British American Tobacco (M)

Foggy Outlook

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UNDERPERFORM ↓

Price : RM29.60

Target Price : RM24.40 ↓

1H19 net profit of RM164.9m (-20%) was dragged by dwindling market volumes and poorer product mix, which is likely to linger owing to persistent affordability issues. Although the debut of the group's "heat-not-burn" products in 4Q19 could spur some excitement, we do not anticipate meaningful contributions in the near-term. Post-results, we cut FY19E/FY20E earnings by 12%/13% and call to UP with revised TP of RM24.40 (from RM28.10).

Below expectations. 1H19 net profit of RM164.9m came in below our /consensus' expectations at 40%/37% of respective full-year estimates. The shortfall was largely owing to the continual decline in legal market size, coupled with the poorer brand mix following the growth in lower-margin Value-for-Money (VFM) offerings. A declared second interim dividend of 26.0 sen (YTD: 56.0 sen) also fell below our FY19E full-year estimate of 137.0 sen, in-line with weaker earnings.

Overall poorer results. 1H19 turnover of RM1.26b slipped 4% YoY following a shrinkage in both legal industry volume (-8%) and BAT's volume (-10%). While the glaring issue of affordability and illicit tobacco trade (despite -3ppt YoY to 60%) persist to be a major issue, a gradual shift in consumer palate towards unregulated e-cigarettes or vapes also contributed to the group's thinning sales. Mounting demand for its lower-margin VFM product (i.e. Rothmans) in addition to the higher opex spent (+20%) on increased marketing efforts on new categories (i.e. Glo and Neo sticks) have also trimmed the group's EBIT margin by 3.4 ppt to 18%, translating to net profit of RM164.9m (-20%).

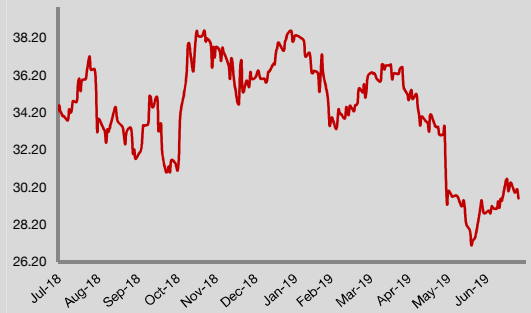
Sequentially, revenue jumped 3.2% QoQ to RM640.8m, on the back of stabilising sales of its flagship product (i.e. Dunhill) coupled with its budding VFM product (1H19 total BAT volume of 10% versus 1H18's 6%). Meanwhile, 2Q19 net profit of RM76.3m is lower by 14% due to the aforementioned higher opex (+37%), which is guided to normalise by 2H19.

Getting heated. Going forward, the group's outlook remains clouded by the obstinate affordability issue and illicit tobacco trades. While we note gradual increase in legal enforcement, more aggressive approach has to be taken to properly address the illegal trades, as we understand that the increasingly sophisticated illegal cigarettes retailers have been rapidly changing their modus operandi to dodge enforcement. On the flip side, the group is finally rolling out its "heat-not-burn" products (Glo and refillables Neo sticks) in 4Q19. While we note that the launch is crucial for the group to stay relevant in light of the shrinking traditional tobacco market and the rising health conscious consumers, we do not expect meaningful contribution in the near-term, with an expected contribution of c.5% of the group's sales in FY20.

Downgrade to UNDERPERFORM with a lower TP of RM24.40 (from RM28.10, previously). While we leave an unchanged valuation of 19.0x PER (closely in-line with stock's -2.0SD over its 3-year mean), we cut our FY19E/FY20E earnings by 12.2%/13.1% to account for dwindling sales volume and poorer product mix. Despite the stock potentially offering fair dividend yield of c.4%, the lack of clear signals of industry volume improvement, stubborn illicit market share and poor affordability remain the main hurdles to the group's profitability.

Risks to our call include: (i) faster-than-expected recovery of legal market share, (ii) lower-than-expected conversion towards less premium brands and (iii) better-than-expected market acceptance for Glo and Neo sticks.

