more large excise tax rises**.

The Australian government says it intends to **ban the use of all trademarks** related to tobacco. We think this ban is likely to go ahead, and it could hurt profit more than we expect.

The trend to **discount products** could invade more of BAT's markets, hurting profits globally.

Conversely, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

Companies Mentioned:
Japan Tobacco (2914.T; ¥407,500; 1); BAT (BATO.KL; RM52.00; 2); British American Tobacco PLC (BATS.L; £30.14; 2); Souza Cruz SA (CRUZ3.SA; R$27.59; Not Rated); Diageo (DGE.L; £14.96; 2); Imperial Tobacco Group PLC (IMT.L; £24.16; 1); Altria Group Inc (MO.N; US$31.78; 2); Nestle (NESN.VX; SFr54.50; 2); Philip Morris International (PM.N; US$84.68; 2); Reynolds American Inc (RAI.N; US$40.86; 1); SABMiller (SAB.L; £24.20; 1)

Notes

Notes

Appendix A-1

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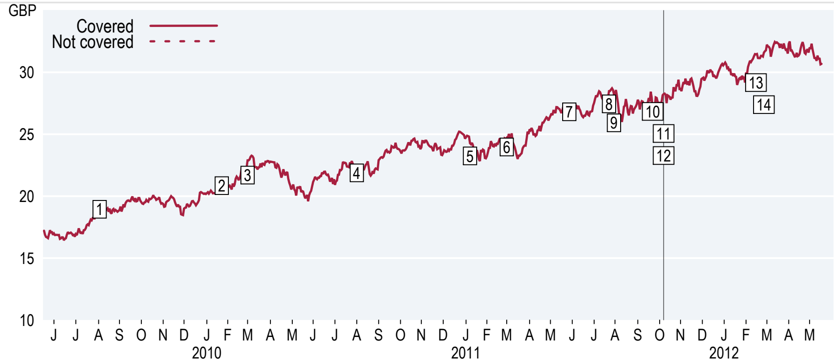
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

British American Tobacco PLC (BATS.L)

Ratings and Target Price History
Fundamental Research

Analyst: Adam Spielman



	Date	Rating	Target Price	Closing Price
1	4-Aug-09	1L	*21.00	18.52
2	22-Jan-10	1L	*23.30	20.54
3	1-Mar-10	1L	*24.60	22.89
4	2-Aug-10	1L	*25.70	21.88
5	7-Jan-11	*2L	*25.00	24.27
6	1-Mar-11	2L	*24.50	24.71
7	27-May-11	2L	*28.00	27.20
8	22-Jul-11	2L	*28.90	28.48
9	29-Jul-11	2L	*29.90	28.21
10	22-Sep-11	2L	*28.75	26.92
11	7-Oct-11	Stock rating system changed		
12	7-Oct-11	*2	28.75	28.24
13	15-Feb-12	2	*32.50	31.45
14	27-Feb-12	2	*33.30	31.59

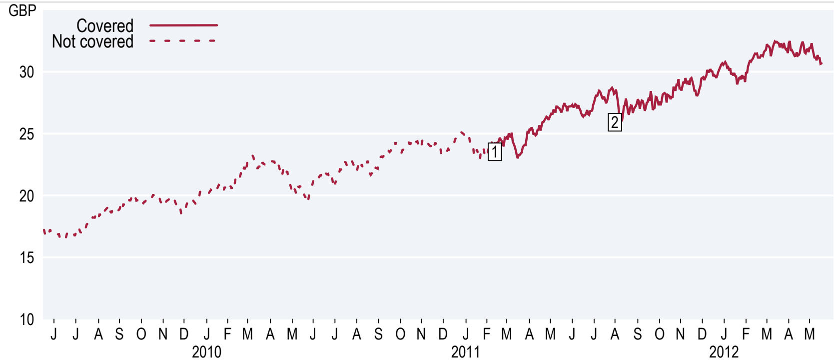
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

British American Tobacco PLC (BATS.L)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Adam Spielman



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	24.24
2	1-Aug-11	*REM LP	-	28.28

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 31 Mar 2012	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	52%	37%	11%	10%	79%	10%
% of companies in each rating category that are investment banking clients	44%	42%	40%	47%	42%	43%

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