

Malaysia Company Guide

British American Tobacco

Version 17 | Bloomberg: ROTH MK | Reuters: BATO.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 Mar 2020

BUY

Last Traded Price (24 Mar 2020): RM9.61 (KLCI : 1,291.14)

Price Target 12-mth: RM11.90 (24% upside) (Prev RM17.10)

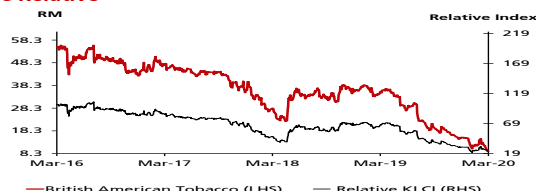
Analyst

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What's New

- COVID-19 pandemic to impact sales volume, weak consumer sentiment may lead to further down trading
- Cut FY20/21F earnings forecast by 17%/10% on lower ASP assumptions
- Trading at 10x forward EPS, or -3 SD of its 10-year mean; attractive dividend yield
- Maintain BUY with lower TP of RM11.90

Price Relative



Forecasts and Valuation

FY Dec (RMm)	2019A	2020F	2021F	2022F
Revenue	2,509	2,439	2,488	2,500
EBITDA	514	392	429	437
Pre-tax Profit	464	359	393	398
Net Profit	346	268	294	298
Net Pft (Pre Ex.)	367	268	294	298
Net Pft Gth (Pre-ex) (%)	(18.2)	(26.8)	9.4	1.3
EPS (sen)	121	94.0	103	104
EPS Pre Ex. (sen)	129	94.0	103	104
EPS Gth Pre Ex (%)	(18)	(27)	9	1
Diluted EPS (sen)	129	94.0	103	104
Net DPS (sen)	118	84.6	92.6	93.8
BV Per Share (sen)	136	134	146	157
PE (X)	7.9	10.2	9.3	9.2
PE Pre Ex. (X)	7.5	10.2	9.3	9.2
P/Cash Flow (X)	8.3	8.7	8.5	8.2
EV/EBITDA (X)	6.1	8.0	7.3	7.1
Net Div Yield (%)	12.3	8.8	9.6	9.8
P/Book Value (X)	7.1	7.2	6.6	6.1
Net Debt/Equity (X)	1.0	1.1	0.9	0.8
ROAE (%)	85.3	69.7	73.6	68.9
Earnings Rev (%):		(17)	(10)	N/A
Consensus EPS (sen):		116	118	N/A
Other Broker Recs:		B: 6	S: 5	H: 6

Source of all data on this page: Company, AllianceDBS, Bloomberg Finance L.P

Value emerging

Attractive valuation; maintain BUY. We expect the ongoing COVID-19 outbreak to lead to lower sales volume and impact British American Tobacco's (ROTH) earnings. Coupled with weak consumer sentiment and slowdown in the economy, these may lead to further down trading by consumers. As such, we cut our FY20/21F earnings forecast by 17%/10%. However, we believe this has been more than priced in with ROTH's 24% m-o-m share price drop. Its valuation is now attractive given that the stock is currently trading at 10x FY20F EPS or -3 SD of its 10-year mean. At current price, the stock offers attractive dividend yield of c.9%.

Where we differ: More conservative than consensus. We assume lower ASP due to down trading. A prolonged outbreak could see further downside to our earnings assumptions. ROTH is expected to be more prudent in spending if consumer sentiment continues to weaken. This could be done by managing its marketing costs and postponing some planned expenditure. These were part of ROTH's initiatives in FY19. Excluding its restructuring exercise and inventory write down, its operating expenses fell by 18% y-o-y in FY19.

Potential catalysts: Faster recovery from COVID-19. A faster recovery from the COVID-19 outbreak would minimise the impact on ROTH's sales volume and reduce spillover effects to the overall economy. The market share for illegal cigarettes has dropped from 74% in 3Q19 to 68% in 4Q19. Further declines would provide a positive boost to ROTH's earnings and share price.

Valuation:

Post-earnings revision, we lower our DCF-based TP (WACC: 8.2%; TG: 0.5%) to RM11.90 – implying 13x FY20 PE.

Key Risks to Our View:

A prolonged COVID-19 outbreak would further drag sales volume.

