

21 February 2020

British American Tobacco (M)

Emerging Value on Sell-down

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FY19 core net profit of RM361.1m exceeded expectations, on greater volume growth and better cost savings. While the group remains challenged by the obstinate illegal trade issue, value may have emerged from the recent sharp sell-down as (i) the stock is now trading below its 10-year low, and (ii) its appealing yield of c.9% which could offer some form of defence under the current market uncertainties. **Maintain OUTPERFORM with higher TP of RM16.70 (from RM16.00) following an earnings bump.**

Positive surprise. FY19 core net profit (CNP) of RM361.1m (after accounting for RM15.4m one-off restructuring expenses) came in above expectations at 108% of both ours and consensus'. We believe the positive deviation is underpinned by better-than-expected product volume growth as well as stronger-than-expected cost savings observed in the 4Q. The declared fourth interim dividend of 33.0 sen (full-year pay-out: 118.0 sen), also came above our forecast of 113.0 sen, which implies a pay-out ratio of 97.5%.

A weaker year overall... YoY, FY19 CNP fell 23%, largely dampened by: (i) weaker revenue (-11%) no thanks to the continual shrink in legal market volume (-10%) due to affordability issues and shift in demand towards illegal vaping products, coupled with (ii) thinner EBIT margin (-3.4ppt) on poorer product mix as well as the absence of GST removal perks and tax stamp refunds. For the individual quarter, 4QFY19 CNP of RM113.1m slid 3%, as lower revenue (-14%) was partially mitigated by the group's effective cost rationalisation efforts through an internal reorganisation, which kept EBIT margin stable at c.21%.

...but with QoQ improvement. 4QFY19 revenue rose 13% sequentially, boosted by greater product volume (+14%) following successful marketing activations for its Dunhill and Rothmans brands. On top of that, the group's efforts to rationalise its cost base pumped EBIT margin up by 1.6ppt, consequently leading to a 36% growth in CNP.

Cloudy with a chance of sun? The group has managed to deliver a commendable QoQ improvement after several quarters of continual disappointments, mainly boosted by its product volume growth coupled with effective cost rationalisation exercises. Still, we remain cautious on its outlook, stemming from the unfavourable operating environment with illegal cigarettes taking up c.63% of the entire market share. That said, any meaningful improvement in the group's fundamentals would only come from a sustained curb on illegal cigarettes. On the flip-side, we do not expect meaningful contribution from the group's newly rolled-out "heat-not-burn" products (Glo and refillable Neo sticks) with an expected contribution of < 10% of the group's sales in FY20.

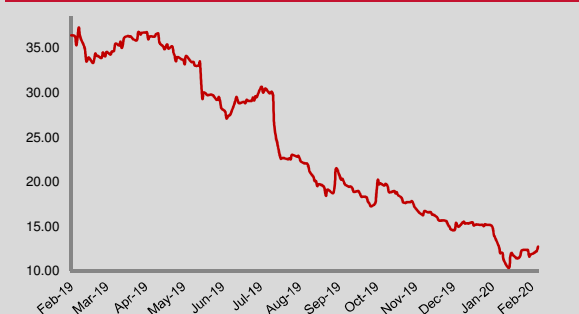
Maintain OUTPERFORM with a higher TP of RM16.70 (from RM16.00). While we leave an unchanged valuation of 14.0x PER (closely in-line with the stock's -1.5S.D. over its 3-year mean), we pumped our FY20E forecast upwards by 4% on account of lower operating expenses. Despite its cloudy outlook, we believe that value has emerged as the recent sharp sell-down in the stock may be overdone, with (i) the stock now trading at a compelling 11.0x PER which fell below its 10-year historical low, and (ii) an attractive dividend yield of c.9%, which could offer some form of defence under the current market environment.

