

British American Tobacco (M) Berhad

(4162 | BAT MK) Consumer Products & Services | Personal Goods

Maintain BUY

Better sequential numbers

Revised Target Price: RM14.90

(Previously RM15.70)

KEY INVESTMENT HIGHLIGHTS

- **1HFY20 earnings below expectations**
- **2QFY20 normalised net profit slipped 19.8%yoy to RM61.2m as sales declined by 14.7%yoy to RM546.6m**
- **Continue to strengthen value for money segment**
- **Earnings revised by -12.9% for FY20E and -4.0% for FY21F**
- **Maintain BUY with a revised TP of RM14.90**

1HFY20 earnings below expectations. British American Tobacco (M) Bhd's (BAT) 1HFY20 normalised earnings recorded RM116.2m, which accounted for 40.8% of ours' and 44.3% of consensus full year estimates. The lower than expected core net profit can be attributed to compressed profit margins due to lower sales volume particularly from the duty-free segment. Income tax rate was also higher than we expected. An interim dividend of 18.0sen was announced, bringing YTD DPS to 35.0 sen.

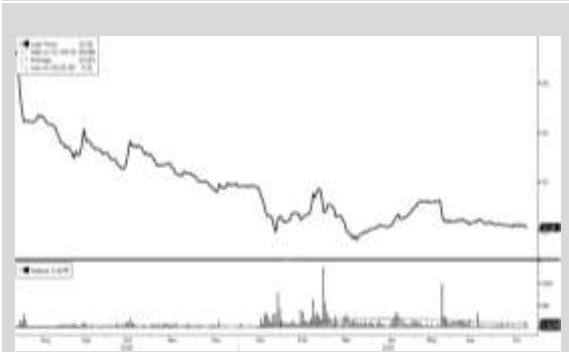
2QFY20 normalised net profit slipped -19.8%yoy to RM61.2m as sales declined by -14.7%yoy to RM546.6m. Normalised net profit for the quarter was lower mainly due to lower sales volume that came down by -16%yoy. We have excluded a one-off restructuring cost amounting to RM6.6m from our normalised PAT. Industry-wide problem, namely illicit products continue to flood the market, thus impacting market share. The illicit cigarettes volume share remains high at close to 70%. That said, the legal market seemed to have stabilised with unchanged industry domestic shipment volume recorded compared to a year ago. The duty-free segment, which comprises 4% of BAT's topline, continued to be adversely impacted by regional and international travel restrictions due to Covid-19. Normalised net profit for 1HFY20 fell -28.4%yoy to RM116.2m while sales declined by -14.7%yoy to RM1.0b.

2QFY20 rebounded from a much weaker 1QFY20. Sequentially, revenue rose -13.6%qoq and normalised earnings climbed -11.2%qoq in tandem with the improvement in sales. We think that this may be attributed to management's agility in sales and distribution along the easing of the Movement Control Order (MCO). This has also resulted in share growth in convenience stores from 44.7% in 1QFY20 to 46.6% for the latest quarter. During the quarter, consumer shifted from general trade to convenience stores. Notably, market share for convenience stores for Dunhill increased by 1.1ppt while Rothmans was up by 0.7ppt qoq. We are hopeful that this may be an early sign of an improving trend going forward.

RETURN STATISTICS

Price @ 23 rd July 2020 (RM)	10.38
Expected share price return (%)	+43.5
Expected dividend yield (%)	+8.0
Expected total return (%)	+51.5

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-6.0	-11.8
3 months	-3.7	-22.9
12 months	-65.4	-64.3


KEY STATISTICS

FBM KLCI	1,606.42
Syariah compliant	No
Issue shares (m)	285.53
Estimated free float (%)	45.93
Market Capitalisation (RM'm)	2,963.80
52-wk price range	RM9.26 - RM30.2
Beta vs FBM KLCI (x)	0.78
Monthly velocity (%)	11.22
Monthly volatility (%)	30.45
3-mth average daily volume (m)	1.15
3-mth average daily value (RM'm)	13.33
Top Shareholders (%)	
BAT Holdings	50.00
Standard Life Aberdeen	5.01
EPF	3.86

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Continue to strengthen value for money (VFM) segment. In view of the growing value for money segment, which was previously not the core of BAT, it is increasing pushing for higher market share in the segment. Among others, it has launched KYO on July 1st, which is priced slightly more attractive than Rothmans. The VFM segment grew to +28% in 1HCY20 from +21% in 2019 and +14% in 2018 as consumers continue to downgrade.