At A Glance

Issued Capital (m shrs)	286
Mkt. Cap (RMm/US\$m)	2,744 / 618
Major Shareholders (%)	
British American Tobacco BV	50.0
Aberdeen Asset	5.0
Employees Provident Fund	3.8
Free Float (%)	42.3
3m Avg. Daily Val (US\$m)	5.6
GIC Industry : Consumer Staples / Food, Beverage & Tobacco	



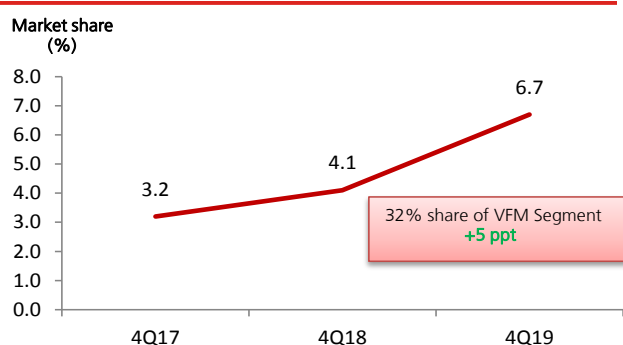
Live more, Bank less

WHAT'S NEW

Possible increase in down trading priced in

Economic slowdown could result in down trading. A prolonged COVID-19 outbreak is likely to have spillover effects on the economy and affect consumer spending. For tobacco players, this could result in down trading. In such a scenario, we believe ROTH's Rothman cigarettes would be least affected, followed by Dunhill and Peter Stuyvesant. Rothman is the company's cheapest brand and has gained market share since it was reintroduced to the local market back in 4QFY17. Now, it controls 32% market share in the Value-for-Money (VFM) segment and 6.7% in overall legal market share.

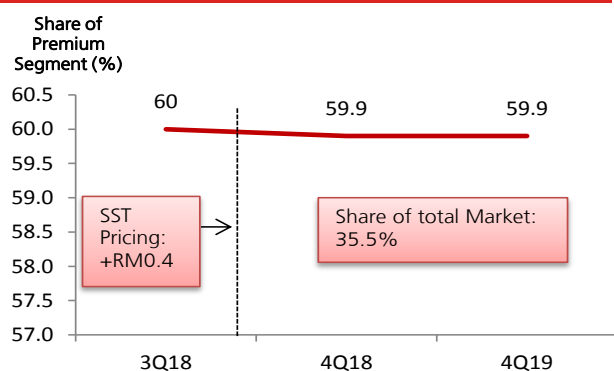
Rothman gaining strength



Source: Company

Dunhill's market share has stabilised despite; 1) a price hike in November 2018 (by RM0.40/pack) and, 2) increasing competition from VFM and illegal cigarettes. We believe that demand for Dunhill should be more resilient compared to Peter Stuyvesant. Now, it commands 60% market share in the premium segment and 35.5% in the overall legal market share.

Dunhill's market share steady even after SST new pricing



Source: Company

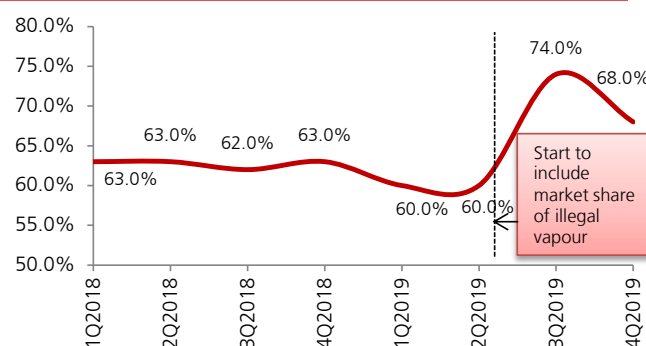
The biggest loser for ROTH is its Peter Stuyvesant brand in the aspirational premium segment, in our view. Most consumers in this segment have down traded to VFM or switched to illegal cigarettes. This was one of the main reasons for the re-introduction of the Rothman brand.

Lower illegal cigarettes' market share would be key earnings driver. The market share for illegal cigarettes has dropped from 74% in 3Q19 to 68% in 4Q19, as a result of continuous efforts by local authorities to clamp down on illegal trades. While we have assumed the market share for illegal cigarettes remains at 68% in the near term given weak consumer sentiment, a drop in share of illicit cigarettes from stricter enforcement would be a key catalyst for the stock. The COVID-19 outbreak could disrupt the supply chain for illegal cigarettes with tightening border controls – which might reduce illegal market share as well. Further declines would provide a positive boost to ROTH's earnings and share price.