Risks to our call include: (i) higher-than-expected operating expenses and (ii) weaker-than-expected product volume

OUTPERFORM ↔

Price : RM12.70
Target Price : RM16.70 ↑

Share Price Performance



KLCI 1,534.98
YTD KLCI chg -3.4%
YTD stock price chg -15.8%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	ROTH MK Equity
Market Cap (RM m)	3,626.2
Shares Outstanding	285.5
52-week range (H)	37.68
52-week range (L)	10.22
3-mth avg daily vol	1,101,119
Free Float	42%
Beta	0.8

Major Shareholders

BAT Holdings (Malaysia) B.V.	50.0%
Standard Life Aberdeen	5.0%
Employees Provident Fund	3.9%

Summary Earnings Table

FY Dec (RM m)	2019A	2020E	2021E
Turnover	2,508.6	2,232.1	2,165.5
EBIT	477.1	470.9	450.7
PBT	462.3	455.6	435.0
Net Profit	345.7	340.8	325.3
Core Net Profit	361.1	340.8	325.3
Consensus (NP)	334.0	322.9	321.2
Earnings Revision	-	4.3%	New
Core EPS (sen)	126.5	119.3	113.9
Core EPS growth (%)	-22.9	-5.6	-4.5
NDPS (sen)	118.0	115.0	110.0
BVPS (RM)	1.5	1.5	1.6
PER (x)	10.0	10.6	11.1
PBV (x)	8.4	8.2	8.1
Net Gearing (x)	0.7	0.6	0.5
Net Div. Yield (%)	9.3	9.1	8.7



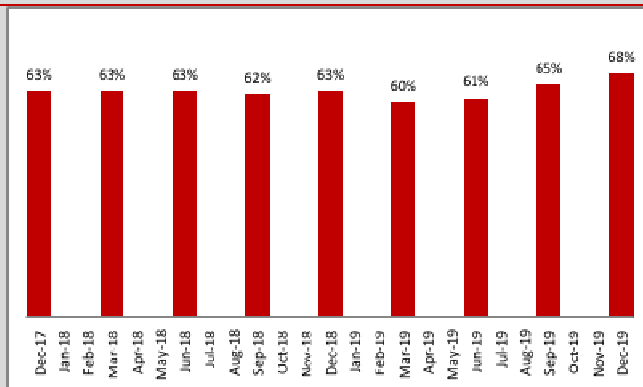
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Results Highlights

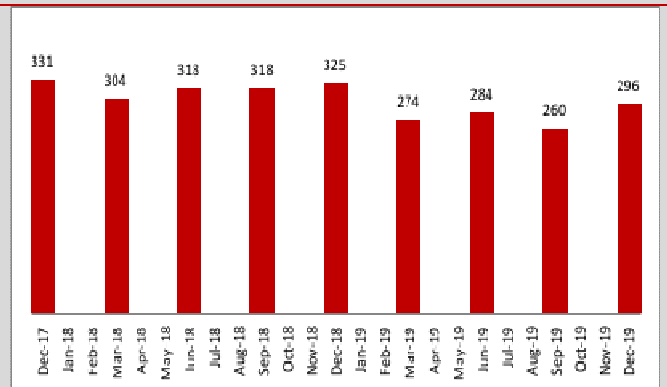
	4Q	3Q	QoQ	4Q	YoY	12M	12M	YoY
FYE Dec (RM m)	FY19	FY19	Chg	FY18	Chg	FY19	FY18	Chg
Turnover	662.4	584.3	13.4%	770.6	-14.0%	2,508.6	2,822.9	-11.1%
Gross Profit	191.8	161.5	18.8%	223.3	-14.1%	717.6	895.1	-19.8%
EBIT	138.4	112.6	22.9%	162.4	-14.8%	478.2	636.5	-24.9%
PBT/(LBT)	134.1	108.8	23.3%	159.0	-15.6%	462.3	623.0	-25.8%
Taxation	(36.4)	(25.7)	-41.8%	(42.6)	14.4%	(116.6)	(154.5)	24.5%
Net Profit	97.7	83.1	17.5%	116.4	-16.0%	345.7	468.5	-26.2%
Core Net Profit	113.1	83.1	36.1%	116.4	-2.8%	361.1	468.5	-22.9%
EPS (sen)	39.6	29.1	36.1%	40.8	-2.8%	126.5	164.1	-22.9%
DPS (sen)	33.0	29.0	13.8%	47.0	-29.8%	118.0	155.0	-23.9%
Gross margin	29.0%	27.6%		29.4%		28.6%	31.7%	
EBIT margin	20.9%	19.3%		21.1%		19.1%	22.5%	
PBT margin	20.2%	18.6%		20.6%		18.4%	22.1%	
NP margin	17.1%	14.2%		15.1%		14.4%	16.6%	
Effective tax rate	27.2%	23.6%		26.8%		25.2%	24.8%	

