

# Investment Research: British American Tobacco (\$BTI) - A Dividend Machine in Structural Transformation

**1. Executive Summary: The Nicotine Pivot** We view British American Tobacco (\$BTI) as a core holding in the global tobacco space, currently undergoing its most meaningful structural pivot in decades. With a market capitalization of \$122 billion, the group is shifting from a historically combustible-centric model toward a modern, multi-category Next Generation Product (NGP) platform.

This transition is not a simple product extension; it is a strategic imperative in response to the secular decline in traditional cigarettes. Our core thesis is that BTI can continue to harvest substantial cash flows from its legacy franchises-Lucky Strike, Dunhill, and Pall Mall-while simultaneously funding the build-out of smokeless alternatives. (see Figures 1, 4 and 6).



Figure 1. Nicotine pivot: strategic imperative

**Key takeaway:** This transition is not a simple product extension; it is a strategic imperative in response to the secular decline in traditional cigarettes. Our core thesis is that BTI can continue to harvest substantial cash flows from its legacy franchises- Lucky Strike, Dunhill, and Pall Mall-while simultaneously...

## The Three-Pillar Investment Thesis

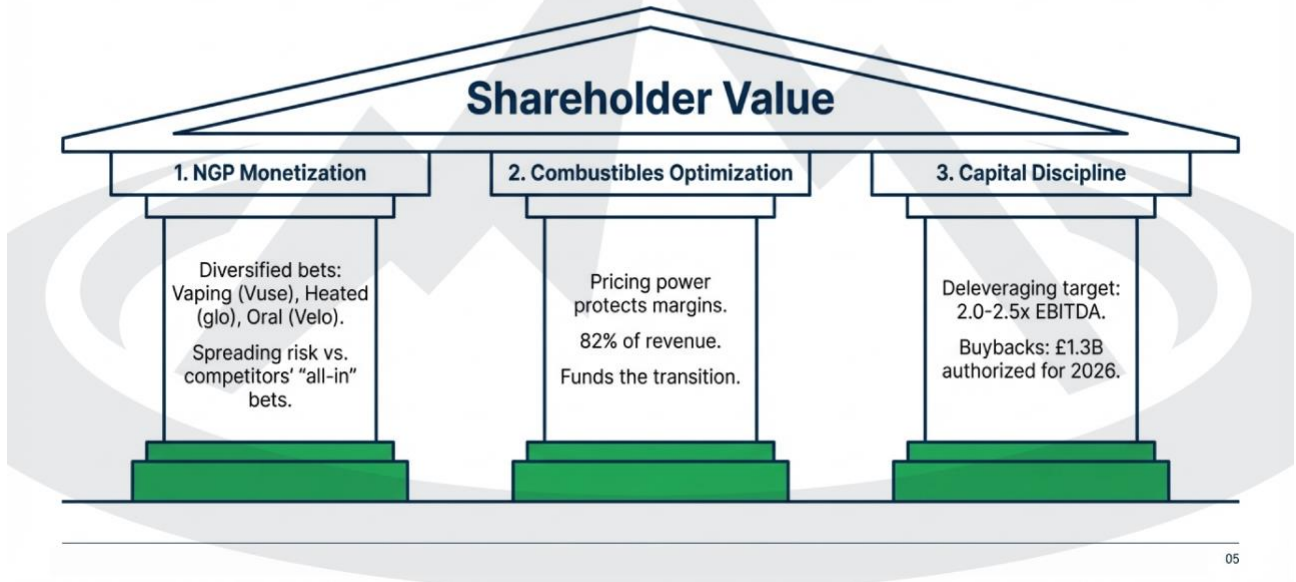


Figure 4. The Three-Pillar Investment Thesis

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## Pillar 2: Managing the Decline for Maximum Cash



- **Market Position:** Controls global brands (Lucky Strike, Dunhill, Pall Mall, Rothmans) across 180+ countries.
- **US Resilience:** +20 bps value share gain.
- **Role:** Funds dividend & NGP CAPEX.

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Figure 6. Pillar 2: Managing the Decline for Maximum Cash

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We see BTI as fundamentally a dividend engine, but we also believe that a substantial portion of the near-term transformation story is already reflected in the current share price. At around \$55.68, we regard \$BTI as broadly fairly valued.

Our positioning is therefore tactical and disciplined: we advocate a “Buy on Dips” approach, with a preferred entry range of \$48-50, where we see the asymmetric reward-to-risk as genuinely compelling for long-term holders. Looking out to 2026, we believe the success of this transition will depend heavily on both macro stability and precise execution in an increasingly crowded NGP arena.

## 2. US Market Dynamics: Equity, Bonds, and the Dollar Influence We see \$BTI as tightly linked to the US macro backdrop, functioning as a high-yield defensive equity that competes directly with bonds for capital.

Against the S&P 500 and Nasdaq, BTI’s 8.1% dividend yield stands out as a serious alternative to traditional fixed-income instruments, including those represented by \$TLT and \$IEF. It is critical, in our view, to compare this yield with the company’s Weighted Average Cost of Capital (WACC) of 7.75%. As long as the dividend yield comfortably exceeds the cost of capital, the income “machine” is running efficiently for yield-oriented investors. (see Figure 10).