Increase in excise duty unlikely. The market share for illegal cigarettes has strong correlation with cigarette prices – an increase in cigarette prices (predominantly due to higher excise and sales tax) is likely to lead to an increase in consumption of illicit cigarettes.

Despite expectation of lower gross domestic product (GDP) and the recent oil price crash affecting the government's coffers, we do not expect an increase in excise duty to compensate for these shortfalls. This is because the tobacco industry is still struggling with high illegal trades. Another tax hike could make it even worse for the industry and consumers.

4Q19 saw positive retreat in illegal market share



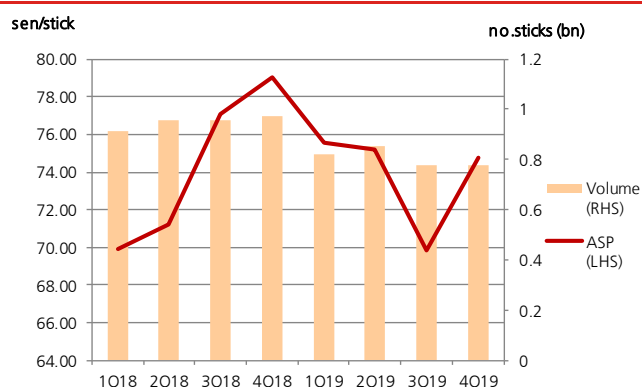
Source: Company

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Better cost control is more important than ever. ROTH is expected to be more prudent in spending if consumer sentiment continues to weaken. This could be done by managing its marketing costs and postponing some planned expenditure. These were part of ROTH's initiatives in FY19. To recap, excluding its restructuring exercise and inventory write down, its operating expenses in FY19 fell by 18% y-o-y (FY18: -4% y-o-y).

Cut FY20-21F earnings forecast by 17%/10%. We cut our FY20-21F earnings forecast by 17% and 10% as we lower our sales volume (to 0% from 4%) and average ASP assumptions (due to down trading) from 70sen/stick to 68sen/stick.

ASP has fallen from peak in 4Q18; more potential downside on down trading

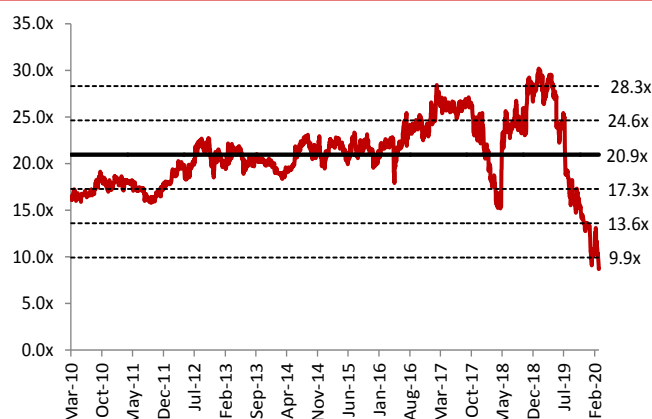


*Changes in ASP largely due to change in sales mix

Source: Company, AllianceDBS

Maintain BUY with revised TP of RM11.90. ROTH's share price fell 24% m-o-m and is now at the lowest levels since 1989. Its valuation is attractive given that the stock is currently trading at 10x FY20F EPS or -3 SD of its 10-year mean. At current price, the stock offers attractive dividend yield of c.9% (assuming 90% payout). Post-earnings revision, we lower our TP to RM11.90 – implying PE of 13x FY20.

Value emerging: Trading close to -3 SD of 10-year mean (PE)



Source: AllianceDBS, Bloomberg Finance L.P

Sensitivity of FY20 earnings to sales volume and ASP

Sales Volume Growth (row) EBIT ASP/stick (column)	0%	-5%	-10%	-15%	-20%	-25%
70.0	312.4	296.3	280.2	264.1	248.0	231.8
69.0	289.8	274.8	259.8	244.8	229.8	214.8
68.0	268.3	253.2	239.4	225.5	211.7	197.8
67.0	244.4	231.7	219.0	206.3	193.5	180.8
66.0	221.8	210.2	198.6	187.0	175.4	163.8
65.0	199.1	188.6	178.2	167.7	157.3	146.8

*Base case: 0% (row); 68sen (column)

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Sensitivity of TP to sales volume and ASP

