

22 October 2018 | 3QFY18 Results Review

## British American Tobacco (M) Berhad

*Positive earnings recovery continues*

### INVESTMENT HIGHLIGHTS

- **Resilient 3QFY18 normalised earnings, despite illicit cigarettes market stand at all time high of 63%**
- **9MFY18 normalised earnings of RM352.2m came in broadly in-line with expectations**
- **Declared a 40.0sen third interim dividend, leading to 9MFY18 cumulative dividend of 108sen**
- **Maintain BUY with an unchanged TP of RM37.70 per share**

**Cumulative 9MFY18 earnings came in as expected.** British American Tobacco (M) Bhd's (BAT) 3QFY18 normalised net profit came in at RM145.8m. This led to 9MFY18 normalised earnings of RM352.2m, which is broadly in-line with ours but within consensus' full-year FY18 earnings estimates at 80% and 76% respectively. Comparing against 3QFY17, revenue contraction has narrowed by -2.9% (from mid-teens in 1QFY18) to RM735.5m whilst the respective earnings grew marginally on a year-over-year basis at +0.2%yoy. On a quarterly sequential basis, revenue staged an encouraging improvement of +8.3%yoy whilst earnings increased by +32.4% respectively where slower rate of contraction is observed.

**Illicit cigarettes market remains at all time high of 63%.** The dip in BAT's revenue and, thus, earnings year-over-year was mainly attributable to the lower domestic and duty-free volumes which slumped by -5.8%yoy. The lower domestic volume was mainly impacted by the legal market volume which contracted by -3.8%ytd in comparison to 3QFY17. Additionally, the illicit cigarettes volume share remains stagnant at a record high of 63% since 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.

**Declared 40sen dividend for 3QFY18.** In-line with its higher earnings for the quarter, BAT declared a third interim dividend of 40sen per share for 3QFY18 (YTD18: 108sen) which represents a 78% payout ratio. This is as opposed to 43sen declared during the same period last year. The YTD dividend declared for the year of 108sen is within our dividend forecast of 149sen for the year. As such, we are maintaining our dividend forecasts at this juncture.


**Maintain BUY**  
**Unchanged Target Price: RM37.70**

RETURN STATS	
Price (19 <sup>th</sup> October 2018)	RM32.02
Target Price	RM37.70
Expected Share Price Return	+17.7%
Expected Dividend Yield	+5.2%
<b>Expected Total Return</b>	<b>+22.9%</b>

STOCK INFO	
KLCI	1,730.48
Bursa / Bloomberg	4162 / ROTH MK
Board / Sector	Main/ Consumer Products & Services
Syariah Compliant	No
Issued shares (mil)	285.5
Market cap. (RM'm)	9,142.67
Price over NA	24.40
52-wk price Range	RM22.40 – RM43.00
Beta (against KLCI)	0.98
3-mth Avg Daily Vol	0.24m
3-mth Avg Daily Value	RM8.41m
Major Shareholders (%)	
British American Tobacco Holdings	50.00
Lazard Ltd	8.91
Aberdeen	5.01

**Earnings estimates maintained.** We are maintaining both our FY18-19F earnings forecasts at this juncture pending the announcement on the potential increase in tobacco-related items tax. The potential increase in tax, which is expected to be announced in the government's upcoming Budget 2019 in less than two weeks, is expected to impact negatively on BAT as we expect it will result in further contraction in volumes sold. That said, we have factored in conservative assumptions in our earnings forecasts previously such as: (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.** 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, we are comforted by the fact that BAT's VFM brand Rothmans in 4Q17 remains the fastest growing brand which we opine will assist in sustaining its position as a market leader in the legal cigarettes domain.

