

30 May 2023

British American Tobacco (M) Black Market Bites

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BAT's 1QFY23 results missed expectations, following a significant uptick in illicit sales during the quarter. Its sales volume fell 24% as black market activities returned in strength, while margins were also hit as inflationary pressure resulted in down trading. Hence, we cut our FY23-FY24F earnings forecasts by 29% and 28%, respectively, reduce our TP by 17% to RM10.00 (from RM12.00) but maintain our MARKET PERFORM call.

Below expectations. 1QFY23 results disappointed, accounting for only 14% of both our full-year forecast and the full-year consensus estimate. We believe the variance against our forecast came largely from a sudden uptick in illicit sales during 1QFY23, resulting in a sharp drop in its sales volume. A dividend declared of 13.0 sen does not appear to be on track to meet our full-year forecast of 99.0 sen.

YoY. 1QFY23 revenue fell by 25% following a 24% decrease in sales volume, mostly attributable to renewed activity in the illicit market. Illicit market share jumped 2.4ppts to 57.2% during 1QFY23, resulting in lower sales across the legal segment. The group also partially attributes the drop in sales to increased sales of vapour products during 1QFY23. We believe this may be spurred by the government's announced intention to regulate the vapour market resulting in consumers rushing purchases ahead of any taxes to be levied on such products. In terms of the group's market share, its premium market share remained relatively flat while mid-range and value-for-money (VFM) segments grew 5% and 3%, respectively. The group also saw an uptick in down trading following the sustained inflationary pressure, resulting in gross margins falling to 22.3% from 24.8% previously.

Overall, net profit fell by 23% YoY as earnings were hit by the drop in sales volume.

QoQ. 1QFY23 revenue fell by 49% as the combination of the uptick in illicit sales, seasonally strong 4QFY22 and lower sales due to *Ramadhan* resulted in significantly weaker sales volume. The group's market share across all its segments remained relatively flat, with its overall market share dropping by 0.1ppt following a minor contraction in its premium market share (-0.3ppt). Overall, earnings fell 35% QoQ, cushioned slightly by the absence of *Cukai Makmur*.

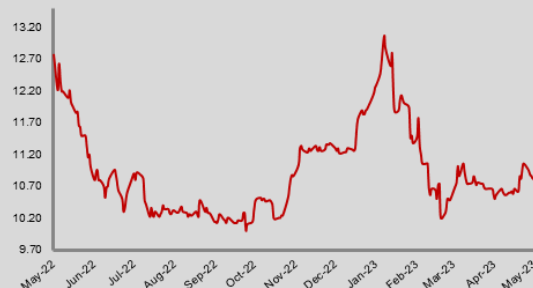
Outlook. Following the unexpected uptick in illicit activity, we remain wary of the group's prospects looking forward. The black market remains the industry's largest near-term headwind, with contrabands controlling a major portion of the market. While illicit market share still remains below its peak during 2019-2020, recent performance has shown that even at current levels, contrabands pose a significant threat to the legal sales volume. When coupled with the sustained inflationary pressure, we remain cautious as the group may see a further increase in down trading, even to the illicit market.

Looking to government regulation, the outlook still seems somewhat mixed. While the group is largely positive on the proposed measures in the revised *Budget 2023*, the implementation seems to be more challenging. While the government has announced its intention to regulate vapour products, the extent and process behind the enforcement has yet to be revealed. While the group had previously commented that it would begin sales of its vapour products once the industry was fully regulated, the full roll-out of the regulations could take longer than initially expected. The government has also yet to re-table the generational ban on cigarettes.