Sales Volume Growth (row) EBIT ASP/stick (column)	0%	-5%	-10%	-15%	-20%	-25%
70.0	13.57	13.32	13.07	12.83	12.58	12.33
69.0	12.74	12.53	12.33	12.12	11.92	11.71
68.0	11.90	11.75	11.58	11.42	11.25	11.09
67.0	11.08	10.96	10.84	10.71	10.59	10.47
66.0	10.25	10.17	10.09	10.01	9.93	9.85
65.0	9.43	9.39	9.35	9.31	9.27	9.23

Source: AllianceDBS, Bloomberg Finance L.P

Sensitivity of FY20 dividend yield to sales volume and ASP

Sales Volume Growth (row) EBIT ASP/stick (column)	0%	-5%	-10%	-15%	-20%	-25%
70.0	10.1%	9.6%	9.1%	8.6%	8.0%	7.5%
69.0	9.4%	8.9%	8.4%	7.9%	7.5%	7.0%
68.0	8.7%	8.2%	7.8%	7.3%	6.9%	6.4%
67.0	7.9%	7.5%	7.1%	6.7%	6.3%	5.9%
66.0	7.2%	6.8%	6.4%	6.1%	5.7%	5.3%
65.0	6.5%	6.1%	5.8%	5.4%	5.1%	4.8%

Source: AllianceDBS, Bloomberg Finance L.P

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CRITICAL DATA POINTS TO WATCH

Pricing policy drives earnings. Operating in an oligopoly with three leading players (ROTH, Japan Tobacco International and Philip Morris International) in the legal cigarette market, the ability of ROTH to raise prices to pass on increased costs (mainly arising from hikes in the country's sin taxes) without affecting its market share and profit remains its key earnings driver.

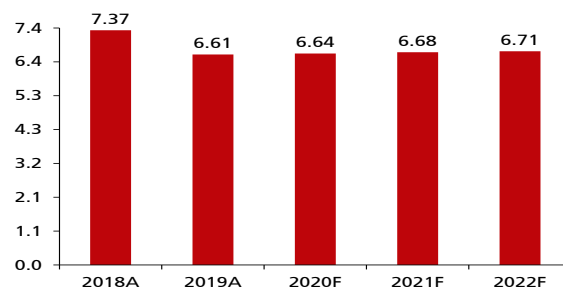
Influence on market price. ROTH has a commanding market share of c.54% in the legal cigarette market in Malaysia. Such a dominant position has, to some extent, allowed the group to be a price-leader.

Optimising costs. To mitigate the impact of illicit trade on its earnings, the group has undertaken cost cutting initiatives such as overhead savings, lower marketing investment and distribution cost. As a result, its operating expenses in FY19 fell by 18% compared to the same period the previous year (FY18: -4%).

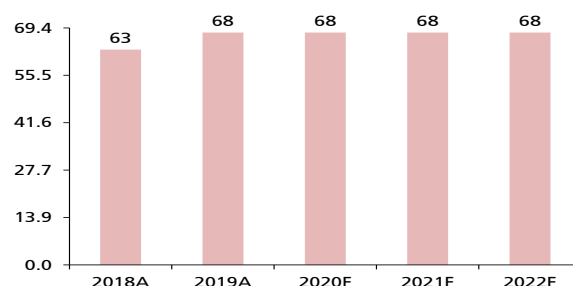
High illicit trade and alternatives. Given ROTH's dominant position in the legal cigarette market, high illicit trade continues to be a drag on its earnings growth. Despite strong enforcement recently by the authorities, illicit trade remains high at 68% of the estimated total market share. The increasing popularity of alternatives such as tobacco heating products (THP) could pose new challenges to the industry.

New government measures. The Malaysian tobacco industry's landscape remains challenging due to, (1) declining cigarette consumption per capita due to an increasingly health conscious population, (2) continuously high illicit trade, (3) regulatory risks and, (4) emergence of alternative offerings such as THP.

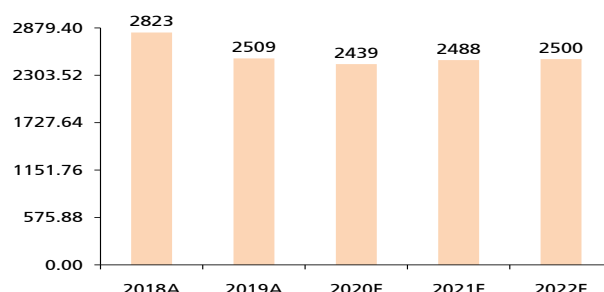
Domestic Legitimate trade volume (bn sticks)