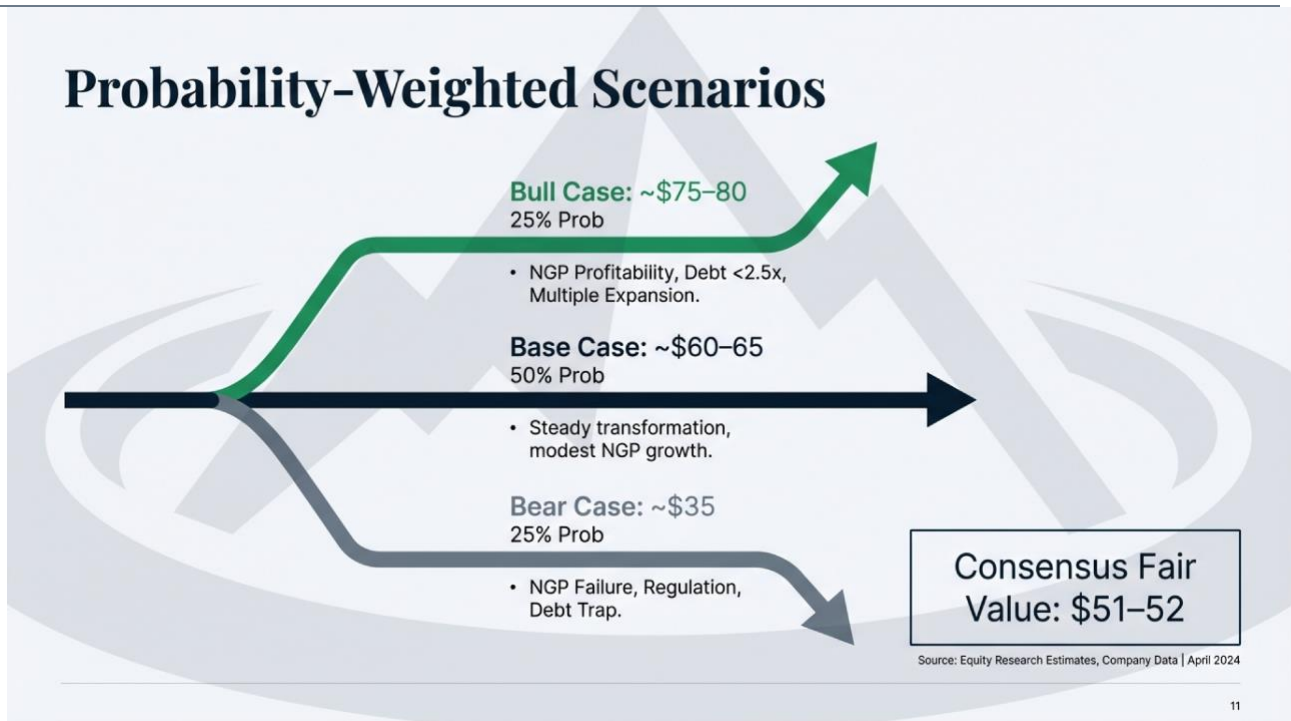


Figure 10. Bull Case: ~\$75-80 x

**Key takeaway:** Against the S&P 500 and Nasdaq, BTI’s 8.1% dividend yield stands out as a serious alternative to traditional fixed-income instruments, including those represented by \$TLT and \$IEF. It is critical, in our view, to compare this yield with the company’s Weighted Average Cost of Capital...

However, we cannot ignore the weight of \$40.5 billion in net debt. In a world of shifting interest rates, the cost of servicing this debt remains a central concern for the balance sheet and effectively inflates enterprise value through leverage.

As a global group operating across currencies while investors benchmark in US dollars, BTI also faces persistent FX translation risk. Movements in the US dollar directly influence how international earnings are perceived and valued.

For retail investors, we think BTI should be seen not only as a “tobacco stock” but as a yield-sensitive asset, whose valuation is acutely responsive to the Federal Reserve’s policy path and the associated trajectory of the dollar.

### 3. Global Footprint: Europe, APMEA, and Emerging Market Realities

**We recognize that \$BTI’s operations in over 180 countries provide a powerful geographic hedge. At the same time, this breadth inevitably heightens exposure to localized regulatory shocks.**

BTI’s global scale is second only to Philip Morris International (\$PM), yet regional performance is far from homogeneous. We noted specific regulatory headwinds in December 2025 across the APMEA

region, especially in Bangladesh and Pakistan, underscoring how quickly local actions can ripple through global volumes.

