

21 November 2022

British American Tobacco (M) Renewing Focus on Premium Segment

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BAT has guided that the group will be renewing focus on their premium Dunhill brand in an effort to regain market share. While its premium and value-for-money (VFM) brands have grown marginally, it has lost overall market share following the contraction of their mid-range offerings. Otherwise, the group is largely positive on the proposed increased regulations in *Budget 2023* to curb the black market. Maintain forecasts, TP of RM11.45 and MARKET PERFORM call.

We attended BAT's analyst briefing and the key takeaways are as follows:

1. The group guided that they will be renewing focus on its premium segment in an attempt to claw back some market share. Its Dunhill brand currently holds a majority of premium market share at 63% as of 3QFY22. A majority of the loss in its market share is within their mid-range segment (-3ppt YoY), partially due to the delisting of its Pall Mall and Kent brands.
2. Illicit volume saw a downtick from 57.7% to 56.1% in 3QFY22 following an increase in inland seizures during the period. Renewed efforts by law enforcement have successfully cut supply for the black market, resulting in the fall in illicit trade.
3. The group is largely positive on the measures proposed by the incumbent government under *Budget 2023* to curb smuggling. The group says the measures under the *Multi Action Task Force* are in line with those proposed by BAT during its previous meetings with government officials. Conversely, the group is not immediately concerned with the proposed generational ban on cigarettes and vapour products as the bill will need to be re-tabled following the election.
4. The group has largely contained the rising cost of production so far via their parent company's global supply chain. Per their guidance, procurement of raw materials through the larger group's channels has allowed for better economies of scale, minimising the effect of rising material prices and distribution costs so far. Additionally, barring an excise increase, the group has guided that raising prices will be a last resort to contain any cost pressure. The group has guided that while any excise increases will be borne by the consumers, its effective ability to pass through costs is limited due to competition from the black market. During the last direct excise increase in 2015, illicit volume spiked from around 35% to 60% following the price increase.

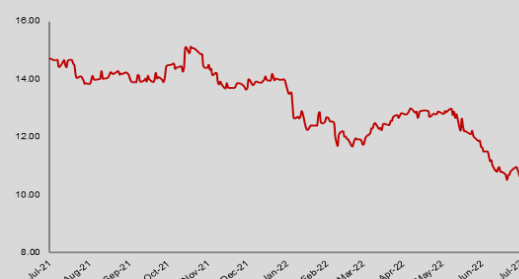
Maintain MARKET PERFORM with an unchanged DCF-derived TP (WACC: 8.1%, TG: -2%) of RM11.45. We also apply a 5% discount based on a 2-star ESG rating as appraised by us. While the stock may appeal to yield seekers due to its high dividend yield of 8.7%, we also see limited prospects given the rising interest rate environment.

We continue to like BAT for its: (i) relatively stable demand in the medium term following the economic reopening, (ii) leading position in the high-margin premium cigarette segment with its Dunhill brand, and (iii) market position as the largest player within the legal tobacco market, holding 51.5% of the legal market share. However, we remain wary of the lack of catalysts for longer term growth as well as rising health consciousness dampens demand.

MARKET PERFORM ↔

Price : RM10.24
Target Price : RM11.45 ↔

Share Price Performance



KLCI	1,449.32
YTD KLCI chg	-7.5%
YTD stock price chg	-26.8%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	ROTH MK Equity
Market Cap (RM m)	2,923.8
Shares Outstanding	285.5
52-week range (H)	14.38
52-week range (L)	10.00
3-mth avg daily vol	151,429
Free Float	38%
Beta	0.7

Major Shareholders

British American Tobacco	50.0%
Tan Yu Yeh	2.3%
Blackrock	2.3%

Summary Earnings Table

FY Dec (RM m)	2021A	2022F	2023F
Revenue	2,637	2,715	2,622
EBIT	411	422	407
PBT	394	401	385
Net Profit	285	271	278
Core Net Profit	285	271	278
Consensus (NP)		265.1	289.3
Earnings Revision	-	0.0%	0.0%
Core EPS (sen)	99.8	94.9	97.5
Core EPS growth (%)	9.3	-4.9	2.8
NDPS (sen)	98.0	90.0	92.0
BVPS (RM)	1.3	1.4	1.4
PER (x)	10.3	10.8	10.5
PBV (x)	7.6	7.4	7.1
Net Gearing (x)	2.0	2.0	1.9
Net Div. Yield (%)	9.6	8.8	9.0

21 November 2022

Risks to our call include: (i) more restrictions on the sales of tobacco products, (ii) higher excise eating into demand, and (iii) illicit trade eating into the legal market.