Earnings revised by -12.9% for FY20E and -4.0% for FY21F. We think that improvement may be seen in 2HFY20 considering how fast BAT's management was able to adjust to the shift in consumer behaviors and circumstances caused by Covid-19. On top of that, the legal market is stabilising and BAT has taken a proactive move to launch the "Stop the Black Market" campaign in creating awareness among various stakeholders including the consumers.

Maintain BUY with a revised TP of RM14.90 from RM15.70 previously. Our valuation is derived from a dividend discount model valuation with an unchanged cost of equity of 8.5% and a long-term expected dividend growth rate of 0.5%. While we think that industry headwinds may persist in the near future, restructuring exercises that had been implemented are expected show positive results when the business environment improves. Dividend yield is deemed attractive at 8.0%. 

INVESTMENT STATISTICS

FYE Dec (RM'm)	FY2018	FY2019	FY2020E	FY2021F	FY2022F
Revenue	2,822.9	2,508.6	2,278.6	2,358.0	2,453.7
Cost of sales	(1,927.8)	(1,790.9)	(1,686.2)	(1,676.5)	(1,693.1)
Gross profit	895.1	717.6	592.4	681.5	760.6
Finance cost	(13.5)	(16.0)	(15.1)	(15.2)	(15.4)
Profit Before Tax	623.0	462.3	341.1	410.9	466.2
Income tax	(154.5)	(116.6)	(88.7)	(102.7)	(116.6)
Profit After Tax	468.5	345.7	252.4	308.2	349.6
Normalised PAT	433.5	345.7	252.4	308.2	349.6
EPS (sen)	164.1	121.1	88.4	107.9	122.5
EPS Growth (%)	(4.9)	(26.2)	(27.0)	22.1	13.5
PER (x)	6.3	8.6	11.7	9.6	8.5
Dividend Per Share (sen)	155.0	35.0	83.1	102.5	116.3
Dividend yield (%)	14.9	3.4	8.0	9.9	11.2

Source: Company, MIDFR

Table 1: BAT's quarterly earnings review

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	2QFY20	1QFY20	2QFY19	YoY (%)	QoQ (%)	6MFY20	6MFY19	YoY (%)
Revenue	546.6	481.2	640.8	(14.7)	13.6	1,027.7	1,261.8	(18.5)
Cost of sales	(406.6)	(358.1)	(457.3)	(11.1)	13.6	(764.7)	(897.5)	(14.8)
Gross Profit	140.0	123.1	183.5	(23.7)	13.7	263.0	364.3	(27.8)
Other operating income	0.3	0.5	0.8	(69.8)	(45.8)	0.7	4.9	(85.6)
Operating expenses	(57.2)	(52.2)	(77.3)	(26.0)	9.7	(109.4)	(142.1)	(23.0)
EBIT	83.0	71.4	107.0	(22.5)	16.3	154.3	227.1	(32.1)
Finance cost	(4.9)	(4.4)	(4.3)	12.4	10.0	(9.3)	(7.8)	18.2
Profit Before Tax	78.1	66.9	102.7	(24.0)	16.7	145.0	219.3	(33.9)
Income tax	(23.5)	(16.2)	(26.4)	(11.2)	45.3	(39.7)	(54.4)	(27.1)
Profit After Tax	54.6	50.8	76.3	(28.4)	7.6	105.4	164.9	(36.1)
EI	(6.6)	(4.2)	-	nm	nm	(10.8)	-	nm
Normalised PAT	61.2	55.0	76.3	(19.8)	11.2	116.2	164.9	(29.5)
EPS (sen)	19.1	17.8	26.7	(28.4)	7.6	36.9	57.7	(36.0)
DPS (sen)	18.0	17.0	26.0	(30.8)	5.9	35.0	56.0	(37.5)
				(+/- ppts)				ppt
Gross profit margin (%)	25.6	25.6	28.6	(3.0)	0.0	25.6	28.9	(3.3)
EBIT margin (%)	15.2	14.8	16.7	(1.5)	0.3	15.0	18.0	(3.0)
PBT margin (%)	14.3	13.9	16.0	(1.7)	0.4	14.1	17.4	(3.3)
PAT margin (%)	10.0	10.6	11.9	(1.9)	(0.6)	10.3	13.1	(2.8)
Normalised PAT margin (%)	11.2	11.4	11.9	(0.7)	(0.2)	11.3	13.1	(1.8)

Source: Company, MIDFR

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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.