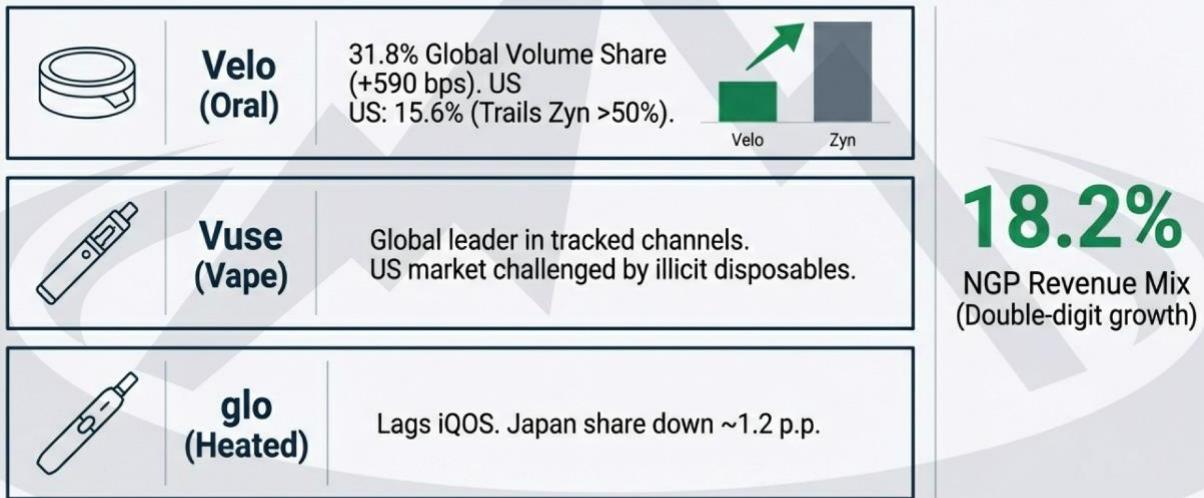
By contrast, Europe and Japan remain at the forefront of NGP adoption. Here, the performance of glo, BTI's heated tobacco platform, is particularly instructive. The brand is making visible progress in Poland and Italy, yet faces intense competitive pressure in Japan, where its volume share recently fell by 1.2 percentage points.

To address this, we are closely following the roll-out of glo Hilo across Japan, Poland, and Italy. These differing regional trajectories highlight a core reality: the transition to “smokeless” products is proceeding at very different speeds across markets, requiring tailored, region-specific strategies, rather than a uniform global playbook.

**4. Sectoral Analysis: Competitive Moats and Key Tickers When we apply Capital Cycle Theory to global tobacco, we see a distinctive pattern: the industry is in the downward leg of the legacy cycle, where substantial cash flows from declining combustibles are being aggressively redeployed into a fragmented, high-growth NGP arena.**

In practice, this is a race to secure the next dominant nicotine formats before traditional moats around combustibles erode further. The competitive field is led by the “Big Three”: \$BTI, Philip Morris International (\$PM), and Altria (\$MO). (see Figure 5).

## Pillar 1: The Race for the ‘Smokeless’ Future



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Figure 5. Pillar 1: The Race for the ‘Smokeless’ Future

**Key takeaway:** In practice, this is a race to secure the next dominant nicotine formats before traditional moats around combustibles erode further. The competitive field is led by the “Big Three”: \$BTI, Philip Morris International (\$PM), and Altria (\$MO).

We observe \$PM has taken a highly concentrated stance, backing iQOS in heated tobacco and Zyn in nicotine pouches. \$BTI, in contrast, has opted for a more diversified NGP architecture across Vuse (vaping), glo (heated tobacco), and Velo (pouches).

The numbers are telling. Velo holds a 31.8% global volume share, while Velo Plus in the US has reached a 15.6% volume share, representing a remarkable 920 bps expansion. Alongside this, we monitor \$JT (Japan Tobacco) and \$IMB (Imperial Brands), as their localized advances can signal shifts in regulatory and competitive dynamics that may later scale globally.

For investors, the central question is clear: is BTI’s diversified NGP strategy building a wider, more resilient moat, or diluting focus versus more specialized peers? We believe this will be a key determinant of relative performance over the next cycle. (see Figure 9).

