

2 BAT – Gerry Gallagher, BUY, close 4914p, 6000p tgt, 22% upside

- BAT offers **50% TSR over the next two years**, only 15ppts of which is from an EV re-rating.
- **Its broad offering in next generation products (NGP)**, both in heat-not-burn and vaping, puts BAT at a competitive advantage could fuel group **organic growth of c5% organic growth FY18 and c6% FY19**.
- BAT is **one of the fastest growing large cap European staples** yet it trades at a **discount to the European sector and its international peers**.
- Key drivers:
 - **Strong organic EBITDA growth and debt pay down (c28ppts)**. EBITDA growth could fuel 10% pa EPS growth, while debt pay-down further shifts the EV to equity.
 - **Attractive dividend (c7ppts upside over next two years)**.
 - **Re-rating to 13.1x 18E EV/EBITDA (c15ppts upside) and still at a discount to staples and international peers**. Concerns regarding potential plans by the FDA to reduce cigarettes' nicotine content (announced in July 2017) have brought the multiple down to 12.4x.
 - The FDA regulatory process takes many years. By its conclusion, NGPs may already be well-established.

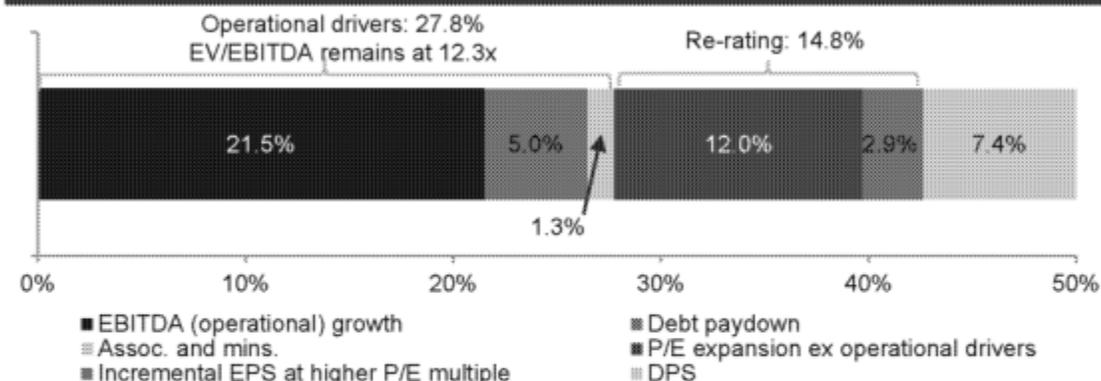
- **Catalysts:** US tax reform (could add 5-8% to EPS); FY17 results end Feb; FDA comments through 2018

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[What's going on \(Gallagher\)](#)

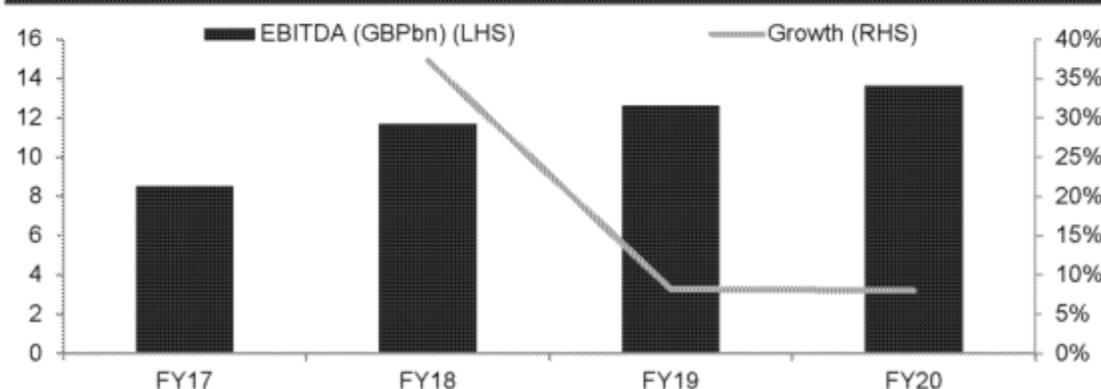
[You can't have your cake and eat it \(Gallagher\)](#)

We see potential for 50% TSR over the next two years



Source: Deutsche Bank estimates; assumes 10% EPS growth

Operational drivers are key – we see substantial EBITDA growth to come



Source: Deutsche Bank estimates; assumes 10% EPS growth