

20 July 2018 | 2QFY18 Results Review

British American Tobacco (M) Berhad

Potential recovery underway

Maintain BUY

Unchanged Target Price: RM37.70

INVESTMENT HIGHLIGHTS

- **2QFY18 earnings within expectations**
- **Illicit cigarettes market remains at all time high of 63%**
- **Rothmans remains the fastest growing brand**
- **Declared 35.0sen second interim dividend**
- **Maintain BUY with an unchanged TP of RM37.70 per share**

Within expectations. British American Tobacco's (BAT) 2QFY18 normalised net profit came in at RM110.1m which is within our but below consensus' full-year earnings estimates at 47.2% and 38.3% respectively. Comparing against 2QFY17, revenue and normalised earnings dipped by -12.3% and -27.3%yoy respectively whilst on a quarterly sequential basis; revenue and earnings improved by +6.5% and +14.5% respectively.

Illicit cigarettes market remains 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 -6.7%ytd. The lower domestic volume was mainly driven by the legal market volume which contracted by -3.5%yoy vs 2QFY17. However, on a quarterly sequential basis, BAT's domestic and duty-free volume increased by +4.8% outperforming the total legal market which grew at +2.2%qoq owing to the introduction of its new fresh and stimulating line as well as festive limited-edition pack. That said, the illicit cigarettes volume share continues remains at record high of 63% in 2QFY18 which consists of smuggled cigarettes at 59% and quasi legal cigarettes with fake tax stamps at 4%.

Rothmans remains the fastest growing brand. BAT's total market share year-to-date within the legal market grew by 1.3ppt to 57.8% in 2QFY18 from 56.5% in 2QFY17. In addition, Dunhill now registers a market share of 39.7% with a share growth of 0.2ppt attributable to its ongoing initiative to reinforce the brand's legacy. Furthermore, its Value For Money (VFM) segment, with the re-introduction of Rothmans; remains the fastest growing brand within the VFM segment with 3.4% market share against last quarter's 3.2%. Meanwhile, the Aspirational Premium segment's market share remains stable despite the growth of the VFM segment. Additionally, management also revealed that it has launched a capsule menthol line for Rothmans as well as; a Dunhill Light line last quarter in order to further entice the market to switch to the legal cigarettes and drive the volume growth.

RETURN STATS	
Price (19 July 2018)	RM33.68
Target Price	RM37.70
Expected Share Price Return	+11.9%
Expected Dividend Yield	+4.9%
Expected Total Return	+16.8%

STOCK INFO	
KLCI	1,759.24
Bursa / Bloomberg	4162 / ROTH MK
Board / Sector	Main/ Consumer Products
Syariah Compliant	No
Issued shares (mil)	285.5
Market cap. (RM'm)	9,616.65
Price over NA	25.66
52-wk price Range	RM22.40 – RM44.90
Beta (against KLCI)	1.17
3-mth Avg Daily Vol	0.52m
3-mth Avg Daily Value	RM16.4m
Major Shareholders (%)	
British American Tobacco Holdings	50.00
Aberdeen	5.01
EPF	5.01

Declared 35sen dividend for 2QFY18. In-line with its higher earnings for the quarter, BAT declared a second interim dividend of 35sen per share for 2QFY18 (YTD: 68sen) which represents a 91% payout ratio (YTD: 94%). This is as opposed to 43sen declared during the same period last year. The 35sen dividend declared for the quarter under review is within our dividend forecast of 149sen for the year. As such, we are making no changes to our dividend forecasts at this juncture.

FY18-19F earnings maintained. We are making no changes to our FY18-19F earnings as we have previously imputed: (i) slow recovery in sales due to high illicit cigarette trade and; (ii) growth in lower price segment (VFM) within the legal market into our earnings assumptions.


Maintain BUY with an unchanged TP of RM37.70. Post earnings announcement, we are maintaining our **BUY** recommendation on BAT with an unchanged target price of **RM37.70**. 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's VFM brand Rothmans which was re-introduced 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. In addition, the launch of capsule line for both Rothmans and Dunhill shows the management's commitment in making sure that it continues to create brand awareness to entice customers to switch to legal cigarettes and drive volume growth. Furthermore, its dividend yield remains attractive at 4.9% FY19F. 

Table 1: BAT's quarterly earnings review

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	2QFY17	1QFY17	2QFY18	QoQ (%)	YoY (%)	1HFY17	1HFY18	YoY (%)
Revenue	774.1	637.6	679.1	6.5	(12.3)	1,522.5	1,316.8	(13.5)
Cost of sales	(492.8)	(446.8)	(471.6)	5.6	(4.3)	(1,007.2)	(918.5)	(8.8)
Gross Profit	281.3	190.8	207.5	8.7	(26.2)	515.3	398.3	(22.7)
Other operating income	0.4	1.3	0.8	(36.6)	89.9	1.0	2.1	102.5
Operating expenses	(79.6)	(62.3)	(56.3)	(9.7)	(29.2)	(154.7)	(118.6)	(23.3)
EBIT	197.9	129.8	152.0	17.1	(23.2)	355.8	281.8	(20.8)
Finance cost	(3.9)	(3.2)	(3.2)	1.1	(17.1)	(5.4)	(6.4)	18.8
Profit Before Tax	194.0	126.6	148.8	17.5	(23.3)	350.4	275.4	(21.4)
Income tax	(46.7)	(30.4)	(38.7)	27.2	(17.1)	(84.3)	(69.1)	(18.0)
Profit After Tax	147.3	96.2	110.1	14.5	(25.2)	266.1	206.4	(22.5)
EI	(4.3)	-	-	nm	nm	(5.8)	-	nm
Normalised PAT	151.6	96.2	110.1	14.5	(27.3)	271.9	206.4	(24.1)
EPS (sen)	51.6	33.7	38.6	14.5	(25.2)	93.2	72.3	(22.5)
DPS (sen)	43.0	33.0	35.0	6.1	(18.6)	83.0	68.0	(18.1)
				(+/- ppts)				(+/- ppts)
Gross profit margin (%)	36.3	29.9	30.6	0.6	(5.8)	33.8	30.3	(3.6)
EBIT margin (%)	25.6	20.4	22.4	2.0	(3.2)	23.4	21.4	(2.0)
PBT margin (%)	25.1	19.9	21.9	2.1	(3.1)	23.0	20.9	(2.1)
PAT margin (%)	19.0	15.1	16.2	1.1	(2.8)	17.5	15.7	(1.8)
Normalised PAT margin (%)	19.6	15.1	16.2	1.1	(3.4)	17.9	15.7	(2.2)

Source: Company, MIDFR

INVESTMENT STATISTICS

FYE Dec (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	4,581.5	3,756.4	3,002.3	2,834.5	3,372.6
Cost of sales	(2,907.4)	(2,486.8)	(1,971.7)	(1,978.5)	(2,360.8)
Gross profit	1,674.1	1,269.6	1,030.6	856.0	1,011.8
Finance cost	(9.2)	(10.5)	(11.4)	(15.1)	(15.1)
Profit Before Tax	1,231.0	908.5	639.2	575.4	681.6
Income tax	(320.9)	(187.2)	(146.6)	(138.1)	(156.8)
Profit After Tax	910.1	721.3	492.6	437.3	524.9
Normalised PAT	910.1	675.1	494.2	437.3	524.9
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	22.0	18.3
Dividend Per Share (sen)	312.0	278.0	169.0	148.6	165.4
Dividend yield (%)	6.2	6.7	4.3	4.4	4.9

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.