## Valuation Model 2: Relative Multiples

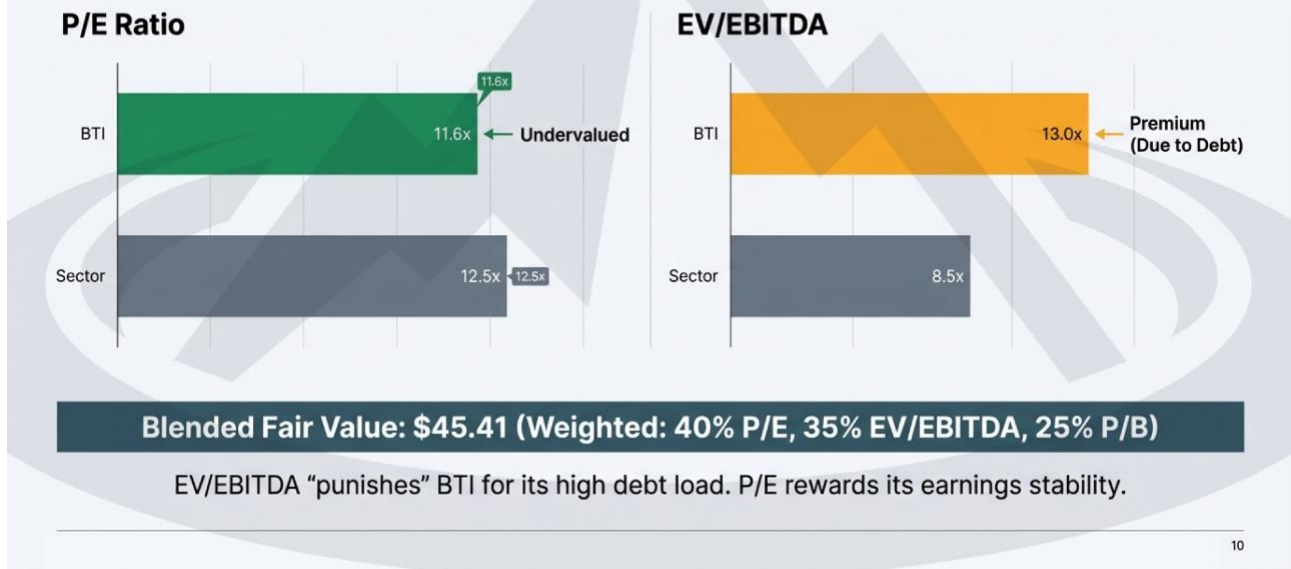
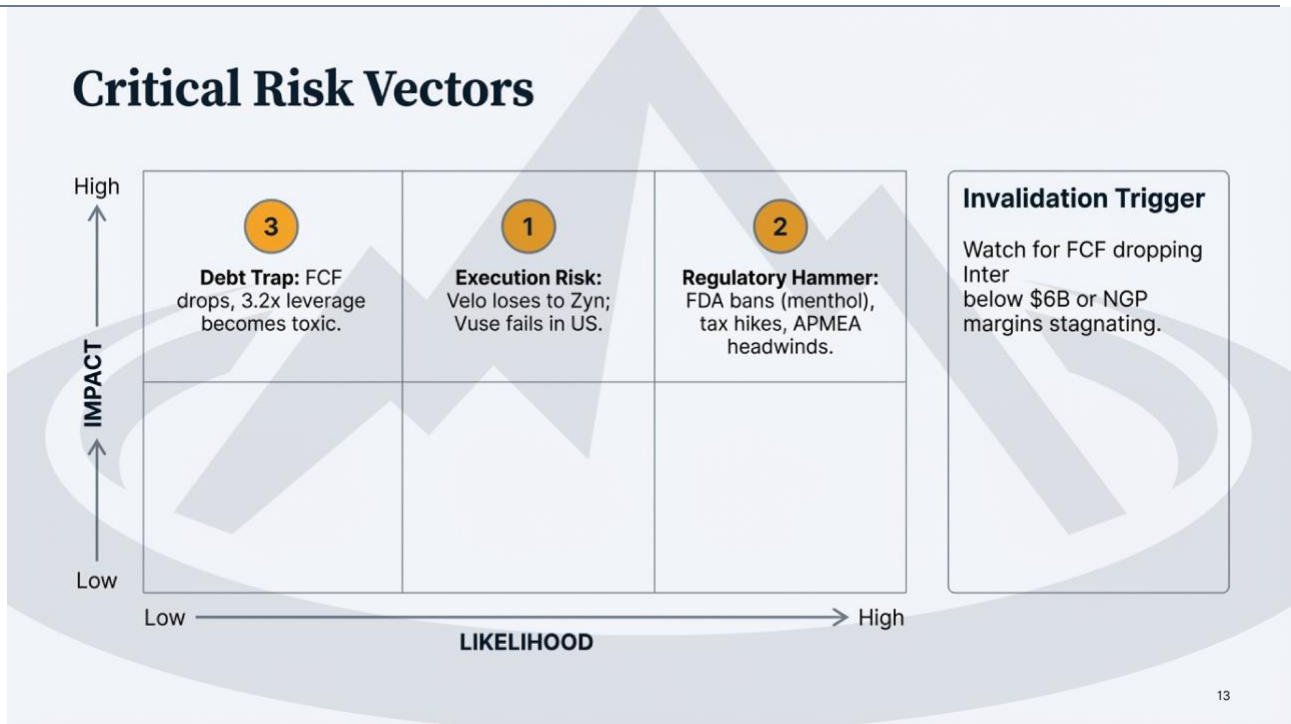


Figure 9. Valuation Model 2: Relative Multiples

**Key takeaway:** For investors, the central question is clear: is BTI’s diversified NGP strategy building a wider, more resilient moat, or diluting focus versus more specialized peers? We believe this will be a key determinant of relative performance over the next cycle.

### 5. The “Gray Rhinos”: High-Impact, Underestimated Signals We deliberately focus on “Gray Rhinos”-high-probability, high-impact risks that are often downplayed until they become unavoidable.

On regulation, the most prominent Gray Rhino is the FDA’s handling of the illegal vape market in the US. These illicit products are far from a marginal issue; they drove a high-single-digit revenue decline for Vuse in 2025. The Baltimore lawsuit against Zyn also serves as a stark reminder of how quickly litigation sentiment can turn against NGPs. (see Figure 12).