Share Price Performance



KLCI	1,656.58
YTD KLCI chg	-2.0%
YTD stock price chg	-18.0%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	ROTH MK Equity
Market Cap (RM m)	8,451.7
Shares Outstanding	285.5
52-week range (H)	38.68
52-week range (L)	26.90
3-mth avg daily vol	251,972
Free Float	36%
Beta	0.6

Major Shareholders

BAT Holdings (Malaysia) B.V.	50.0%
Lazard Ltd	8.8%
Standard Life Aberdeen	5.0%

Summary Earnings Table

FY Dec (RM m)	2018A	2019E	2020E
Turnover	2,822.9	2,460.3	2,474.7
EBIT	635.3	495.8	498.1
PBT	623.0	485.2	488.7
Net Profit	**468.5**	**363.9**	**366.5**
Core Net Profit	**468.5**	**363.9**	**366.5**
Consensus (NP)	-	440.5	477.6
Earnings Revision	-	-12.2%	-13.1%
Core EPS (sen)	164.1	127.5	128.4
Core EPS growth (%)	-10.3%	-22.3%	0.7%
NDPS (sen)	155.0	121.0	121.0
BVPS (RM)	1.5	1.5	1.6
PER (x)	18.0	23.2	23.1
PBV (x)	20.0	19.2	18.4
Net Gearing (x)	0.8	0.5	0.5
Net Div. Yield (%)	5.2%	4.1%	4.1%

Results Highlights

FYE Dec (RM'm)	2Q FY19	1Q FY19	QoQ Chg	2Q FY18	YoY Chg	6M FY19	6M FY18	YoY Chg
Turnover	**640.8**	**621.0**	**3.2%**	**679.1**	**-5.6%**	**1,261.8**	**1,316.8**	**-4.2%**
Gross Profit	183.5	180.7	1.5%	207.5	-11.5%	364.3	398.3	-8.5%
EBIT	107.0	120.1	-10.9%	152.0	-29.6%	227.1	281.8	-19.4%
PBT/(LBT)	102.7	116.6	-11.9%	148.8	-31.0%	219.3	275.4	-20.4%
Taxation	(26.4)	(28.0)	5.5%	(38.7)	31.6%	(54.4)	(69.1)	21.2%
Net Profit	**76.3**	**88.6**	**-13.9%**	**110.1**	**-30.7%**	**164.9**	**206.3**	**-20.1%**
EPS (sen)	26.7	31.0	-13.9%	38.6	-30.7%	57.7	72.3	-20.1%
DPS (sen)	26.0	30.0	-13.3%	35.0	-25.7%	56.0	68.0	-17.6%
Gross margin	28.6%	29.1%		30.6%		28.9%	30.3%	
EBIT margin	16.7%	19.3%		22.4%		18.0%	21.4%	
PBT margin	16.0%	18.8%		21.9%		17.4%	20.9%	
NP margin	11.9%	14.3%		16.2%		13.1%	15.7%	
Effective tax rate	25.7%	24.0%		26.0%		24.8%	25.1%	

