

14 February 2018 | 4QFY17 Results Review

British American Tobacco (M) Berhad

Recovery in sight with 5.4% dividend yield

INVESTMENT HIGHLIGHTS

- **4QFY17 earnings within expectations**
- **Illicit cigarettes market remains high at >55%**
- **Rothmans begins to gain traction**
- **Declared a 43.0sen fourth interim dividend**
- **Upgrade to BUY with a revised TP of RM41.10 per share**

Within expectations. British American Tobacco's (BAT) 4QFY17 normalised net profit came in at RM81.0m. This brings its full-year normalised earnings to RM494.2m which is broadly within our expectations, but below consensus full-year earnings estimates at 94% and 87% respectively. Comparing against 4QFY16, revenue and normalised earnings dipped by -16.7% and -48.5%yoy respectively while on a quarterly sequential basis, both revenue and earnings declined marginally lower by -7.5% and -44.3% respectively.

Illicit cigarettes market remains high at >55%. The dip in BAT's revenue and earnings yoy was mainly attributable to the lower domestic volume and cessation of contract manufacturing during the year. The domestic and duty-free volumes slumped by -14.2%ytd. The lower domestic volume was mainly driven by the legal market volume which contracted by -10%ytd vs FY16. Additionally, a new illicit cigarettes trend has emerged in the market in the form of cigarettes sold with a false customs stamp. Therefore, despite the illegal cigarettes markets showing a decline from 58% in December 2016 to 56.1% in August 2017, concerns remain that decline does not truly reflect the actual situation.

Rothmans begins to gain traction. BAT's total market share year-to-date within the legal market is currently at 54.9% vs 57.1% in FY16. Dunhill now registers a market share of 37.7% as of 4Q17, vs 37.1% in December 2016 and we expect further improvement in Dunhill's market share as BAT is expecting to invest more in strengthening the Dunhill brand. In addition, we note that its other brand Peter Stuyvesant and Pall Mall have continuous leadership in the Aspiration Premium Brand segment for the 10th consecutive month with a combined market share of 10.9%. This was mainly driven by Peter Stuyvesant's solid growth trajectory in the 1H17 as well as its resilience in the 2H17. As for the Value For Money (VFM) segment, with the re-introduction of its previous brand Rothmans, BAT's Rothmans became the fastest growing brand within the VFM segment with a market share of 2.8%.

Upgrade to BUY
(Previously Neutral)
Revised Target Price :RM41.10
(Previously RM44.40)

RETURN STATS	
Price (13 February 2017)	RM32.88
Target Price	RM41.10
Expected Share Price Return	+25.0%
Expected Dividend Yield	+5.4%
Expected Total Return	+30.4%

STOCK INFO	
KLCI	1,833.02
Bursa / Bloomberg	4162 / ROTH MK
Board / Sector	Main/ Consumer Products
Syariah Compliant	No
Issued shares (mil)	285.5
Market cap. (RM'm)	9,388.23
Price over NA	22.0
52-wk price Range	RM31.40 – RM51.00
Beta (against KLCI)	1.41
3-mth Avg Daily Vol	0.31m
3-mth Avg Daily Value	RM11.3m
Major Shareholders (%)	
British American Tobacco Holdings	50.00
Aberdeen	5.01
EPF	5.01

Declared 43sen dividend for 4QFY17. In-line with its lower earnings for the quarter, BAT declared a fourth interim dividend of 43sen per share for 4QFY17 which brings the FY17 dividend declared to-date to 169sen. The total dividend declared represents a 98% payout ratio for FY17. This is as opposed to 123sen declared during the same period last year which was inclusive of a 46sen special dividend from the proceeds from the disposal of its plant in Petaling Jaya. The 43sen dividend declared for the quarter under review is within our dividend forecast of 171sen for the year. As such, we are maintaining our dividend forecast of 177sen per share for FY18F.

Revision in earnings. Post earnings announcement, we are revising our FY18 earnings lower by -13.0% 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.