MARKET PERFORM ↔

Price : RM10.82
Target Price : RM10.00 ↓

Share Price Performance



KLCI 1,404.93
YTD KLCI chg -6.1%
YTD stock price chg -3.6%

Stock Information

Shariah Compliant	No
Bloomberg Ticker	ROTH MK Equity
Market Cap (RM m)	3,089.4
Shares Outstanding	285.5
52-week range (H)	13.18
52-week range (L)	10.00
3-mth avg daily vol	309,610
Free Float	38%
Beta	0.6

Major Shareholders

British American Tobacco	50.0%
Tan Yu Yeh	3.5%
Cheng Heng Lee	2.2%

Summary Earnings Table

FY Dec (RMm)	2022A	2023F	2024F
Turnover	2,597	1,991	2,041
EBIT	407	309	317
PBT	385	288	295
Net Profit	263	208	213
Consensus (NP)	-	288	296
Earnings Revision	-	-29%	-28%
EPS (sen)	91.9	73.0	74.7
EPS growth (%)	-7.8	-20.6	2.4
NDPS (sen)	88.0	69.3	71.0
BVPS (RM)	1.3	1.4	1.4
PER (x)	11.7	14.8	14.4
PBV (x)	8.2	8.0	7.7
Net Gearing (x)	1.8	1.6	1.5
Net Div. Yield (%)	8.1	6.4	6.6



30 May 2023

Earnings forecasts. We lower our FY23-24F net profit forecasts by 29% and 28%, respectively, as we impute lower sales volume due to higher illicit incidence. We also take into account slightly lower margins following a minor uptick in down trading. We also reduce our FY23-24F dividend forecasts by the same magnitude to 69.3 sen and 71.0 sen, (from 99.0 sen and RM1.00), respectively.

We continue to like BAT for: (i) relatively stable market demand in the medium term following the economic reopening, (ii) its leading position in the high-margin premium cigarette segment with its Dunhill brand, and (iii) its 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 awareness dampening demand.

We decrease our DCF-derived TP (WACC: 8.1%; TG:-2%) by 17% to RM10.00 from RM12.00 previously. We also apply a 5% discount based on a 2-star ESG rating as appraised by us (see Page 3). Maintain **MARKET PERFORM**.

Risks to our call include: (i) regulatory risks including more restrictions on the sales of tobacco products and hikes in duties, (ii) illicit trade eating into the legal market, and (iii) rising risk premium as ESG investing gains more traction.

Results Highlights

FYE Dec (RM m)	1Q23	4Q22	QoQChg	1Q22	YoY Chg	3M23	3M22	YoY Chg
Turnover	390.2	770.7	-49.4%	521.6	-25.2%	390.2	521.6	-25.2%
Gross Profit	86.9	206.6	-57.9%	129.6	-32.9%	86.9	129.6	-32.9%
Opex	(24.5)	(102.8)	-76.1%	(45.1)	-45.6%	(24.5)	(45.1)	-45.6%
EBITDA	62.9	104.6	-39.8%	85.1	-26.0%	62.9	85.1	-26.0%
EBIT	58.8	100.3	-41.3%	82.1	-28.3%	58.8	82.1	-28.3%
Interest Expense	(5.8)	(6.0)	-3.2%	(5.0)	16.5%	(5.8)	(5.0)	16.5%
PBT	53.0	94.3	-43.8%	77.1	-31.2%	53.0	77.1	-31.2%
Tax Expense	(12.7)	(32.6)	-61.0%	(24.8)	-48.7%	(12.7)	(24.8)	-48.7%
Net Profit	40.3	61.7	-34.7%	52.3	-22.9%	40.3	52.3	-22.9%
Core EPS (sen)	0.14	0.22	-34.7%	0.2	-22.9%	0.14	0.18	-22.9%
DPS (sen)	13.0	21.0	-38.1%	17.0	-23.5%	13.0	17.0	-23.5%
Gross Margin	22.3%	26.8%		24.8%		26.0%	24.8%	
Opex Margin	-6.3%	-13.3%		-8.7%		-6.3%	-8.7%	
EBITDA Margin	16.1%	13.6%		16.3%		16.1%	16.3%	
EBIT Margin	15.1%	13.0%		15.7%		15.1%	15.7%	
PBT Margin	13.6%	12.2%		14.8%		13.6%	14.8%	
Core Net Profit Margin	10.3%	8.0%		10.0%		10.3%	10.0%	