Source: Company, Kenanga Research

Illegal Volume Share



BAT Volumes Monthly Averages (mns)



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.			
F&B AND RETAIL																	
7-ELEVEN MALAYSIA HOLDINGS BHD	1.40	1,610.3	N	12/2019	12.4%	4.9%	13.6%	5.5%	33.6	29.6	28.1	23.3	22.6	77.5%	2.9%	1.35	MP
AEON CO (M) BHD	1.32	1,853.3	Y	12/2019	5.5%	5.4%	-26.4%	16.4%	14.9	20.3	17.4	0.9	0.9	4.5%	3.0%	1.60	OP
AMWAY MALAYSIA HOLDINGS BHD	5.60	920.6	Y	12/2019	2.2%	2.0%	5.5%	6.3%	16.9	16.0	15.1	3.9	3.7	23.8%	4.9%	5.90	MP
DUTCH LADY MILK INDUSTRIES BHD	44.62	2,855.7	Y	12/2019	-3.0%	2.0%	-17.5%	10.1%	23.0	27.9	25.3	27.1	26.7	97.8%	3.6%	49.30	MP
FRASER & NEAVE HOLDINGS BHD	31.70	11,626.9	Y	09/2020	2.4%	3.0%	2.5%	6.0%	27.7	27.0	25.5	4.6	4.3	16.4%	2.1%	35.20	OP
HAI-O ENTERPRISE BHD	2.03	589.4	N	04/2020	1.7%	2.3%	-24.9%	8.7%	12.4	16.6	15.2	1.9	1.9	11.4%	4.9%	1.50	UP
MYNEWS HOLDINGS BHD	0.890	607.1	N	10/2020	24.3%	17.0%	11.2%	20.8%	22.7	20.4	16.9	2.0	1.9	9.5%	1.1%	1.10	MP
NESTLE (MALAYSIA) BHD	143.30	33,603.9	Y	12/2019	2.5%	3.8%	3.5%	7.2%	51.7	50.0	46.7	51.4	50.6	104.6%	2.0%	128.00	UP
PADINI HOLDINGS BHD	3.37	2,217.2	Y	06/2020	0.5%	4.8%	12.8%	5.3%	14.2	12.6	11.9	3.3	2.9	24.5%	3.4%	4.00	OP
PARKSON HOLDINGS BHD	0.190	202.8	Y	06/2020	0.4%	0.5%	749.4%	16.5%	N.A.	24.4	21.0	0.1	0.1	0.3%	0.0%	0.220	MP
POWER ROOT BHD	2.37	970.0	Y	03/2020	13.3%	10.5%	53.9%	12.3%	28.0	18.8	17.3	4.3	3.8	21.8%	3.8%	2.75	OP
QL RESOURCES BHD	8.46	13,725.8	Y	03/2020	10.9%	11.6%	13.1%	9.6%	63.3	56.0	51.1	6.8	6.3	12.1%	0.7%	8.30	MP
SPRITZER BHD	2.25	472.4	Y	12/2019	8.0%	1.2%	27.7%	6.5%	19.5	15.3	14.4	1.2	1.1	7.7%	1.8%	2.50	OP
Simple Average					6.3%	5.3%	63.4%	10.1%	27.3	25.8	23.5	10.1	9.7	31.7%	2.6%		
SIN																	
BRITISH AMERICAN TOBACCO (M) BHD	12.70	3,626.2	N	12/2020	-11.0%	-3.0%	-5.6%	-4.3%	10.0	10.6	11.1	8.4	8.2	78.2%	9.1%	16.70	OP
CARLSBERG BREWERY MALAYSIA BHD	38.04	11,630.7	N	12/2019	16.0%	7.3%	13.6%	9.0%	43.0	37.9	34.7	64.8	63.5	175.6%	2.6%	30.00	OP
HEINEKEN MALAYSIA BHD	30.34	9,165.7	N	12/2019	22.4%	4.0%	21.3%	5.1%	32.4	26.8	25.5	24.7	21.5	85.9%	3.1%	28.60	OP
Simple Average					9.1%	2.8%	9.7%	3.3%	28.5	25.1	23.8	32.6	31.1	113.2%	4.9%		

Source: Bloomberg, Kenanga Research

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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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