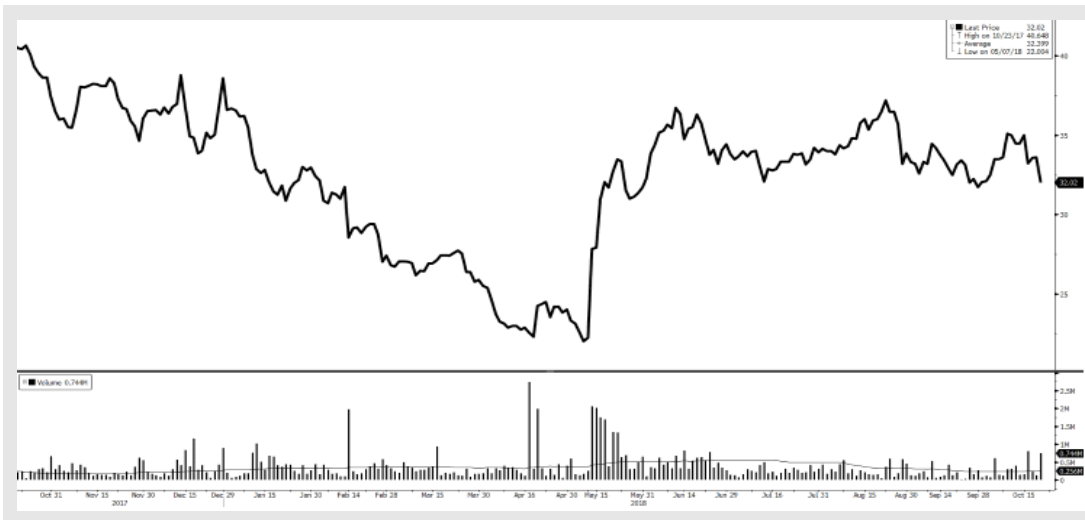
Additionally, the revenue and volume contraction has narrowed to low single digit from low double digits earlier this year and previous FY. This narrowing contraction which is mainly attributable to BAT's ongoing cost rationalisation initiatives has translated to the recovery in BAT's earnings and profit margin over the past few quarters. We understand from the Management that, this will be an ongoing process to cushion the effect of the decline in legal cigarette volume. As the share price of BAT has taken a beating recently due to the announcement of an increase in tobacco-related items tax, we opine that the current price presents a good opportunity for accumulation of the stock. Aside from the recovery in earnings, its dividend yield remains attractive at 5.2% FY19F. 

## 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	20.9	17.4
Dividend Per Share (sen)	312.0	278.0	169.0	148.6	165.4
Dividend yield (%)	6.2	6.7	4.3	4.6	5.2

Source: Company, MIDFR

## DAILY PRICE CHART



Noor Athila Mohd Razali  
noor.athila@midf.com.my  
03-2772 1679

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

FYE Dec (RM'm)	Quarterly results				Cummulative results			
	3QFY17	2QFY17	3QFY18	QoQ (%)	YoY (%)	9MFY17	9MFY18	YoY (%)
<b>Revenue</b>	<b>757.3</b>	<b>679.1</b>	<b>735.5</b>	8.3	(2.9)	<b>2,279.7</b>	<b>2,052.3</b>	(10.0)
Cost of sales	(481.2)	(471.6)	(462.0)	(2.0)	(4.0)	(1,488.4)	(1,380.4)	(7.3)
<b>Gross Profit</b>	<b>276.1</b>	<b>207.5</b>	<b>273.5</b>	31.8	(0.9)	<b>791.4</b>	<b>671.9</b>	(15.1)
Other operating income	0.4	0.8	0.4	(51.2)	-	1.5	2.5	74.1
Operating expenses	(85.0)	(56.3)	(81.7)	45.1	(3.9)	(239.7)	(200.3)	(16.4)
<b>EBIT</b>	<b>189.5</b>	<b>152.0</b>	<b>192.3</b>	26.5	1.5	<b>545.3</b>	<b>474.1</b>	(13.0)
Finance cost	(2.6)	(3.2)	(3.6)	12.5	38.7	(8.0)	(10.0)	25.3
<b>Profit Before Tax</b>	<b>186.9</b>	<b>148.8</b>	<b>188.6</b>	26.8	0.9	<b>537.2</b>	<b>464.1</b>	(13.6)
Income tax	(41.4)	(38.7)	(42.8)	10.8	3.5	(125.6)	(111.9)	(10.9)
<b>Profit After Tax</b>	<b>145.5</b>	<b>110.1</b>	<b>145.8</b>	32.4	0.2	<b>411.6</b>	<b>352.2</b>	(14.4)
EI	(2.0)	-	-	nm	nm	(7.9)	0.0	nm
<b>Normalised PAT</b>	<b>147.5</b>	<b>110.1</b>	<b>145.8</b>	32.4	(1.2)	<b>419.5</b>	<b>352.2</b>	(16.0)
EPS (sen)	51.0	38.6	50.9	31.9	(0.1)	144.2	122.5	(15.0)
DPS (sen)	43.0	35.0	40.0	14.3	(7.0)	126.0	108.0	(14.3)
					(+/- ppts)			(+/-) ppts
Gross profit margin (%)	36.5	30.6	37.2	6.6	0.7	34.7	32.7	(2.0)
EBIT margin (%)	25.0	22.4	26.1	3.8	1.1	23.9	23.1	(0.8)
PBT margin (%)	24.7	21.9	25.6	3.7	1.0	23.6	22.6	(1.0)
PAT margin (%)	19.2	16.2	19.8	3.6	0.6	18.1	17.2	(0.9)

Normalised PAT margin (%)	19.5	16.2	19.8	3.6	0.3	18.4	17.2	(1.2)
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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.