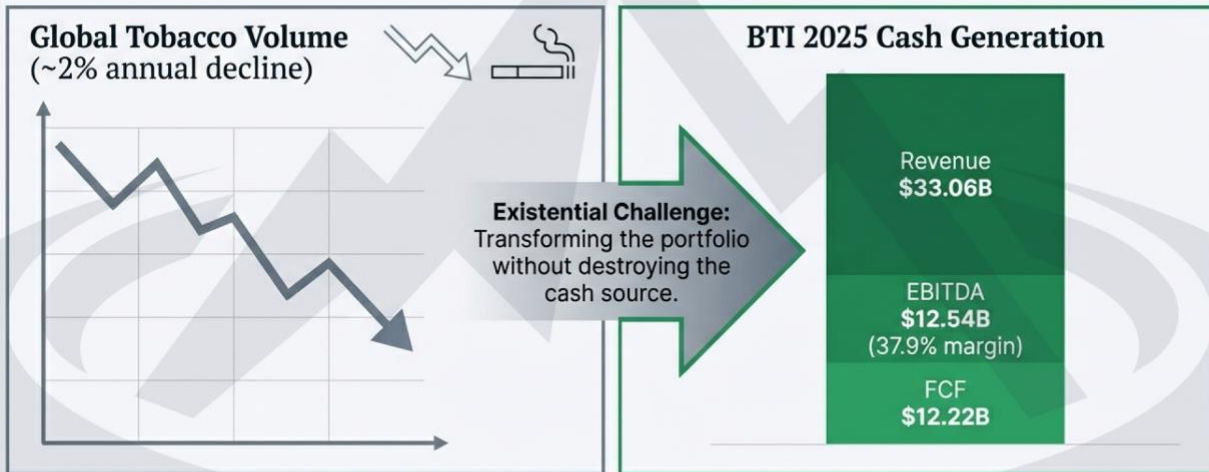
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Figure 12. Regulatory risk: illegal vape market (US)

**Key takeaway:** On regulation, the most prominent Gray Rhino is the FDA’s handling of the illegal vape market in the US. These illicit products are far from a marginal issue; they drove a high-single-digit revenue decline for Vuse in 2025.

On capital allocation, we see another Gray Rhino within the payout structure. The payout ratio on net income stands at about 170%, an apparently alarming figure, whereas the payout on Free Cash Flow (FCF) is a more manageable 55%. This structure is viable only as long as FCF remains robust. (see Figures 3, 8 and 11).

## A Cash Flow Engine in a Secularly Declining Industry



Despite the noise around new products, BTI remains a defensive quality position with cyclical elements. It is a powerful cash generator, but the market demands a discount due to the shrinking combustible volume.

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Figure 3. A Cash Flow Engine in a Secularly Declining Industry

**Key takeaway:** On capital allocation, we see another Gray Rhino within the payout structure. The payout ratio on net income stands at about 170%, an apparently alarming figure, whereas the payout on Free Cash Flow (FCF) is a more manageable 55%.

## Valuation Model 1: Discounted Cash Flow (DCF)

↗ Revenue CAGR	1.5%
% WACC	7.75% (Risk-free 4.18%, Beta 0.85)
↗ Terminal Growth	2.5%

**Fair Value: \$58.87**

↑ +5.7% upside from \$55.68

		Growth		
		1.5%	2.5%	3.5%
WACC	6.75%	\$63.73	\$73.52	\$83.78
	7.75%	\$51.02	<b>\$58.87</b>	\$67.77
	8.75%	\$63.67	\$44.22	\$52.54

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Figure 8. Valuation Model 1: Discounted Cash Flow (DCF)

**Key takeaway:** On capital allocation, we see another Gray Rhino within the payout structure. The payout ratio on net income stands at about 170%, an apparently alarming figure, whereas the payout on Free Cash Flow (FCF) is a more manageable 55%.