Income Statement					Financial Data & Ratios				
FY Dec (RM m)	2020A	2021A	2022E	2023E	FY Dec	2020A	2021A	2022E	2023E
Revenue	2,315.5	2,637.3	2,714.8	2,621.9	Growth (%)				
Operating Profit	338.9	411.0	422.3	406.7	Turnover	-7.7%	13.9%	2.9%	-3.4%
Depreciation	-7.5	-12.9	-13.7	-14.4	EBITDA	-27.6%	22.4%	2.8%	-3.4%
Interest Inc/(Exp)	-16.3	-16.9	-21.1	-21.6	Operating Profit	-29.0%	21.3%	2.7%	-3.7%
Profit Before Tax	329.3	394.1	401.2	385.0	PBT	-28.8%	19.7%	1.8%	-4.0%
Taxation	-87.4	-109.3	-130.4	-106.7	Core Net Profit	-27.8%	9.3%	-4.9%	2.8%
Net Profit	241.8	284.9	270.8	278.3	Profitability (%)				
Core Net Profit	260.7	284.9	270.8	278.3	Operating Margin	14.6%	15.6%	15.6%	15.5%
Balance Sheet					PBT Margin	14.2%	14.9%	14.8%	14.7%
FY Dec (RM m)	2020A	2021A	2022E	2023E	Core Net Margin	10.4%	10.8%	10.0%	10.6%
Fixed Assets	57.5	49.7	41.7	32.9	Effective Tax Rate	26.6%	27.7%	32.5%	27.7%
Intangible Assets	411.6	411.6	411.6	411.6	ROA	22.3%	22.5%	19.1%	19.1%
Other Fixed Assets	15.5	6.2	6.2	6.2	ROE	63.5%	75.4%	69.5%	68.9%
Inventories	229.9	177.6	186.3	205.6	DuPont Analysis				
Receivables	396.5	723.0	801.5	780.9	Net Margin (%)	10.4%	10.8%	10.0%	10.6%
Other Current Assets	3.9	1.5	1.5	1.5	Assets Turnover (x)				
Cash	29.1	22.3	-5.3	39.1		2.0	1.9	1.9	1.8
Total Assets	1,144.0	1,392.0	1,443.6	1,477.9	Leverage Factor (x)				
						3.1	3.6	3.6	3.6
Payables	198.8	191.0	207.6	205.4	ROE (%)	63.5%	75.4%	69.5%	68.9%
Short Term Borrowings	510.0	775.0	796.0	817.0	Net Leverage (x)	10.4%	10.8%	10.0%	10.6%
Other Short Term Liability	43.3	28.9	28.9	28.9	Debt/Asset (x)	0.4	0.6	0.6	0.6
Long Term Borrowings	0.0	0.0	0.0	0.0	Debt/Equity (x)	1.4	2.0	2.0	2.0
Other Long Term Liability	19.2	14.6	14.6	14.6	Net (Cash)/Debt	480.9	752.7	801.3	777.9
Net Assets	372.6	382.5	396.4	412.0	Net Debt/Equity (x)	1.3	2.0	2.0	1.9
					Valuations				
Shareholders' Equity	372.6	382.5	396.4	412.0	Core EPS (sen)	91.3	99.8	94.9	97.5
Minority Interests	0.0	0.0	0.0	0.0	NDPS (sen)	83.0	98.0	90.0	92.0
Total Equity	372.6	382.5	396.4	412.0	BV/sh (RM)	1.3	1.3	1.4	1.4
Cashflow Statement					PER (x)				
FY Dec (RM m)	2020A	2021A	2022E	2023E	Div. Yield (%)	8.1%	9.6%	8.8%	9.0%
Operating CF	196.1	34.9	234.1	312.4	PBV (x)	7.8	7.6	7.4	7.1
Investing CF	-0.4	-4.1	-4.6	-4.6	EV/EBITDA (x)	10.2	7.7	7.3	7.9
Financing CF	-187.1	-37.6	-257.1	-263.3					
Change In Cash	8.6	-6.8	-27.6	44.4					
Free CF	192.7	29.2	228.5	306.7					

