

28 March 2014 | Sector update

Tobacco sector

**Maintain
NEUTRAL**

Nationwide crackdown on illicit a potential boost to the sector

- **Nationwide crackdown on all contrabands since 1 January 2014.**
- **RM345m worth of contrabands seized from January to 20 March 2014.**
- **Royal Customs Department aims to confiscate RM36b of smuggled goods in 2014.**
- **Cigarette tax second highest contributor after vehicle tax.**
- **Maintain NEUTRAL on the sector as we have yet to see impact of nationwide crackdown.**

New regulation starting 1 January 2014. New regulation against the possession of illicit cigarettes came into practice with the amendments to the Control of Tobacco Product Regulations 2004 under the Food Act 1983, effective 1 January 2014. The Regulation now states that “No person shall sell or offer for sale, buy or have in his possession any packet or carton of cigarettes that is not printed with the texts set and health warning images.” This means that it is not only illegal to sell cigarettes, but it is also illegal to buy them. Those in possession of contrabands is now punishable by a fine not exceeding RM10,000 or two years imprisonment or both. However, those caught selling the contraband items will face a maximum three years imprisonment or a fine of up to 20 times the value of the seized item, or both. Repeat offenders will face a maximum of five years imprisonment and a fine of up to 40 times the value of the item.

Nationwide crackdown seized RM345m worth of illicit. The Royal Customs Department has formed 44 strike teams to conduct checks and raids on suspected outlets nationwide in order to enforce the new regulation. While focusing on retailers, those caught buying or even possessing the illegal item would face similar punishments. From January to 20 March 2014 alone, a total of RM345m worth of contrabands has been seized. This is a huge increase as compared to that last year when only a total of RM31m was seized. As Malaysia has one of the highest levels of illegal cigarette consumption in the world. This has caused the government to incur a loss of RM1.9b of unpaid taxes in 2013

Top 6 illegal cigarette brands



Source: Wave 3 2013 (October – December) of the Illicit Cigarette Study, commissioned by the Confederation of Malaysian Tobacco

Reduce contraband level to 30%. According to the British American Tobacco, an increase of 14.5pp of illicit cigarettes reduced the legal volume by 5.4b sticks during the 10 years of 2002 – 2012. This implies that for every 1% increase in illicit cigarettes, the legal volume will reduce by 0.37b sticks. The Royal Customs Department expects to reduce the current level of illicit cigarettes of 36% to 30% this year which is expected to increase the legal volume by 2.2b sticks in 2014. Meanwhile in 2015, it is expected to reduce by 25%, increasing the legal volume by 1.9b sticks.

Maintain NEUTRAL. Despite the positive vibe from this news, we are still maintaining our NEUTRAL call on this sector. It is apparent that this is the start of a long fight, and with regular enforcement by the authorities it is not impossible that the illicit cigarette market will shrink. However, we believe that it is still early to come to any conclusion as the enforcement effort need to be sustained.



Nationwide crackdowns as reported in the news since January 2014.

State	Action	Brands
Kuala Lumpur	Ulu Kelang – Detained sundry shop worker and seized 3,000 sticks of illicit cigarettes	Gudang Garam Nusantara, June, Zone King, Luffman
Johor	Segamat – Raided three outlets selling illicit cigarettes in Kampung Jawa, Tenang Station, and Jalan Medoi.	John, June Slims Luffman, Gudang Garam, Zon King, Nusantara
Kedah	Alor Setar – arrested 42-year old sundry shop owner in Pokok Sena and seized 84 packets	Bingo, June, John, Surya, Gudang Garam, Luffman
Penang	George town – Raided four sundry shops in Balik Pulau, Paya Terubong, Gelugor, Bayan Lepas and seized 78 cartons	John and various others.
Selangor	Shah Alam – Seized >4,000 sticks from three retil shops.	Luftman, Pine, John, Canyon
Perak	Seri Manjung – Raided a mini-market and a sundry shop and seized a quantity of illegal cigarettes. Lumut, Kg. Padang Tembak – Raided a grocery shop and arrested the shopowner.	John
Kelantan	Tanah Merah – Raided two shops in Kampung Manal and Kampung belimbing. Arrested a man and a woman for possession of the contraband. Several thousand sticks were confiscated and a car (the man) was also seized. Tumpat – Raided three sundry shos and sentenced three the owners each to six days' jail, and fines of between RM1,500 and RM3,000	Surya, Nusantara, John, Tex, Astro, D&J

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >15% 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.