Source: Company, Kenanga Research

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Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
F&B AND RETAIL																	
7-ELEVEN MALAYSIA HOLDINGS BHD	1.46	1,710.4	N	12/2019	12.4%	4.9%	13.6%	5.5%	35.1	30.9	29.3	24.3	23.6	77.5%	2.7%	1.35	UP
AEON CO (M) BHD	1.77	2,485.1	Y	12/2019	3.1%	3.0%	9.2%	3.6%	20.0	18.3	17.7	1.2	1.2	6.6%	2.3%	2.10	OP
AMWAY MALAYSIA HOLDINGS BHD	6.12	1,006.0	Y	12/2019	2.2%	2.0%	5.5%	6.3%	18.5	17.5	16.5	4.3	4.1	23.8%	4.5%	5.90	MP
DUTCH LADY MILK INDUSTRIES BHD	64.00	4,096.0	Y	12/2019	1.0%	2.0%	-2.2%	7.0%	33.0	33.8	31.6	38.8	38.9	115.2%	3.0%	62.90	MP
FRASER & NEAVE HOLDINGS BHD	34.46	12,639.2	Y	09/2019	5.9%	7.0%	9.4%	2.9%	31.8	29.1	28.3	5.5	5.0	18.0%	1.9%	36.60	MP
HAI-O ENTERPRISE BHD	2.31	670.7	N	04/2020	1.7%	2.3%	0.1%	1.8%	14.1	14.1	13.9	2.1	2.2	15.1%	5.6%	1.95	UP
MYNEWS HOLDINGS BHD	1.42	968.7	N	10/2019	27.3%	14.2%	21.0%	20.7%	36.6	30.2	25.0	3.1	3.0	10.2%	0.7%	1.55	OP
NESTLE (MALAYSIA) BHD	148.10	34,729.5	Y	12/2019	2.3%	3.8%	12.8%	4.3%	53.5	47.4	45.5	53.1	53.1	114.7%	2.2%	137.00	MP
PADINI HOLDINGS BHD	3.55	2,335.6	Y	06/2019	2.0%	2.4%	-13.2%	21.8%	13.1	15.1	12.4	3.6	3.2	22.3%	3.2%	3.75	MP
PARKSON HOLDINGS BHD	0.25	266.8	Y	06/2019	1.2%	0.2%	-50.4%	718.1%	N.A.	N.A.	32.2	0.1	0.1	-1.7%	0.0%	0.24	UP
POWER ROOT BHD	1.89	748.2	Y	03/2020	12.3%	9.7%	26.6%	16.0%	22.6	18.4	16.4	3.4	3.1	18.1%	4.8%	2.30	OP
QL RESOURCES BHD	6.87	11,146.2	Y	03/2020	10.9%	4.5%	13.0%	4.2%	51.4	45.5	43.7	5.5	5.1	12.1%	0.8%	6.05	UP
SPRITZER BHD	2.26	474.5	Y	12/2019	5.1%	1.2%	14.6%	13.0%	19.6	17.1	15.1	1.2	1.2	7.0%	1.8%	2.40	MP
Simple Average					**6.7%**	**4.4%**	**4.6%**	**63.5%**	**29.1**	**26.5**	**25.2**	**11.2**	**11.1**	**33.8%**	**2.6%**		
SIN																	
BRITISH AMERICAN TOBACCO (M) BHD	29.60	8,451.7	N	12/2019	-12.8%	0.6%	-22.3%	0.7%	18.0	20.4	20.0	20.0	19.2	84.5%	4.1%	24.40	UP
CARLSBERG BREWERY MALAYSIA BHD	24.66	7,585.9	N	12/2019	11.4%	4.6%	6.9%	4.8%	27.7	25.9	24.7	44.6	48.7	186.7%	4.1%	23.95	MP
HEINEKEN MALAYSIA BHD	23.28	7,032.8	N	12/2019	6.1%	5.0%	2.8%	5.1%	24.9	24.2	23.0	18.9	18.8	77.9%	4.1%	23.25	MP
Simple Average					**1.6%**	**3.4%**	**-4.2%**	**3.5%**	**23.5**	**23.5**	**22.6**	**27.9**	**28.9**	**116.4%**	**4.1%**		
CONSENSUS ESTIMATES																	
BERJAYA FOOD BHD	1.57	563.0	N	06/2019	10.1%	8.8%	22.4%	11.1%	21.4	17.5	15.7	1.5	1.5	7.8%	3.4%	2.06	BUY
BONIA CORPORATION BHD	0.31	240.9	Y	06/2019	3.4%	3.1%	-29.7%	18.2%	12.2	17.3	14.7	0.7	0.7	3.2%	2.3%	0.30	SELL
COCOALAND BHD	1.83	418.7	Y	12/2019	6.9%	4.8%	2.2%	6.4%	13.5	13.3	12.4	1.7	1.5	12.1%	3.3%	2.16	NEUTRAL
KAWAN FOOD	1.40	503.3	Y	12/2019	16.5%	19.9%	11.7%	27.0%	22.1	19.8	15.6	1.6	1.5	5.2%	2.7%	0.98	SELL
MAGNI-TECH INDUSTRIES BHD	5.11	831.2	Y	04/2020	18.8%	4.5%	13.0%	5.2%	8.1	7.2	6.8	1.6	N.A.	20.3%	N.A.	6.60	BUY

Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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