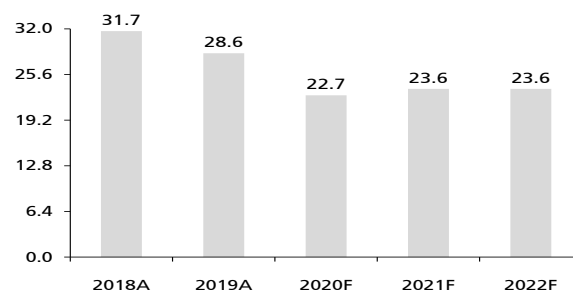
Illicit trade market share (%)



Total revenue (RM m)



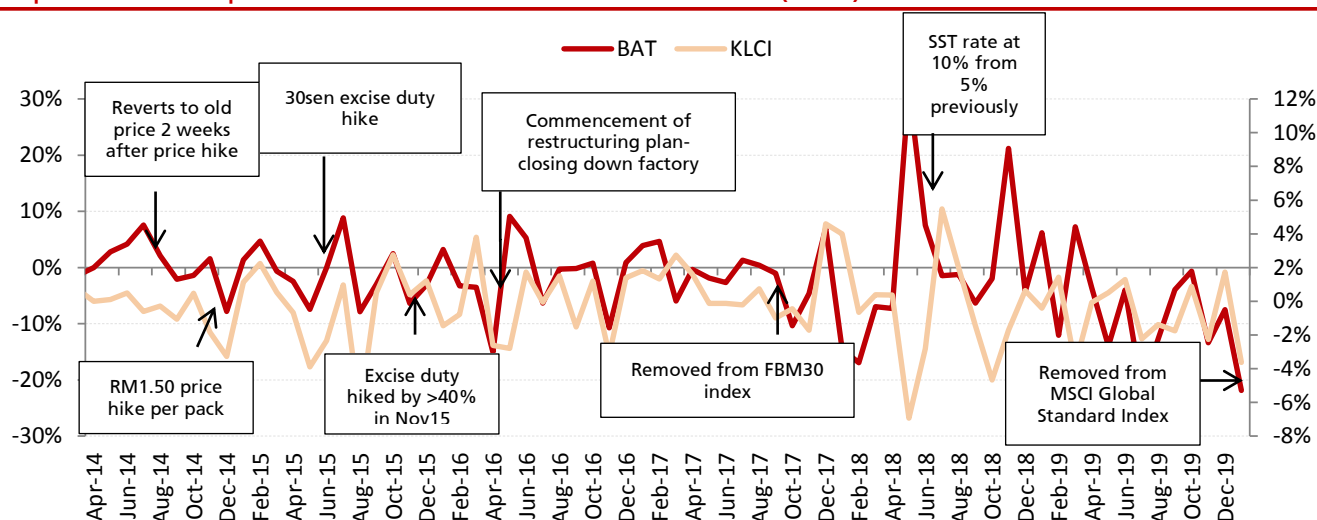
Gross margin (%)



Source: Company, AllianceDBS

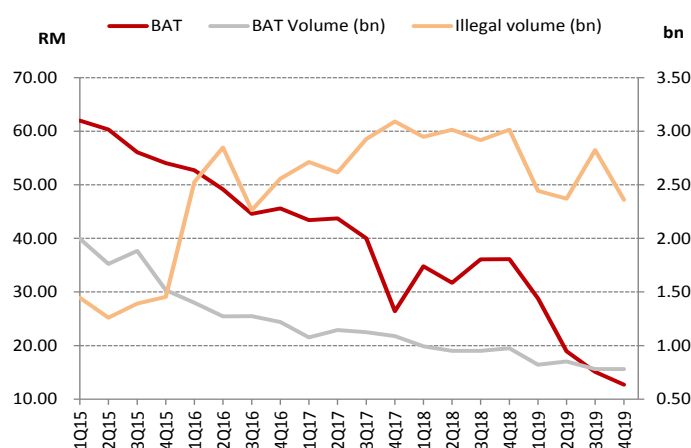
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Graph 1: ROTH's share price movement relative to FBM KLCI index movement (m-o-m)



