

22 May 2018 | 1QFY18 Results review

## British American Tobacco (M) Berhad

*Illicit cigarettes at all time high of 63%*

**Maintain BUY**

**Revised Target Price: RM37.70**  
(Previously RM41.10)

### INVESTMENT HIGHLIGHTS

- **1QFY18 earnings below expectations**
- **Illicit cigarettes market at all time high of 63%**
- **Rothmans remains the fastest growing brand**
- **Declared a 33.0sen first interim dividend**
- **Maintain BUY with a revised TP of RM37.70 per share**

**Below expectations.** British American Tobacco's (BAT) 1QFY18 normalised net profit came in at RM96.2m which is below our and consensus' full-year earnings estimates at 18.6% and 18.2% respectively. Comparing against 1QFY17, revenue and normalised earnings dipped by -14.8% and -20%yoy respectively while on a quarterly sequential basis, revenue declined by -8.9% whilst earnings increased by +16.8% respectively.

**Illicit cigarettes market at all time high of 63%.** The dip in BAT's revenue and earnings yoy was mainly attributable to the lower domestic and duty-free volumes which slumped by -6.0%yoy. The lower domestic volume was mainly driven by the legal market volume which contracted by -4.0%ytd vs 1QFY17. Additionally, the illicit cigarettes volume share continues to increase to a record high of 63% in 1QFY18 which consists of smuggled cigarettes at 59% and quasi legal cigarettes with fake tax stamps at 4%. This in return has impacted the group's volume translating to a decline by -8%qoq in terms of the group's overall volume sold.

**Rothmans remains the fastest growing brand.** BAT's total market share year-to-date within the legal market grew by 0.8ppt to 54.7% in 1QFY18 from 53.9% in 4QFY17. In addition, Dunhill now registers a market share of 38.2% with a share growth of 0.5ppt vs 37.7% in 4QFY17; attributable to its ongoing initiative to reinforce the brand's legacy. Furthermore, its Value For Money (VFM) segment, with the re-introduction of its previous brand Rothmans; remains the fastest growing brand within the VFM segment with a +1.2ppt growth in market share against last quarter's 2.8%. The launch of Rothmans has also enabled the group to achieve a 30% market share in the VFM segment which is line with our expectations. However, the Aspirational Premium segment experienced a slight decline in market share due to the growth of the VFM segment. That said, the group managed to extend its leadership in the segment from 42% in FY17 to 44% in 1QFY18.

RETURN STATS	
Price (21 May 2018)	RM33.40
Target Price	RM37.70
Expected Share Price Return	+12.9%
Expected Dividend Yield	+5.0%
<b>Expected Total Return</b>	<b>+17.9%</b>

STOCK INFO	
KLCI	1,853.58
Bursa / Bloomberg	4162 / ROTH MK
Board / Sector	Main/ Consumer Products
Syariah Compliant	No
Issued shares (mil)	285.5
Market cap. (RM'm)	9,536.70
Price over NA	24.96
52-wk price Range	RM22.40 – RM45.90
Beta (against KLCI)	1.60
3-mth Avg Daily Vol	0.45m
3-mth Avg Daily Value	RM12.3m
Major Shareholders (%)	
British American Tobacco Holdings	50.00
Aberdeen	5.01
EPF	5.01

**Declared 33sen dividend for 1QFY18.** In-line with its lower earnings for the quarter, BAT declared a first interim dividend of 33sen per share for 1QFY18 which represents a 98% payout ratio. This is as opposed to 40sen declared during the same period last year. The 33sen dividend declared for the quarter under review is below our dividend forecast of 177sen for the year. As such, we are lowering our dividend forecast to 149sen per share for FY18F. Subsequently, we have also reduced our FY19F dividend assumption to 165sen from 182sen previously.

**Revision in earnings.** Post earnings announcement, we are revising our FY18-19F earnings lower by -15.4% and -9.1% respectively as we factor in: (i) slow recovery in sales due to high illicit cigarette trade; (ii) continued weak consumer spending power as well as; (iii) growth in lower price segment (VFM) within the legal market.