Upgrade to BUY with a revised TP of RM41.10. We opine that while business environment might remain challenging for BAT however, we are comforted by the fact that the market share for illicit cigarettes has shown a declining trend albeit gradually. BAT has also ventured into the VFM segment with launch of its new product Rothmans in 4Q17 which will assist in sustaining its position as a market leader in legal cigarettes. Although the reintroduction comes 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, we also opine that the recent sell down of BAT shares has been overdone as we believe that the downside for BAT has bottomed-out. Share price recovery is now in sight as the decline in revenue has tapered quarter-over-quarter compared against the same period last year. Furthermore, its dividend yield remains attractive at 5.4% FY18F. Hence, we are upgrading our recommendation on BAT to a **BUY** (previously Neutral) with a revised TP of **RM41.10**. 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%.



Table 1: BAT's quarterly earnings review

FYE Dec (RM'm)	Quarterly results					Cumulative results		
	4QFY16	3QFY17	4QFY17	QoQ (%)	YoY (%)	FY16	FY17	YoY (%)
Revenue	840.6	757.3	700.2	(7.5)	(16.7)	3,756.4	3,002.3	(20.1)
Cost of sales	(572.8)	(481.2)	(483.3)	0.4	(15.6)	(2,486.8)	(1,971.7)	(20.7)
Gross Profit	267.8	276.1	216.9	(21.5)	(19.0)	1,269.6	1,030.6	(18.8)
Other operating income	0.6	0.4	8.1	1,905.5	1,334.5	2.2	9.5	325.8
Operating expenses	(83.3)	(85.0)	(118.2)	39.1	41.8	(399.1)	(380.3)	(4.7)
EBIT	317.0	189.5	105.3	(44.4)	(66.8)	919.0	650.6	(29.2)
Finance cost	(0.5)	(2.6)	(3.3)	27.9	578.7	(10.5)	(11.4)	8.3
Profit Before Tax	316.5	186.9	102.0	(45.4)	(67.8)	908.5	639.2	(29.6)
Income tax	(27.2)	(27.2)	(21.0)	(22.8)	(22.8)	(187.2)	(146.6)	(21.7)
Profit After Tax	289.3	145.5	81.0	(44.3)	(72.0)	721.3	492.6	(31.7)
EI	0.0	0.0	0.0	nm	nm	46.2	(1.6)	nm
Normalised PAT	157.4	145.5	81.0	(44.3)	(48.5)	675.1	494.2	(26.8)
				(+/- ppts)				(+/-) ppts
Gross profit margin (%)	31.9	36.5	31.0	-5.5	-0.9	33.8	34.3	0.5
EBIT margin (%)	37.7	25.0	15.0	-10.0	-22.7	24.5	21.7	-2.8
PBT margin (%)	37.7	24.7	14.6	-10.1	-23.1	24.2	21.3	-2.9
PAT margin (%)	34.4	19.2	11.6	-7.6	-22.8	19.2	16.4	-2.8

Source: Company, MIDFR

INVESTMENT STATISTICS

FYE Dec (RM'm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	4,581.5	3,756.4	3,002.3	3,190.1	3,422.2
Cost of sales	(2,907.4)	(2,486.8)	(1,971.7)	(2,201.1)	(2,344.2)
Gross profit	1,674.1	1,269.6	1,030.6	988.9	1,078.0
Finance cost	(9.2)	(10.5)	(11.4)	(9.6)	(8.2)
Profit Before Tax	1,231.0	908.5	639.2	680.4	750.1
Income tax	(320.9)	(187.2)	(146.6)	(163.3)	(172.5)
Profit After Tax	910.1	721.3	492.6	517.1	577.6
Normalised PAT	910.1	675.1	494.2	517.1	577.6
EPS (sen)	318.70	282.63	172.53	181.11	202.29
EPS Growth (%)	0.9	-11.3	-39.0	5.0	11.7
PER (x)	17.6	11.6	19.1	18.2	16.3
Dividend Per Share (sen)	312.00	278.00	169.00	177.48	182.06
Dividend yield (%)	5.6	8.5	5.1	5.4	5.5

Source: Company, MIDFR

DAILY PRICE CHART



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

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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.