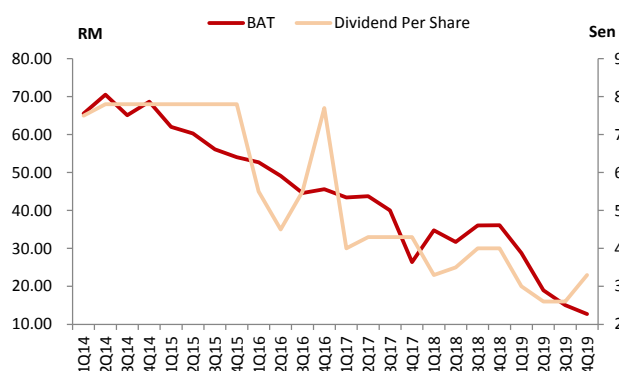
Source: Company, Bloomberg Finance L.P., AllianceDBS

ROTH's share price vs sales volume



Source: Company, Bloomberg Finance L.P., AllianceDBS

ROTH's share price vs dividend per share (ex-special div)



Source: Company, Bloomberg Finance L.P., AllianceDBS

Remarks

As the largest distributor of cigarettes in Malaysia with c.54% market share of the legal cigarette market, ROTH's share price performance correlates strongly with the expansion and contraction of the group's domestic sales volume (correlation coefficient of 0.9), given that the group mainly derives its earnings from domestic consumption.

Remarks

With strong cash flow generating operations and consistently high dividend payout, ROTH is viewed as a dividend yield stock by the investment community. As such, the group's share price performance is closely correlated with its ability to pay out higher dividends (correlation coefficient of 0.8).

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Balance Sheet:

Healthy balance sheet. The group's balance sheet remains healthy despite its net gearing position of about 0.8x (mainly used for working capital), given the strong cash generation of its business, which allows the group to comfortably meet its debt obligations and maintain a high dividend payout without overstretching its balance sheet.

Share Price Drivers:

Decline in illicit trade. A consistent drop in market share of illegal cigarettes could be a major game changer as it is an early indicator of the industry's performance.

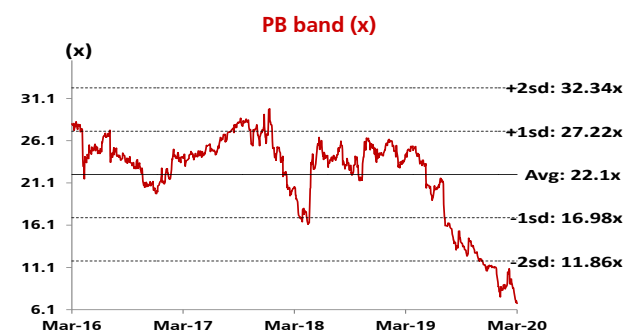
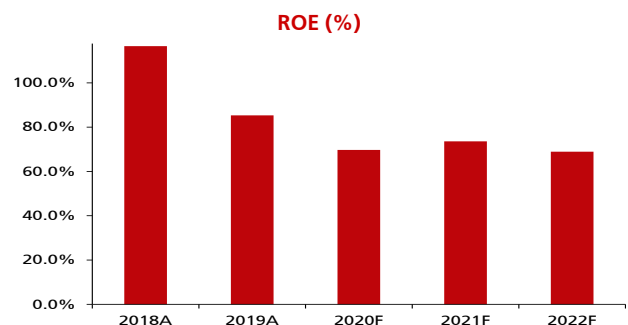
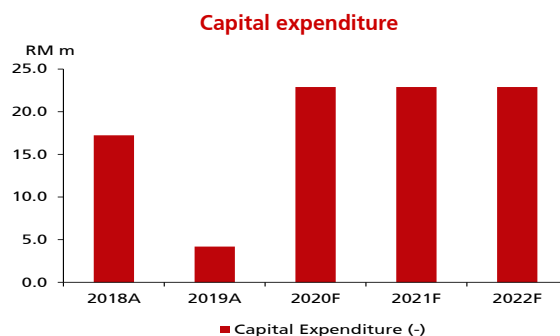
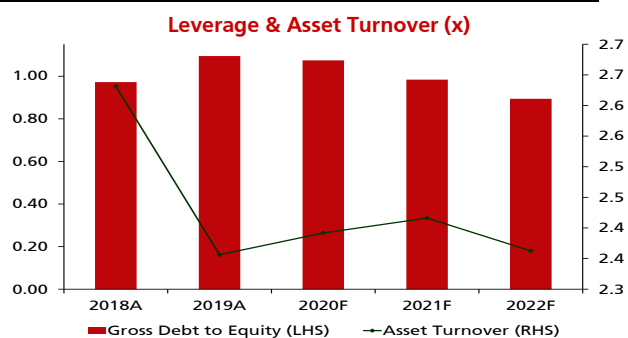
Key Risks:

High illicit trade. Counterfeit and smuggled cigarettes could continue to cap domestic sales volume in the legal cigarette market. Illicit trade rose from 47.1% in November 2015 to 58% of total market share in December 2016. Combined with vapour products, illegal cigarettes' market share hit an all-time high of 74% in September 2019. As of December 2019, illegal market share stood at 68%

High taxes. In view of the persistently high illicit trade and low consumer affordability, we are doubtful of the ability of tobacco players to fully pass on any potential sales tax hike.

