Securities

AFFIN HWANG CAPITAL

Out think. Out perform.

Weak start to the year

BAT's 1Q17 core earnings decreased by 31.4% yoy to RM120.4m, coming in below our and consensus expectations. Domestic volume continued to decline as consumer demand shifts to illegal cigarettes. We cut earnings as we assume legal industry volume would drop by 10% yoy in FY17 and remain flat in FY18-19. Recall that BAT may see cost savings from 2H17 onwards from sourcing tobacco products regionally. Maintain HOLD with lower TP of RM43.50.

1Q17 earnings below expectations

BAT recorded a decline of 1Q17 revenue by 24.5% yoy to RM770.7m due to the group's domestic volume decline of 23.0% yoy. Stripping out one-off restructuring expenses due to the winding down of the factory of RM1.6m, core net profit decreased by 31.4% yoy to RM120.4m, coming in below our and consensus expectations at 16.7% and 16.4% of forecasts respectively. The group declared a 1st interim DPS of 40 sen (vs. 1Q16:55sen).

Losing market share due to shift in demand to illegal cigarettes

The decline in volume was largely due to a spike in demand for illegal cigarettes from 54.3% in October 2016 to a high of 57.1% in December 2016. This caused BAT's market share within the legal industry to drop to 53.5% (vs. 54.3% in 4Q16 and 57.1% in FY16) as consumers continued to switch to illegal cigarettes which are cheaper alternatives. Premium brand leader Dunhill registered a drop of 1.3 ppts qoq to 37.3% in February 2017 whereas aspirational premium brands Peter Stuyvesant and Pall Mall recorded a total market share of 12.1%, higher than 11.5% in 4Q16.

Maintain HOLD with lower DDM-derived TP of RM43.50

We tweak our assumptions post the release of BAT's final 2016 accounts and cut our forecasts by 8-11% for FY17-19, mainly by estimating legal industry volume to drop by 10% yoy in FY17 and stay flat in FY18-19 (previously forecasting a recovery of 1-6% from the low FY16 base). Recall that BAT is currently restructuring its business operations by sourcing tobacco products from other BAT factories regionally such as Indonesia, Singapore and Korea, which should bring about cost savings, and these business transformations are targeted to be completed by 2H17. We maintain our HOLD rating with a lower 12-month DDM-derived TP of RM43.50 (from RM46.90). Dividend yields of about 5% in FY17-19E should be supportive of the share price. Key upside risks include stronger-than-expected sales volume growth and lower-than-expected operating expenses whereas a key downside risk includes excise hikes which would lead to price increases and industry volume declines.

Earnings & Valuation Summary

FYE Dec	2015	2016	2017E	2018E	2019E
Revenue (RMm)	4581.5	3756.4	3485.2	3485.2	3485.2
EBITDA (RMm)	1277.3	929.6	879.9	897.4	907.8
Pretax profit (RMm)	1231.0	908.5	872.6	889.2	898.4
Net profit (RMm)	910.1	721.3	664.1	676.7	683.7
EPS (sen)	318.7	236.4	232.6	237.0	239.5
PER (x)	14.8	19.9	20.2	19.9	19.7
Core net profit (RMm)	910.1	675.1	664.1	676.7	683.7
Core EPS (sen)	318.7	236.4	232.6	237.0	239.5
Core EPS growth (%)	0.9	(25.8)	(1.6)	1.9	1.0
Core PER (x)	14.8	19.9	20.2	19.9	19.7
Net DPS (sen)	312.0	278.0	231.0	235.0	238.0
Dividend Yield (%)	6.6	5.9	4.9	5.0	5.1
EV/EBITDA (x)	10.7	14.6	15.4	15.0	14.9
Chg in EPS (%)			-8.1	-10.5	-10.2
Affin/Consensus (x)			0.9	0.9	0.9

Source: Company, Affin Hwang estimates

Results Note

British American Tobacco

ROTH MK
Sector: Consumer

RM47.06 @ 20 Apr 2017

HOLD (maintain)

Downside 7.6%

Price Target: RM43.50

Previous Target: RM46.90

Price Performance

	1M	3M	12M
Absolute	-1.3%	+7.7%	-11.8%
Rel to KLCI	-1.0%	+2.9%	-13.5%

Stock Data

Issued shares (m)	285.5
Mkt cap (RMm)/(US$m)	13,437/3,053.5
Avg daily vol - 6mth (m)	0.3
52-wk range (RM)	40.3-55.6
Est free float	40.9%
BV per share (RM)	2.15
P/BV (x)	21.91
Net cash/ (debt) (RMm) (1Q17)	(330.0)
ROE (2017E)	107%
Derivatives	Nil
Shariah Compliant	No

Key Shareholders

British American Tobacco	50.0%
Aberdeen	7.1%
EPF	5.9%

Source: Affin Hwang, Bloomberg

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Fig 1: Results comparison

FYE Dec (RMm)	1Q17	QoQ % chg	YoY % chg	Comments
Revenue	770.7	*(8.3)*	*(24.5)*	1Q17 revenue decline mainly due to volume decline of 23% yoy due to shift in demand to illicit cigarettes, which are cheaper alternatives
Op costs	(613.0)	*57.4*	*(21.1)*	
EBITDA	157.7	*(65.0)*	*(35.5)*	
EBITDA margin	20.5	*(33.2)*	*(3.5)*	
Depr & Amort	(1.4)	*(38.3)*	*(84.9)*	
EBIT	156.3	*(65.2)*	*(33.5)*	
EBIT margin (%)	*20.3*	*(33.1)*	*(2.7)*	Contraction due to escalating cost pressure.
Int expense	(1.5)	*>100*	*(62.7)*	
Int and other inc	0.0	*0.0*	*0.0*	
Associates	0.0	*0.0*	*0.0*	
Exceptional items	1.6	*n.m.*	*n.m*	One-off restructuring expenses in 1Q17 due to the winding down of the factory.
-Project costs	0.4			
-Storage and transfer of raw materials	*0.7*			
-Change management costs	*0.5*			
Pretax	**156.4**	*(50.6)*	*(32.3)*	
Tax	(37.6)	*38.4*	*(32.4)*	
Tax rate (%)	*24.0*	*15.5*	*(0.0)*	
MI	0.0	*0.0*	*0.0*	
Net profit	**118.8**	*(58.9)*	*(32.3)*	
EPS (sen)	41.6	*(58.9)*	*(32.3)*	
Core net profit	**120.4**	***(23.5)***	***(31.4)***	Below expectations.

Source: Affin Hwang, Company data

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

This report is printed and published by:
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