**Maintain BUY with a revised TP of RM37.70.** Post earnings revision and rolling forward our valuation base year to FY19, we are maintaining our **BUY** recommendation on BAT with a lower target price of **RM37.70** (from RM41.40 previously). Our valuation is derived from a dividend discount model valuation with a cost of equity of 6.5% and a long term expected dividend growth rate of 1.25%. We opine that while business environment will continue to remain challenging for BAT however, we are comforted by the fact that BAT VFM brand Rothmans in 4Q17 remains the fastest growing brand which we opine will assist in sustaining its position as a market leader in legal cigarettes. Although the reintroduction will come at the expense of lower expected earnings for the next 2-3years due to the lower pricing of Rothmans, we opine that this will nonetheless cushion the negative impact on earnings coming from the high illicit cigarettes. Furthermore, its dividend yield remains attractive at 5.0% FY19F.



**Table 1: BAT's quarterly earnings review**

FYE Dec (RM'm)	Quarterly results				
	1QFY17	4QFY17	1QFY18	QoQ (%)	YoY (%)
<b>Revenue</b>	<b>748.4</b>	<b>700.2</b>	<b>637.6</b>	(8.9)	(14.8)
Cost of sales	(514.4)	(483.3)	(446.8)	(7.6)	(13.1)
<b>Gross Profit</b>	<b>234.0</b>	<b>216.9</b>	<b>190.8</b>	(12.0)	(18.4)
Other operating income	0.6	8.1	1.3	(83.9)	111.4
Operating expenses	(75.1)	(118.2)	(62.3)	(47.3)	(17.1)
<b>EBIT</b>	<b>157.9</b>	<b>105.3</b>	<b>129.8</b>	23.2	(17.8)
Finance cost	(1.5)	(3.3)	(3.2)	(4.6)	111.3
<b>Profit Before Tax</b>	<b>156.4</b>	<b>102.0</b>	<b>126.6</b>	24.1	(19.0)
Income tax	(37.6)	(21.0)	(30.4)	45.1	(19.1)
<b>Profit After Tax</b>	<b>118.8</b>	<b>81.0</b>	<b>96.2</b>	18.7	(19.0)
EI	(1.6)	(1.4)	-	nm	nm
<b>Normalised PAT</b>	<b>120.4</b>	<b>82.4</b>	<b>96.2</b>	16.8	(20.0)
EPS (sen)	41.6	28.4	33.7	18.7	(19.0)
DPS (sen)	40.0	43.0	33.0	(23.3)	(17.5)
				(+/- ppts)	
Gross profit margin (%)	31.3	31.0	29.9	(1.0)	(1.3)
EBIT margin (%)	21.1	15.0	20.4	5.3	(0.7)
PBT margin (%)	20.9	14.6	19.9	5.3	(1.0)
PAT margin (%)	15.9	11.6	15.1	3.5	(0.8)
Normalised PAT margin (%)	16.1	11.8	15.1	3.3	(1.0)

Source: Company, MIDFR

## INVESTMENT STATISTICS

FYE Dec (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
<b>Revenue</b>	<b>4,581.5</b>	<b>3,756.4</b>	<b>3,002.3</b>	<b>2,834.5</b>	<b>3,372.6</b>
Cost of sales	(2,907.4)	(2,486.8)	(1,971.7)	(1,978.5)	(2,360.8)
<b>Gross profit</b>	<b>1,674.1</b>	<b>1,269.6</b>	<b>1,030.6</b>	<b>856.0</b>	<b>1,011.8</b>
Finance cost	(9.2)	(10.5)	(11.4)	(15.1)	(15.1)
<b>Profit Before Tax</b>	<b>1,231.0</b>	<b>908.5</b>	<b>639.2</b>	<b>575.4</b>	<b>681.6</b>
Income tax	(320.9)	(187.2)	(146.6)	(138.1)	(156.8)
<b>Profit After Tax</b>	<b>910.1</b>	<b>721.3</b>	<b>492.6</b>	<b>437.3</b>	<b>524.9</b>
<b>Normalised PAT</b>	<b>910.1</b>	<b>675.1</b>	<b>494.2</b>	<b>437.3</b>	<b>524.9</b>
EPS (sen)	318.7	282.6	172.5	153.2	183.8
EPS Growth (%)	0.9	(11.3)	(39.0)	(11.2)	20.0
PER (x)	15.7	14.7	22.8	21.8	18.2
Dividend Per Share (sen)	312.0	278.0	169.0	148.6	165.4
Dividend yield (%)	6.2	6.7	4.3	4.4	5.0

Source: Company, MIDFR

## DAILY PRICE CHART



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### MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

#### STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

#### SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.