Company Background

ROTH is a major distributor of cigarettes in Malaysia. Its portfolio includes the Dunhill, Pall Mall and Kent brands. The group has a c.54% market share of legal cigarettes in Malaysia. It used to manufacture cigarettes in Malaysia to cater to local and overseas demand but ceased the manufacturing operations in 2017. It is now sources its products from other British American Tobacco Group's factories in the region such as Indonesia and Singapore. ROTH announced a special dividend of 46sen following the disposal of its land that used to house its manufacturing facility.



British American Tobacco

Key Assumptions

FY Dec	2018A	2019A	2020F	2021F	2022F
Domestic Legitimate trade volume (bn sticks)	7.37	6.61	6.64	6.68	6.71
Illicit trade market share	63.0	68.0	68.0	68.0	68.0
Gross margin (%)	31.7	28.6	22.7	23.7	23.7

Drop due to lower ASP and volume

Income Statement (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Revenue	2,823	2,509	2,439	2,488	2,500
Cost of Goods Sold	(1,928)	(1,791)	(1,885)	(1,899)	(1,909)
Gross Profit	895	718	554	588	591
Other Opg (Exp)/Inc	(279)	(218)	(180)	(181)	(179)
Operating Profit	617	500	374	407	412
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(12.2)	(14.7)	(15.2)	(14.6)	(14.4)
Exceptional Gain/(Loss)	20.0	(21.3)	0.0	0.0	0.0
Pre-tax Profit	624	464	359	393	398
Tax	(154)	(117)	(90.5)	(99.1)	(100)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	469	346	268	294	298
Net Profit before Except.	449	367	268	294	298
EBITDA	624	514	392	429	437

Lower opex following restructuring exercise in 2019

Growth

Revenue Gth (%)	(6.0)	(11.1)	(2.8)	2.0	0.5
EBITDA Gth (%)	(10.0)	(17.6)	(23.7)	9.4	2.0
Opg Profit Gth (%)	(9.4)	(19.0)	(25.1)	8.9	1.2
Net Profit Gth (Pre-ex) (%)	(14.1)	(18.2)	(26.8)	9.4	1.3

Margins & Ratio

Gross Margins (%)	31.7	28.6	22.7	23.6	23.6
Opg Profit Margin (%)	21.8	19.9	15.3	16.4	16.5
Net Profit Margin (%)	16.6	13.8	11.0	11.8	11.9
ROAE (%)	116.6	85.3	69.7	73.6	68.9
ROA (%)	43.7	32.5	26.3	28.5	28.1
ROCE (%)	58.3	44.9	33.9	36.7	35.9
Div Payout Ratio (%)	94.5	97.5	90.0	90.0	90.0
Net Interest Cover (x)	50.4	34.0	24.7	27.9	28.6

Source: Company, AllianceDBS

British American Tobacco

Quarterly / Interim Income Statement (RMm)

FY Dec	4Q2018	1Q2019	2Q2019	3Q2019	4Q2019
Revenue	771	621	641	584	662
Cost of Goods Sold	(547)	(440)	(457)	(423)	(471)
Gross Profit	223	181	184	162	192
Other Oper. (Exp)/Inc	(70.1)	(60.3)	(77.0)	(49.1)	(31.9)
Operating Profit	153	120	107	112	160
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	0.0	0.0	0.0	0.0
Net Interest (Exp)/Inc	(3.1)	(3.1)	(4.1)	(3.6)	(4.0)
Exceptional Gain/(Loss)	8.94	(0.8)	0.26	0.0	(21.8)
Pre-tax Profit	159	117	103	109	134
Tax	(42.6)	(28.0)	(26.4)	(25.7)	(36.4)
Minority Interest	0.0	0.0	0.0	0.0	0.0
Net Profit	116	88.6	76.3	83.1	97.7
Net profit bef Except.	107	89.4	76.0	83.1	119
EBITDA	155	124	110	116	164