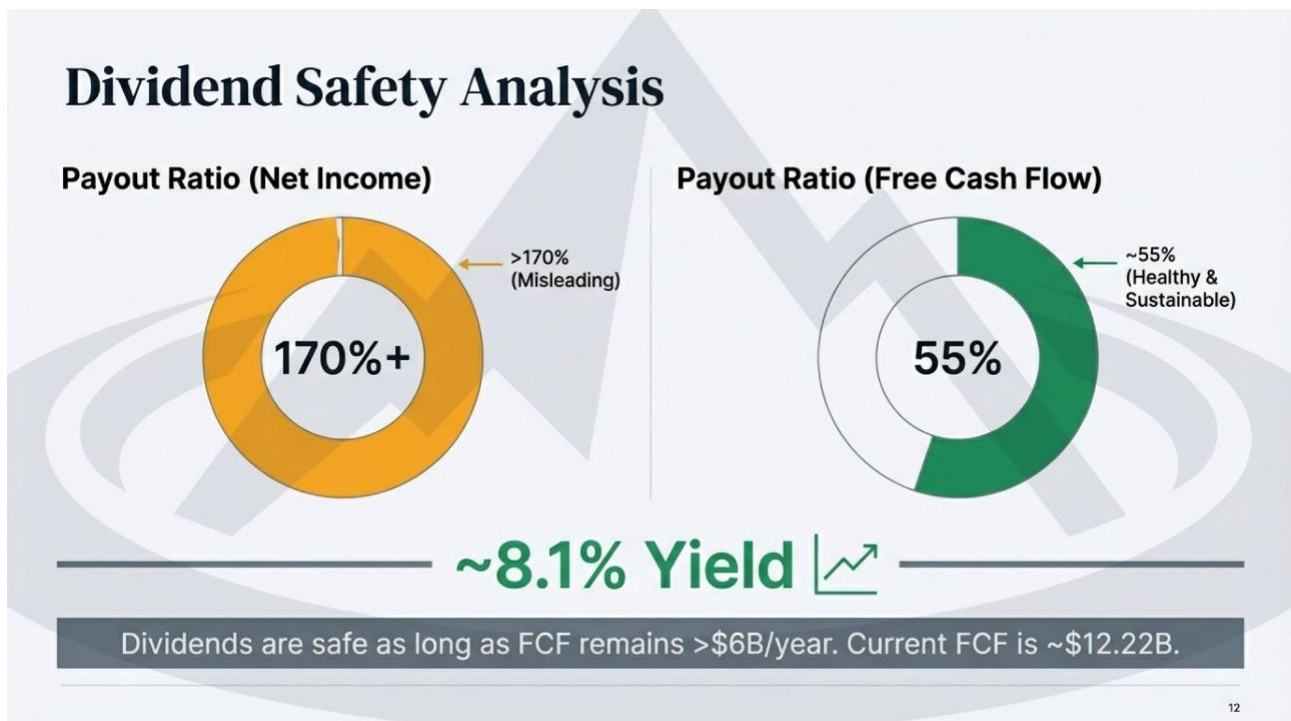


Figure 11. Payout Ratio (Net Income) Payout Ratio (Free Cash Flow)

**Key takeaway:** On capital allocation, we see another Gray Rhino within the payout structure. The payout ratio on net income stands at about 170%, an apparently alarming figure, whereas the payout on Free Cash Flow (FCF) is a more manageable 55%.

In our view, the second-order consequences of failing to scale NGPs are severe. Should annual FCF fall below the ~\$6 billion threshold, the perceived “margin of safety” around the dividend would rapidly erode. We believe that such a development could trigger a sharp re-rating of the shares, as income-focused investors reassess the risk profile.

**6. Scenario Analysis: Mapping 2026 Probabilities To frame BTI’s potential paths, we rely on probabilistic scenario analysis that reflects the inherent volatility of a business in transition.**

We intend to watch the Q1 2026 results closely as an early indication of which trajectory is gaining traction. In particular, we will focus on FDA enforcement actions and the speed of deleveraging, as these will be pivotal signposts for ongoing valuation adjustments.

## 7. MoatPeak Internal Synthesis: Beyond the Data Points At MoatPeak, we often apply the principle of “Inversion”: we ask what would have to go wrong for \$BTI to face a truly adverse outcome.

Our internal debate centers on whether BTI’s broad NGP strategy signals operational strength or a risk of “diworsification”. While \$PM is attempting to dominate individual categories, BTI’s wider spread raises the question of whether it is becoming a “jack of all trades, master of none.” (see Figures 13 and 14).

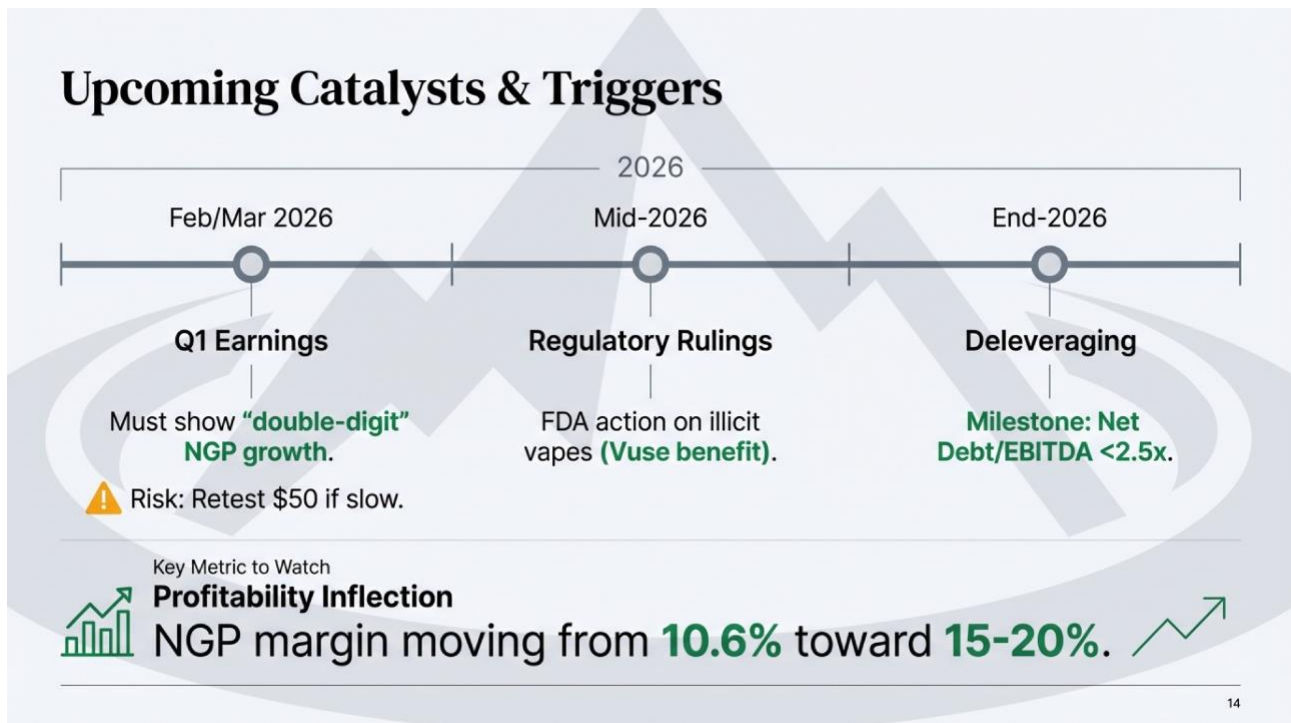


Figure 13. Upcoming Catalysts & Triggers

**Key takeaway:** Our internal debate centers on whether BTI’s broad NGP strategy signals operational strength or a risk of “diworsification”. While \$PM is attempting to dominate individual categories, BTI’s wider spread raises the question of whether it is becoming a “jack of all trades, master of none.”