Source: Company, Kenanga Research

30 May 2023

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																	
7-ELEVEN MALAYSIA HOLDINGS BHD	OP	2.04	2.38	16.67%	2,264.5	N	12/2023	6.7	8.5	11.5%	26.3%	30.4	24.0	16.4	57.0%	2.7	1.3%
AEON CO. (M) BHD	OP	1.33	1.80	35.34%	1,867.3	Y	12/2023	9.1	10.0	15.2%	9.4%	14.6	13.3	1.1	7.3%	4.0	3.0%
DUTCH LADY MILK INDUSTRIES BHD	MP	25.52	26.99	5.76%	1,633.3	Y	12/2023	116.6	122.7	-16.4%	5.2%	21.9	20.8	3.4	16.3%	60.0	2.4%
FRASER & NEAVE HOLDINGS BHD	OP	25.92	28.44	9.72%	9,506.9	Y	09/2023	118.6	129.1	13.5%	8.8%	21.9	20.1	3.0	14.1%	62.5	2.4%
MR D.I.Y. GROUP (M) BHD	MP	1.61	1.67	3.73%	15,187.8	Y	12/2023	6.3	6.4	24.8%	2.7%	25.7	25.0	9.1	38.1%	4.0	2.5%
MYNEWS HOLDINGS BHD	UP	0.465	0.410	-11.83%	317.2	N	10/2023	1.0	2.2	-135.8%	127.7%	48.8	21.4	1.4	2.8%	0.0	0.0%
NESTLE (MALAYSIA) BHD	UP	132.60	121.18	-8.61%	31,094.7	Y	12/2023	303.0	305.1	14.6%	0.7%	43.8	43.5	44.2	106.9%	270.0	2.0%
PADINI HOLDINGS BHD	OP	3.75	6.00	60.00%	2,467.2	Y	06/2023	34.2	38.6	46.0%	12.8%	11.0	9.7	2.5	24.1%	10.0	2.7%
POWER ROOT BHD	OP	2.10	2.70	28.57%	907.4	Y	03/2024	14.3	15.2	0.8%	6.0%	14.7	13.8	2.6	18.1%	12.0	5.7%
QL RESOURCES BHD	OP	5.56	6.66	19.78%	13,531.1	Y	03/2023	14.3	17.7	60.3%	23.5%	38.8	31.4	4.3	12.1%	6.0	1.1%
SECTOR AGGREGATE					78,777.4					23.0%	8.2%	29.7	27.4	6.2	21.0%		2.3%
TOBACCO PRODUCTS & BREWERIES																	
BRITISH AMERICAN TOBACCO (M) BHD	MP	10.82	10.00	-7.58%	3,089.4	N	12/2023	73.0	74.7	-20.6%	2.4%	14.8	14.5	8.0	54.5%	69.3	6.4%
CARLSBERG BREWERY MALAYSIA BHD	MP	21.10	23.50	11.37%	6,451.3	N	12/2023	113.7	122.8	13.0%	8.0%	18.6	17.2	32.7	203.3%	100.0	4.7%
HEINEKEN MALAYSIA BHD	MP	27.00	28.60	5.93%	8,156.6	N	12/2023	144.2	150.4	5.5%	4.3%	18.7	18.0	20.9	111.1%	144.2	5.3%
Sector Aggregate					17,697.4					0.9%	5.2%	17.8	16.9	20.5	123.0%		5.5%

Source: Bloomberg, Kenanga Research

Stock ESG Ratings:

	Criterion	Rating				
GENERAL	Earnings Sustainability & Quality	★	★	☆		
	Community Investment	★	★	☆		
	Workers Safety & Wellbeing	★	★	★		
	Corporate Governance	★	★	★		
	Anti-Corruption Policy	★	★	★		
	Emissions Management	★	★	★		
SPECIFIC	Product Health & Safety	★				
	Consumer Education	★	☆			
	Water Management	★	★	★		
	Effluent/Waste Management	★	★	★		
	Energy Efficiency	★	★	☆		
	Supply Chain Management	★	★	★		
OVERALL		★	★			

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

30 May 2023

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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