Source: Kenanga Research

21 November 2022

Peer Comparison

Name	Rating	Last Price (RM)	Target Price (RM)	Upside (%)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Core EPS (sen)		Core EPS Growth		PER (x) - Core Earnings		PBV (x)	ROE (%)	Net Div. (sen)	Net Div Yld (%)
								1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.
CONSUMER																	
AEON CO. (M) BHD	OP	1.37	1.95	42.34%	1,923.5	Y	12/2022	10.0	10.2	64.4%	2.5%	13.7	13.4	1.1	8.1%	4.1	3.0%
AMWAY (MALAYSIA) HOLDINGS BHD	OP	5.03	5.65	12.33%	826.9	Y	12/2022	42.5	37.5	89.4%	-11.7%	11.8	13.4	3.5	30.6%	35.0	7.0%
DUTCH LADY MILK INDUSTRIES BHD	MP	31.18	32.60	4.55%	1,995.5	Y	12/2022	119.8	148.1	-69.1%	23.6%	26.0	21.0	4.7	18.9%	50.0	1.6%
FRASER & NEAVE HOLDINGS BHD	OP	21.36	26.11	22.24%	7,834.4	Y	09/2023	118.6	129.1	13.5%	8.8%	18.0	16.5	2.5	14.1%	62.5	2.9%
MR D.I.Y.	MP	2.00	2.00	0.00%	18,857.9	Y	12/2022	4.9	7.1	6.8%	44.6%	40.9	28.3	13.6	36.4%	2.6	1.3%
MYNEWS HOLDINGS BHD	OP	0.575	0.700	21.74%	392.2	N	10/2022	(3.1)	3.2	-50.6%	-202.3%	N.A.	18.0	1.7	-9.0%	0.0	0.0%
NESTLE (MALAYSIA) BHD	UP	130.20	115.65	-11.18%	30,531.9	Y	12/2022	270.1	295.2	11.1%	9.3%	48.2	44.1	57.0	113.2%	290.0	2.2%
PADINI HOLDINGS BHD	OP	3.24	4.10	26.54%	2,131.6	Y	06/2023	22.6	28.6	-3.4%	26.4%	14.3	11.3	2.2	16.0%	10.0	3.1%
POWER ROOT BHD	OP	2.20	2.35	6.82%	920.1	Y	03/2023	6.7	6.3	7.3%	-6.8%	32.8	35.2	2.9	17.0%	10.0	4.5%
QL RESOURCES BHD	OP	5.45	6.00	10.09%	13,263.4	Y	03/2023	12.6	16.1	41.6%	27.1%	43.1	33.9	4.3	10.8%	6.0	1.1%
Simple Average								60.5	68.1	11.1%	-7.8%	27.7	23.5	9.3	25.6%		2.7%
TOBACCO PRODUCTS & BREWERIES																	
BRITISH AMERICAN TOBACCO (M) BHD	MP	10.24	11.40	11.33%	2,923.8	N	12/2022	94.9	97.5	-4.9%	2.8%	10.8	10.5	7.4	69.5%	90.0	8.8%
CARLSBERG BREWERY MALAYSIA BHD	MP	23.20	23.05	-0.65%	7,093.4	N	12/2022	105.2	114.6	56.0%	8.9%	22.1	20.2	33.2	147.9%	106.0	4.6%
HEINEKEN MALAYSIA BHD	MP	24.74	25.80	4.28%	7,473.9	N	12/2022	129.7	129.3	59.5%	-0.3%	19.1	19.1	18.9	99.2%	129.7	5.2%
Simple Average								109.9	113.8	36.9%	3.8%	17.3	16.6	19.8	105.5%		6.2%

Source: Bloomberg, Kenanga Research

21 November 2022

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	★		
	Corporate Social Responsibility	★	★	☆		
	Management/Workforce Diversity	★	★	☆		
	Accessibility & Transparency	★	★	★		
	Corruption-Free Pledge	★	★	★		
	Carbon-Neutral Initiatives	★	★	★	☆	
	SPECIFIC	Product Safety to Users	★			
Product Safety to the Public		★				
Substitutes to Unsafe Products		★				
Supply Chain Auditing		★	★	☆		
Work Site Safety		★	★	☆		
Industrial Waste Disposal		★	★	★		
OVERALL		★	★			

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP
 ★★★★★ +10% premium to TP

21 November 2022

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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