Figure 14. Portfolio Decision Checklist

**Key takeaway:** Our internal debate centers on whether BTI’s broad NGP strategy signals operational strength or a risk of “divorsification”. While \$PM is attempting to dominate individual categories, BTI’s wider spread raises the question of whether it is becoming a “jack of all trades, master of none.”

Yet the numbers show progress. The NGP contribution margin stands at 10.6%, up 280 bps year-on-year, indicating a tangible move toward sustainable profitability in the new platform.

We also consider the reflexive nature of the share price. A yield of 8.1% naturally attracts a dedicated cohort of income-seeking capital. However, if the market perceives even a modest risk of a dividend cut driven by FCF pressure, that same capital could exit quickly, creating a self-reinforcing downward spiral in the stock. (see Figure 2).

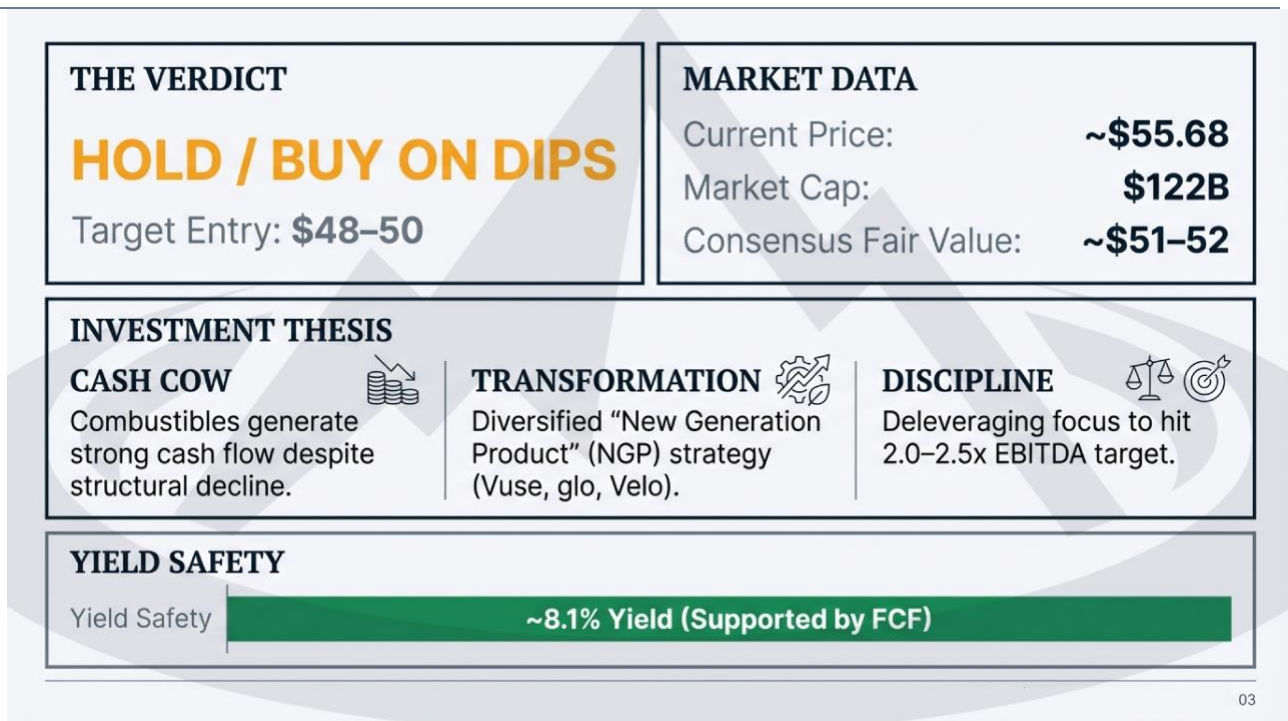


Figure 2. THE VERDICT MARKET DATA

**Key takeaway:** We also consider the reflexive nature of the share price. A yield of 8.1% naturally attracts a dedicated cohort of income-seeking capital.

Our internal Quality Score of 7.1/10 signals that the underlying franchise remains strong. At the same time, a Financial Health Score of 5.8/10 suggests the balance sheet does not yet have “fortress” status and could be tested by a simultaneous downturn in both combustibles and NGPs.

## 8. Strategic Roadmap for the Retail Investor (2026 Horizon) Looking toward 2026, we do not categorize \$BTI as a speculative growth name. Instead, we see it as a disciplined, income-oriented position within a diversified portfolio.