Growth

Revenue Gth (%)	4.8	(19.4)	3.2	(8.8)	13.4
EBITDA Gth (%)	(15.3)	(20.0)	(11.2)	5.2	41.1
Opg Profit Gth (%)	(15.5)	(21.4)	(11.5)	5.5	42.3
Net Profit Gth (Pre-ex) (%)	(20.6)	(16.8)	(15.0)	9.4	43.7

Margins

Gross Margins (%)	29.0	29.1	28.6	27.6	29.6
Opg Profit Margins (%)	19.9	19.4	16.6	19.2	24.1
Net Profit Margins (%)	15.1	14.3	11.9	14.2	14.7

Margin improved
restructuring cost – thanks to
better sales mix

Balance Sheet (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Net Fixed Assets	44.0	65.5	69.3	69.6	66.5
Invt in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other LT Assets	444	432	434	435	437
Cash & ST Invt	79.5	20.8	8.17	35.9	57.2
Inventory	162	98.3	95.5	97.4	97.9
Debtors	361	403	397	401	402
Other Current Assets	9.42	8.22	8.22	8.22	8.22
Total Assets	1,101	1,028	1,012	1,048	1,069
ST Debt	410	425	410	410	400
Creditor	236	171	177	177	178
Other Current Liab	33.6	21.7	21.7	21.7	21.7
LT Debt	0.0	0.0	0.0	0.0	0.0
Other LT Liabilities	0.0	21.8	21.8	21.8	21.8
Shareholder's Equity	422	389	382	417	447
Minority Interests	0.0	0.0	0.0	0.0	0.0
Total Cap. & Liab.	1,101	1,028	1,012	1,048	1,069
Non-Cash Wkg. Capital	264	317	302	308	309
Net Cash/(Debt)	(330)	(405)	(402)	(374)	(343)
Debtors Turn (avg days)	43.0	55.6	59.8	58.5	58.6
Creditors Turn (avg days)	48.7	41.8	33.9	34.4	34.4
Inventory Turn (avg days)	37.9	26.8	18.9	18.7	18.9
Asset Turnover (x)	2.6	2.4	2.4	2.4	2.4
Current Ratio (x)	0.9	0.9	0.8	0.9	0.9
Quick Ratio (x)	0.6	0.7	0.7	0.7	0.8
Net Debt/Equity (X)	0.8	1.0	1.1	0.9	0.8
Net Debt/Equity ex MI (X)	0.8	1.0	1.1	0.9	0.8
Capex to Debt (%)	4.2	1.0	5.6	5.6	5.7

Mainly due to working
capital

Source: Company, AllianceDBS

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Cash Flow Statement (RMm)

FY Dec	2018A	2019A	2020F	2021F	2022F
Pre-Tax Profit	623	462	359	393	398
Dep. & Amort.	7.05	14.2	17.7	21.1	24.6
Tax Paid	(124)	(117)	(90.5)	(99.1)	(100)
Assoc. & JV Inc/(loss)	0.0	0.0	0.0	0.0	0.0
Chg in Wkg.Cap.	(24.3)	(42.6)	15.0	(5.5)	(1.1)
Other Operating CF	11.5	14.0	15.2	14.6	14.4
Net Operating CF	494	331	316	324	336
Capital Exp.(net)	(17.2)	(4.2)	(22.9)	(22.9)	(22.9)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	3.29	2.45	0.79	1.04	1.04
Net Investing CF	(14.0)	(1.7)	(22.1)	(21.9)	(21.9)
Div Paid	(431)	(377)	(275)	(259)	(267)
Chg in Gross Debt	32.0	11.0	(15.4)	0.0	(10.0)
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(13.5)	(21.8)	(16.0)	(15.7)	(15.5)
Net Financing CF	(413)	(388)	(307)	(274)	(293)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	67.1	(58.2)	(12.6)	27.8	21.3
Opg CFPS (sen)	181	131	106	115	118
Free CFPS (sen)	167	115	103	105	110

Source: Company, AllianceDBS

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	29 May 19	31.00	30.00	HOLD
2:	26 Jul 19	26.20	25.00	FULLY VALUED
3:	01 Nov 19	18.50	16.30	FULLY VALUED
4:	21 Feb 20	14.34	17.10	BUY

Source: AllianceDBS

Analyst: Abdul Azim Muhthar

AllianceDBS recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

Completed Date: 24 Mar 2020 19:52:40 (MYT)

Dissemination Date: 25 Mar 2020 07:27:11 (MYT)

Sources for all charts and tables are AllianceDBS unless otherwise specified.

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