In the interest of intellectual honesty, we highlight that our DCF-based fair value stands at \$58.87, while our blended consensus fair value is clustered around \$51-52. The mismatch is largely driven by the EV/EBITDA framework, which values BTI at \$30.01 and appropriately penalizes the \$40.5 billion net debt, lifting enterprise value and compressing the implied equity valuation.

This leaves only a narrow Margin of Safety at current prices. Offsetting this, we see a total shareholder yield of roughly 10%, supported by a £1.3 billion buyback program (an 18% y/y increase), which we believe offers a meaningful buffer for patient investors.

For existing shareholders, our stance is HOLD, primarily to harvest the yield while monitoring execution on the NGP pivot and deleveraging. (see Figure 7).

## Pillar 3: Deleveraging & Capital Returns

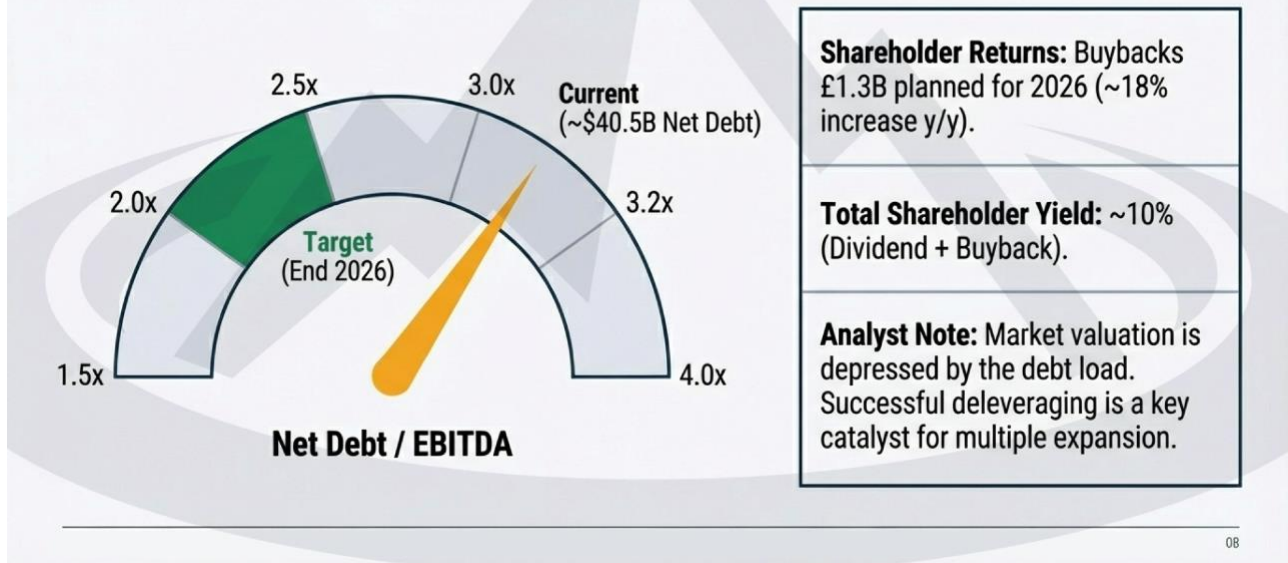


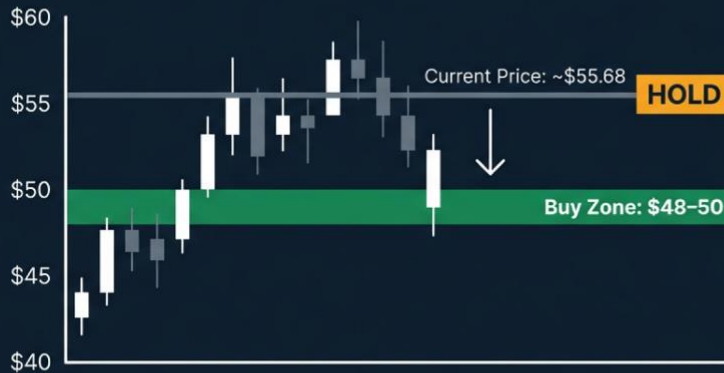
Figure 7. Pillar 3: Deleveraging & Capital Returns

**Key takeaway:** For existing shareholders, our stance is HOLD, primarily to harvest the yield while monitoring execution on the NGP pivot and deleveraging.

For prospective investors, our guidance remains clear: BUY ONLY ON DIPS into the \$48-50 range. At that level, we believe investors are adequately compensated for both the transformation risk and the heavy debt burden.

At MoatPeak, our philosophy is that investing in structural transformations demands both analytical rigor and emotional patience. Capital preservation comes first. Waiting for prices that offer a truly asymmetric reward-to-risk profile is, in our view, a defining characteristic of sophisticated long-term investing. (see Figure 15).

# Final Verdict: Asymmetric Opportunity



Accumulate aggressively at \$48–50.

The margin of safety compensates for transformation risks.

“ An asymmetric opportunity masked as a boring dividend stock. 14% potential total return for the patient investor. ”



Figure 15. Final Verdict: Asymmetric Opportunity

**Key takeaway:** At MoatPeak, our philosophy is that investing in structural transformations demands both analytical rigor and emotional patience. Capital preservation comes first.

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Our research integrates insights from global investment banks, asset managers, and macroeconomic data sources, translated into clear, actionable perspectives for long-term, strategic investors.

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